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"Policies to Boost UK Productivity" *by John Van Reenen*

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Professor Van Reenen's talk began with an analysis of UK productivity – why is productivity important, and where does the UK stand relative to other developed economies? Professor Van Reenen then discussed policies to boost productivity, arguing that investment in human capital is most important.

Analysis of Productivity

Productivity is very high on the political agenda – Chancellor Gordon Brown talks of it frequently, and the European Union is committed to the 'Lisbon agenda' to boost it at the European level. This focus is justified; ultimately, productivity growth is required to drive growth in consumption and real wages. It is difficult to see real downsides to productivity growth; the strongest critique comes from the literature on happiness, which finds, for instance, that people in the US do not say they are more happy now than in the 1960s.

Output per capita in the UK is similar to output in France and Germany, but output per hour is around 20% lower; more Britons work, and for longer hours, but they are less productive when at work. Most of this difference is because France and Germany have higher fixed and human capital. US output per hour (and per capita) is notably higher than in the UK; this is due to a combination of both higher total factor productivity and a larger capital stock.

In terms of the labour market, UK labour utilisation is relatively strong, but there are some problems, such as high levels of inactivity of older workers due to disability. There has also been a rapid increase in wage inequality since the late 1970s; this is probably because the increase in demand for skilled workers has outstripped the increase in supply. There are serious problems at the low-skilled end, suggesting a need to raise human capital at the bottom.

US productivity growth is still roaring ahead relative to the EU, and this acceleration does not seem to be just an artifact of the data. While the UK's performance has been stronger than the EU average recently, particularly in IT-using industries, it has not seen such a strong acceleration as the US. Some interesting explanations for this gap include different business environments and differences in management and organisational styles. A recent McKinsey / LSE survey provides some evidence that British management practices are generally substantially worse than those in the US (and somewhat worse than in France and Germany). This may be because it has historically been difficult to attract the British elite into manufacturing.

UK Policies to Raise Productivity

Professor Van Reenen argued that policies to improve human capital are most important. He felt that the UK system does reasonably well at the top, but extremely badly at the bottom; basic skills are very poor, and technical skills also lag behind other developed countries. The picture doesn't seem to be improving; recent school-leavers are at least as likely to be functionally illiterate as the middle-aged.

What can be done? The best kind of intervention is to get in really early, especially pre-school. Reorganisation of schools and teaching could also help; for instance, there is some evidence that the introduction of 'literacy hours' in primary schools has been effective. For secondary schools, it may be necessary to put lots of resources into getting star teachers to work in poor areas, especially in maths and sciences. A big issue is how to reach the existing very low-skilled; the best option is probably to act through reforms to benefit system, encouraging people to gain skills in order to receive benefits.

Research and development is another important issue. Basic science is strong in the UK, but often this has not been translated into successful commercial innovations. Fiscal incentives, notably R&D tax credits, are being used by the government. There is some evidence that these have worked in other countries, but a proper cost-benefit analysis is needed.

Professor Van Reenen argued that a lack of careful analysis is a general problem in the field of productivity policy; there are many policies whose rationale and outcomes are both non-existent or poor. For instance, there is very little evidence on the success or otherwise of Small Business Scheme.

Competition policy in the UK has been strengthened, and the position looks strong on OECD indicators. On regulatory barriers, the UK looks better than just about every other country. It is arguable that measures of regulations do not tell the whole story, because implementation and enforcement can differ across countries. This may be so, but in any case there will often be important trade-offs involved; for instance, laxer planning regulation may be tricky because we live on a small, crowded island.

What should we not do? Some particular policies that should be ruled out are ‘grands projets’ (most European subsidy schemes have been very wasteful), repatriation of R&D, tinkering with the tax system, attempting to use R&D policy to create inter-regional equality, and large ICT subsidies.

Conclusions

Professor Van Reenen concluded that the main focus of policies to address the productivity gap should be on human capital investment. Such policies could have a ‘double whammy’ effect if they were to concentrate on the bottom end of the labour market; inequality would fall, and overall productivity would rise. Whatever policies are used, there is a significant need for rigorous evaluation to assess success. This has sometimes been lacking in previous programmes.

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