Disappointing productivity growth: an international dimension

In our November forecast the outlook for UK annual productivity growth from 2016 was downgraded by around 0.3 per cent a year to be lower than 1 per cent a year. NIESR was not alone in making such a downgrade. The Office for Budget Responsibility (OBR) also downgraded the outlook for productivity growth in the November Budget. The principal reason for the reductions was that productivity growth had not only been slow but had been slower than expected – in effect, there have been repeatedly disappointing productivity growth expectations. Such changes in outlook, in particular with their implications for living standards and fiscal positions, raise the issue of whether the UK has been alone in seeing disappointing productivity growth or whether this may be a more general international experience.

It is clear that productivity since the Great Recession has grown more rapidly in the other major western economies than in the UK, although Italy is the exception to this (see figure 1). But the issue examined here is different – despite the faster productivity growth elsewhere, the question is whether productivity growth in the other major western economies has also disappointed expectations.

In order to examine this on a consistent basis, published Institute forecasts over a run of years were used and the labour productivity path forecasts made at different times were compared with the subsequent outturn of productivity. The results are presented in a series of charts below. Productivity in the context of NIESR’s forecast is calculated from the separate forecasts for GDP, the number of employees and hours worked per employee per quarter.

The clear visual message from the charts is that the UK is far from alone in seeing productivity failing to pick up after the recession to the extent that was anticipated. The charts, with the exception of Italy, display the same general pattern as that for the UK.

Since forecasters’ expectations of productivity trends will have been based on both (then) current information and previous experience of productivity behaviour after recessions, one immediate conclusion is that the disappointing behaviour on productivity growth has been a more general feature of the major industrial economies in the post-recession period – it is not confined to the UK. The various arguments made about the nature of the recession, in particular the dislocations that resulted in the financial system, seem to have some force, even though the precise mechanism by which this feeds through into overall productivity trends remains unclear. In addition, in so far as this is a cause of the slow productivity performance, the issue remains as to how much longer any effect will last.

Perhaps of more concern in a medium-term context is the hypothesis that this period of disappointment may be due to some deeper structural process such as, for example, argued by Robert Gordon (2016) and Marc Levinson (2016). Others have also expressed concern about the methods of measuring economic activity (and hence productivity) connected to the growth of the Digital Economy (Nakamura et al., 2017). Clearly more evidence and time will be needed to analyse these issues.

In the November Review Crafts and Mills (2017) undertook an econometric analysis of US productivity growth (using total factor productivity (TFP) rather than labour productivity as shown in the charts here) and concluded somewhat more positively that “the case for assuming that slow TFP growth is the ‘new normal’ is ‘not proven’.” This gives hope that the patterns of lower than anticipated industrial economy productivity growth revealed by the charts may not be a permanent feature of economic forecasts, especially if the global outlook continues to strengthen.
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Figure 2. Labour productivity forecasts in the UK, US, Germany and Italy

Source: NiGEM database and forecast. Note: GDP at market prices, per person per hour.

References

This box was prepared by Yanitsa Kazalova and Barry Naisbitt.