

Summary of NIESR Business Conditions Forum January 2022

The National Institute of Economic and Social Research (NIESR) hosted the Business Conditions Forum (BCF) on 12 January 2022. The aim of the BCF is to have informed and analytical discussions of data and surveys to better understand the current state of the UK economy. The discussions are under Chatham House Rules to encourage free and open discussion. NIESR is grateful to the ESRC and the Impact Accelerator Award (IAA) for funding the BCF.

Agenda

The discussion at this meeting focused on the factors driving the UK productivity puzzle and the potential methods on transitioning towards a high productivity economy and levelling up.

Main discussion points

Productivity: past, present and the future

The UK has been experiencing a stark productivity puzzle, with significant heterogeneity among industries and firms. Before the global financial crisis, labour productivity in the UK grew at an average rate of around 2% a year for many decades, and thereafter slowed to around 0.5% - a rate unseen since the Napoleonic era. Some key points discussed in presentations and discussions:

- If productivity had continued the trend that it was on before the GFC, it would be about 20% higher today.
- Productivity in the extraction sector started declining in the early 2000 while productivity growth in finance only declined following the GFC.
- Productivity growth in finance was strong before the GFC, potentially due to low levels of regulatory capital.
- The long-term factors influencing productivity and output growth are still negative, resulting in scarring effects.
- The outlook for productivity is highly uncertain.
- Upside risks include greater homeworking, and online retail.
- Downside risks include lower business investment.
- A vital question is whether we can combine the digital advantage from remote working with other key drivers i.e., skills and innovation capabilities.

Potential reasons for the productivity puzzle that were raised include:

- Systemic underinvestment in key components of intangible capital.
- Significant amount of low skilled, low wage and low productive jobs for the past 15 years.
- Regional disparities in productivity (weak performance of second-tier cities and London racing ahead).
- Repeated changing industrial policies over the past couple of decades.
- Equity finance heavily skewed towards London and South East.
- Metro mayors lack fiscal power.

There was a discussion on poor productivity being a residual and boiling down to weaker demand rather than supply, since the GFC. New macroeconomic research emphasizes considerable heterogeneity at the sector and firm level, and measurement uncertainty. Therefore, sectoral analysis, local and regional governance are key, rather than having a loose, central demand management tool which would lead to inflationary pressures.

Getting on the path towards a high productivity economy: what will it take?

Between 1996 and 2006, around two-thirds of GDP growth was due to labour productivity growth. In the future, the growth in working hours will significantly slow down because of an ageing workforce, rising retirement, and a limited number of young people coming into the workforce. Consequently, growth will have to come from productivity. For GDP growth as fast as in 1996-2006, growth in productivity will need to be some 3%.

Key industrial policy proposals shared included:

- Digital transformation. The UK struggles with diffusion of technologies between firms and adoption of technologies within firms.
- Skills formation. The UK struggles with further education, apprenticeships, and non-technical skills.
- Institutional reform. Local and regional governance, fiscal reform, and industrial policy.
- Export performance and competition policy.

Geographical disparities and levelling up:

There was a discussion based around the concept of economic complexity, which is highly correlated with productivity. Complex activities tend to be knowledge-intensive services such as, pharmaceuticals and finance; low complexity activities include mining and some manufacturing. Key points raised:

- Cities which lack knowledge and capital struggle to get more complex over time.
- Complex cities in 1981 were in the South and are the most productive and complex today.
- Cities in North and Midlands tend to be low productivity-complexity: they are one reason why regional productivity levels in the UK are below Western Europe.
- Using existing assets and strengths do not always lead to higher productivity-complexity: some cities have successfully 'reinvented' themselves.

Suggestions for what levelling up needs to consider:

- The knowledge of each geographical region.
- Making second-tier cities more functional and helping with housing costs to attract greater knowledge and resources.
- Metro mayors need to have more fiscal power or fiscal devolution.
- Complementarity between private and public financing.

Poll Results

