

# Britain's era of abysmal productivity growth could be at an end

www.economist.com

April 12th, 2018



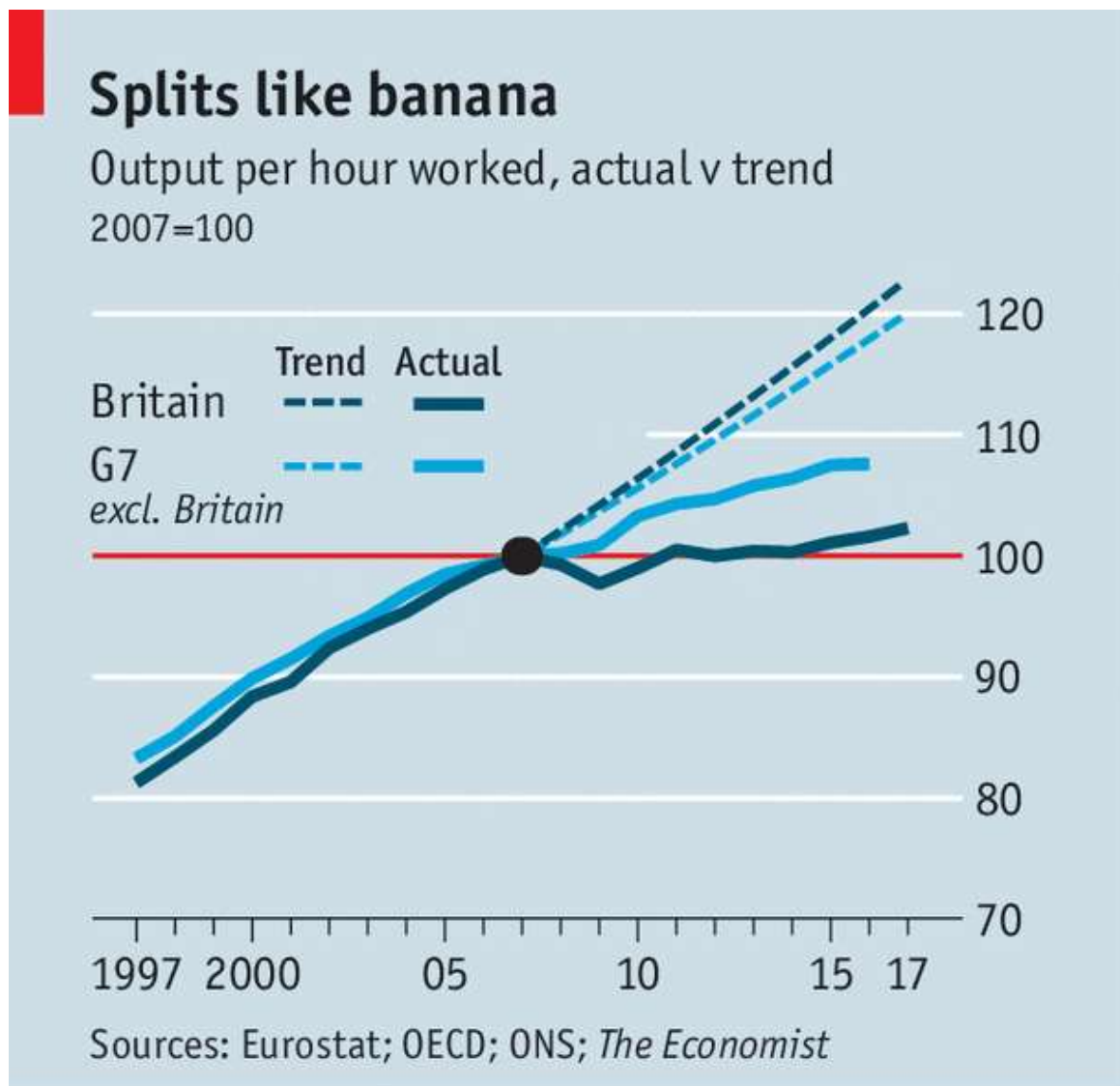
A FEW years ago the traffic lights around Trafalgar Square in London had a makeover. In place of the usual green man, which flashes when it is safe to cross the road, some lights had an image fitted of a same-sex couple holding hands. Timed to coincide with a gay-pride parade, the change was meant to symbolise London's cosmopolitanism. But some economists joked that it was a symbol of something quite different. Where once a single worker was able to shepherd pedestrians across the road, two are now required. What better metaphor for Britain's woeful labour-productivity growth?

It is little wonder that economists see weak productivity wherever they look. Britain has had a decade of barely any growth in the amount of output per hour of work (see chart). In the long term, productivity determines how much workers get

paid. Stagnation over the past decade has thereby left Britons' pay packets some 20% smaller than they would otherwise have been. It has also pressed down on the government's tax take, ensuring that fiscal austerity has lasted longer than it otherwise might have. It is no stretch to say that weak productivity is Britain's biggest economic problem—bigger, even, than the prospect of Brexit.

### Get our daily newsletter

Upgrade your inbox and get our Daily Dispatch and Editor's Picks.



Economist.com

Lately, however, things have been looking better. Since 2016 productivity growth has been moving in the right direction. And in the second half of 2017, the latest period for which figures are available, output per hour grew by 1.7%, marking the country's strongest performance in more than a decade. Are British workers shaping up at last?

Hear the bang, see the spark

The uptick has taken economists by surprise. It was only in November that the Office for Budget Responsibility, the official fiscal watchdog, sharply downgraded its future projections for productivity growth, having been over-optimistic time and again. The pessimists may yet be proved right. In the post-crisis period productivity growth has occasionally jumped up, only to turn negative once again, as happened in 2011.

Yet there is a case for optimism. In the second half of 2017 two-thirds of British industries saw productivity growth above their pre-crisis average. Productivity growth has not been so broad-based since the economy picked its way from the wreckage of the financial crisis. Output per hour in the manufacturing sector, which has weighed heavily on overall productivity, jumped by 2.6% in the final quarter of 2017, its biggest rise in over a decade. Our back-of-the-envelope estimate of productivity growth in early 2018 suggests that although it has slowed, it has not stopped.

One possible explanation for the boost is a tighter labour market. The unemployment rate is at its joint-lowest in 40 years. Add to that a 50% fall in net migration from the European Union since June 2016, and labour is getting harder to find. Nominal-wage growth is slowly rising, as employers compete more fiercely for workers. In April the minimum wage went up from £7.50 (\$10.65) to £7.83 an hour, adding to the pay packets of over 2m people.

Rising labour costs may have two effects on productivity. The first is that it becomes harder for firms in unproductive industries, such as hospitality, to expand. Our analysis suggests that in 2010-17 the number of poorly paid jobs (ie, those paying below 70% of the average wage) grew twice as fast as the number of better-paid ones. Employment in hairdressing—an indispensable industry but not a very productive one—is some 50% higher than in 2010. As unproductive industries grew faster than productive ones, the overall figures were dragged down. In the past year, however, that trend has gone into reverse, with employment growing more quickly in the snazzier professions.

The second effect is on investment. Since the financial crisis depressed wages, it has made sense for many firms to rely on labour rather than capital—ie, to hire a person to do a job instead of buying a robot to do it. But with labour getting pricier, more companies seem to be choosing machines over man. Business investment as a share of GDP has edged up since the end of 2016. It is now above the average of the past decade. Investment in computers is booming. In 2016 purchases of industrial robots rose for the first time in five years. As Britain's capital stock gets more sophisticated, workers can become more productive.

The country's banks, which are healthier than they have been in some time, have helped business investment along. The latest figures show that lending to non-financial firms is growing at 3% a year, far faster than in the post-crisis period. On the other side, banks appear less likely than they were to show forbearance to underperforming businesses that have no realistic chance of paying back loans. The rate of business failures has been edging up, points out Paul Hollingsworth of Capital Economics, a consultancy. That allows capital to be moved away from unproductive outfits and towards more productive ones.

Britain still has a long way to go. Its workers are some 15% less productive than others in the G7. A particular concern is the economy's long tail of slothful firms. According to one calculation, a third of British businesses have seen no productivity growth at all this century. If Brexit ends up causing trade and

investment to decline, productivity is bound to suffer in the long term. But if the latest trends continue, double-manned traffic lights will look increasingly out of place.