DR JOHN PHILPOTT SAYS THE GOVERNMENT MUST ADOPT A 'SMART WORK' POLICY IF THE UK IS TO CLOSE THE PRODUCTIVITY GAP ON ITS RIVALS.

Smart can span the gap

The latest international productivity comparisons, published by the Office for National Statistics (ONS) at the end of February showed that the UK continues to trail other countries in the productivity stakes. After a year in which UK productivity growth fell to zero, it is high time the government took a fresh policy approach to boosting workplace productivity.

The latest international snapshot from the ONS includes experimental data showing that UK output per hour continues to fall well short of what is achieved in France, the US and Germany.

Gordon Brown has seized on the new ONS figures to reinforce his latest drive to boost UK productivity, drawing upon the ideas of business leaders and his new adviser, Alan Greenspan, the former Head of the US Federal Reserve.

To coincide with the new figures, the Chartered Institute of Personnel and Develoment has published a report concluding that UK productivity will continue to disappoint in the absence of a joined-up public policy agenda that promotes improved workplace management practice – 'smart work' – across all sectors of the economy.

PEOPLE MANAGEMENT The available evidence shows that inadequate people management is one of the biggest factors underlying the gap between the US, the UK and the EU economies in so-called 'total factor productivity'. In other words, productivity differentials are not due to differences in the relative stocks of capital, skill levels or research and development between various countries but to the differences in how effectively available resources are put to use.

Coming after a year when UK productivity growth plummeted to zero, the latest international comparisons will be disappointing for the Chancellor, who for almost a decade has put considerable policy effort into closing the productivity gap.

It must be extremely frustrating for the Chancellor to see UK productivity growth stall after nine years of policies designed to push on the accelerator. Like all his post-war predecessors, Brown has struggled against the reluctance of UK plc to invest enough in capital, skills and technology, despite his time in office coinciding with a period of economic stability, with low inflation, low interest rates, reasonable rates of return on investment and a generally favourable corporate tax regime.

However, the underlying problem, mostly overlooked by government policy, is that the vast majority of UK organisations still don't make a good enough fist of managing the productive resources they do have, especially their people. If this fact hadn't dawned upon Brown in 1997, the penny must surely have dropped by now, not least because his preferred brand of top-down, target-focused management of the public services has failed to make the most of the billions of pounds of extra investment he has provided.

PRACTISING WHAT THEY PREACH Work smarter, not harder has become a modern management mantra. The trouble is too few UK organisations practice what they preach, while the government struggles to develop a coherent policy approach to improving workplace productivity – exemplified by the still-born effort at rebranding the Department of Trade and Industry (DTI) after last year's general election, which would have given it an overt productivity focus. Organisations are generally more concerned about their overall performance – market share, profits and shareholder value, or, in the public and voluntary sectors, quality of service provision – than about productivity as such.

Most appreciate that getting more from their staff at given pay rates lowers unit labour costs and can contribute to improved performance. For private sector firms, this means higher profits or the capacity to cut prices in order to attract more customers; for public and voluntary sector bodies, it means a bigger bang for each taxpayer buck or charitable donation.

However, organisations with easy access to a plentiful supply of cheap labour might have little incentive to raise productivity. And even those that do want to boost productivity may try to achieve this simply by sweating their assets, cutting jobs and piling extra hours or bigger workloads on staff.

Executive summary

- **The UK continues to trail in the productivity stakes.**
- **The majority of UK businesses don't effectively manage the resources they have.**
- **UK productivity will continue to disappoint unless there is a public policy agenda promoting improved workplace management practice.**

SMART WORK STRATEGY It is vital that an effective smart work strategy is constructed – and high time that government, in partnership with employers and other relevant stakeholders, made a start. The key elements of a smart work agenda, include:

- Making improved people management and working practices central to the government's policy agenda, rather than treating it as subsidiary to what the Treasury and DTI consider the main drivers of productivity growth (investment, innovation, skills, enterprise, and competitive product and labour markets).
- Better national and international benchmarking of the adoption of people management practices – in particular, the degree to which staff are multiskilled and given discretion and autonomy over their work.
- Active promotion of the value of these practices to employers, particularly small and medium-sized businesses, couched in the kind of positive performance-focused language such organisations can relate to and act on.
- Increased policy emphasis on work-related training and work-based learning, rather than simply the acquisition of formal academic or vocational qualifications.

- A sensible limit on working hours to encourage employers to focus on enabling staff to achieve more in each hour worked, but with sufficient flexibility to allow people to work longer hours at certain times if this suits their needs and preferences.

- Support for two-way involvement and engagement between employers and staff at an individual as well as collective level.

- A minimum standard of external reporting by organisations of their people (or human capital) management practices and the measured impact of these practices.

If effective management of people is both essential to high productivity and performance and a practical matter that organisations can relate to, its Cinderella status in the policy debate must be addressed with urgency.

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For the CIPD report, Smart Work: People, Productivity and Performance, *see www.cipd.co.uk/perspectives*

Understanding the productivity gap

A nation's material standard of living is measured by the value of what organisations in aggregate produce per head of population. Living standards can be improved by raising the employment rate or the rate of productivity growth (in other words, what is produced in each hour worked by people in employment). The UK currently has the highest employment rate of the major economies (75% of the population of working age). Given limits on employment growth (80% is likely to be the maximum attainable rate), higher productivity is needed to generate further wealth. And since the UK performs relatively less well on productivity than on employment, the productivity gap is a handy measure of room for improvement.

How big is the gap?

In 2003, UK output per worker was on a par with Germany but 10% lower than in France and 25% lower than in the US. Adjusting for hours worked – which, compared with the UK, are longer in the US and shorter in France and Germany – the productivity gap between the UK and the US narrows to 16%, but widens relative to Germany (15%) and France (25%).

Broken down by sector, the gap is more than 20% (compared with the US) in wholesale and retailing, financial intermediation, and machinery and equipment; around 10% in the rest of manufacturing, business services, hotels and restaurants; and negative (in other words the UK is relatively more productive) in mining and gas, electricity and water.

The average productivity gap has narrowed since the early 1990s when the hourly gaps with the US, Germany and France were 29%, 25%, and 40%, respectively. But this is due to slower growth in output in the other major economies rather than any absolute improvement on the UK's part.

The UK's trend rate of productivity growth has remained close to 2% a year for the past half-century despite attempts by governments of all persuasions to raise it. To close the gap, the UK will need to raise its rate of productivity growth relative to that of the US, France and Germany for as long as it takes to match their levels of productivity. The Treasury reckons that if the UK could match the US in productivity, national income per head would be £6,000 higher than at present. The Exchequer's take – in the form of increased tax revenue – would enable extra spending on schools, the NHS and other public infrastructure without having to raise tax rates, which is another reason why politicians are keen for the gap to close.

What accounts for the gap?

To explain the hourly productivity gap, economists look first at the two things known to enable workers to produce more – the amount or quality of the physical capital they use, and their level of skill. High productivity is typically associated with a large stock of capital and skills in an economy, and stocks of both are relatively low in the UK. Capital stock per hour worked in the UK is around 20% lower than in the US, 50% lower than in France and 70% lower than in Germany. The UK also devotes a relatively low share of national income to research and development (1.9% of gross domestic product in 2003 compared with 2.7% in the US, 2.5% in Germany and 2.2% in France). As for skills, the proportion of the UK workforce with degree-level qualifications (just over a quarter) is comparable with that in France and Germany but lower than in the US.

A relatively low proportion of the UK workforce (below a third) has intermediate-level qualifications. This skills shortfall is particularly evident in vocational qualifications and extends to lower- and middle-level management qualifications. The overall inadequacy of the skills profile is further highlighted by a relatively high proportion (above a third) qualified at or below NVQ level 2 (including people lacking basic literacy and numerically skills).

Investment that raises the stock of productive resources tends to be reciprocal. Organisations are more likely to invest in state-of-the-art technology if workers have the skills to use it, and vice versa. But this doesn't usually account for the entire productivity gap.

There is normally a residual element, called 'total factor productivity', which measures how well physical capital and skills are used. Explanations of the productivity gap thus boil down to understanding both why some countries have better-equipped and better-skilled workers than the UK (the resource gap) and why some countries make better use of those resources (the efficiency gap). In addition, it's useful to understand any relationship between the resource and efficiency gaps (for example, organisations able to make maximum use of skills may invest more in skills).

Analyses by Mary O'Mahoney and her colleagues at the National Institute of Economic and Social Research estimate no difference in the efficiency gap between the UK and France and only a small gap with Germany, so we could close the productivity gap with those countries simply by investing as much as they do in physical capital and skills. However, these resource differences only account for half the UK's productivity gap with the US. To match the US, the UK not only has to invest more but make considerably better use of any investment so as to close the efficiency gap. The aim should be to achieve this while maintaining a high rate of employment, since joblessness represents a waste of human resources.

One reason why investment in machinery and skills is so high in France and Germany is that labour is relatively costly to employers. As a result, the high level of productivity in these countries is mirrored by a low employment rate. This detracts from the benefit of high productivity on material living standards as well as giving rise to the various social costs that stem from unemployment (and also to some extent affects measured productivity since many of the least productive members of society in France and Germany are jobless).