Improving National Performance

A recent issue of the Financial Times reminded us that "The ultimate objective of economics is productivity. Economists have interesting things to say about other issues from interest rates to drug abuse, but in the long run it is improvements in our use of effort and materials that makes us better off."

This is a timely reminder in a period of stagnation if not recession that attention must turn again to nations' and companies' competitiveness and productivity performance. Several reports published in mid-2001 provide relevant pointers. First, the Geneva-based IMD's 2001 International Competitiveness Report. This reminds us that the most important competitiveness factors cannot be altered overnight; the development of a country's technological infrastructure, the efficiency of its governmental administration, the quality of its education and the productivity of its workforce can only be improved through long-term action. However, that is no excuse for not starting action today.

More specifically on the workforce productivity factor, the report also reminds us of the need to differentiate between trends and levels both within and between competitiveness and productivity. Thus Italy, though languishing in overall competitiveness performance (behind not just other advanced economies but also Estonia, Chile and Hungary at 50% of US level), is nevertheless 4th in worldwide overall productivity performance. Indeed, it is just two places below France, still Europe's leader in output per hour worked. However, this measure only gives half the story for, overall, France performs at some 60% of the US level.

Thus, countries (and companies) need to see how they compare - "benchmark" - with others in a whole range of aspects. This is where a second report provides another series of insights. Ireland's 2001 Annual Competitiveness Report concludes that although it is Europe's leader in labor productivity growth (as well as in economic and employment growth), Ireland has still serious shortcomings in other areas impacting on competitiveness. Particularly important shortcomings are costs (especially building costs), infrastructure (not just poor railways and roads and a housing shortage, but also excessive commuting time to and from work) and telecoms and e-business (Internet hosts are relatively few and costs high).

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Moreover, Ireland's leadership in labor productivity performance owes much to foreign investments. Indigenous industry — essentially small and medium-sized enterprises (SMEs) — lags behind at 60% or less of the national average. However, it is not just the quality and extent of foreign direct investment which explains Ireland's high labor productivity. A significant factor is attributed to the quality of the tangible (capital) and intangible (human) resources. Ireland has been investing heavily from the 1960s in quality university education, a decision which is now paying off, a decade or more later.

So Ireland and other European economies as well have a problem of labor productivity in SMEs. Under European law, governments are no longer supposed to provide business with subsidized services (though, in fact, at 1 per cent of GDP, Ireland is still the European Union leader in giving subsidies, a figure which compares with 0.2 per cent for the UK, the Union's lowest). Moreover, governments have to respect the criteria for introducing the new Euro currency, one of which is reducing their spending. Thus, they have fewer resources available to support activities which are essentially market-driven. Indeed, governments are themselves striving to ensure that there is more competition in order to spur innovation.

This is clearly the case of the UK, examined in a third report. Its newly re-elected government remains one of the few in Europe to place explicit emphasis on raising national productivity performance. "From today, our energies must be directed to productivity," stated the government's finance minister in June. US output per worker is two fifths higher and the French one fifth higher than the British. Attempts to catch up have been slow and difficult in the past, despite being able to copy best business practices and technologies.

One reason is that British workers have less capital equipment. As the stock of capital needed is much bigger than total annual output, it takes a long time for investment to deal with such a shortfall. In fact, investment by the public sector (such as transport) has become the lowest proportion of GDP since 1945. Only in information technology hardware and software have recent levels of the UK's investment matched American performance.

Even if British capital per worker were to increase substantially, there would still be a major productivity shortfall for two reasons. On the one hand, the skills and expertise of the workforce are inadequate; a significant proportion of the population still lacks "functional literacy." On the other, Britain is still inherently a less dynamic and innovative country than America, which has a much stronger science-based education and a higher business R&D spending. But change is under way. There is now a tendency in Britain C and in Europe in general as well C to follow a US-style entrepre-

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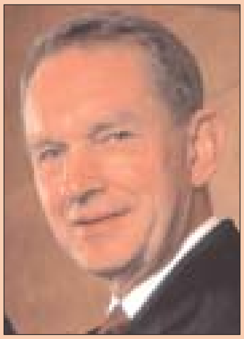

neurial culture of reducing capital gains tax, reviewing planning systems, reforming insolvency laws, bringing more enterprise into schools, and introducing draconian legislation against collusion in price-fixing.

Indeed, the productivity achievements of the British economy over the past half decade augur well for its future in other ways. Thus, between 1996 and 2000 the absolute number of jobs rose by 1.6 m. Although these new entrants into employment were initially between one third and one half less productive than existing workers, their learning curves have now risen considerably. In the same period, manufacturing productivity hardly increased overall. It then rose by 5% between 1999 and 2001 as companies adjusted to the increased value of the pound sterling. Competition is good for productivity and competitiveness.

Finally, we must not forget that competitiveness depends not just on productivity but also on prices. In this respect, European Union countries now have a significant new asset in their new currency, the Euro. From now on, excepting for Britain, Denmark and Sweden, exchange rates among the EU trading partners are fixed. The introduction of the Euro produces a much more level playing field for competition since trading within the European Union is far larger that between the EU countries and the outside world. And costs, prices and values become much more transparent.

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