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Host:

- **Bart van Ark**, Managing Director of The Productivity Institute and Professor of Productivity Studies at The University of Manchester (BvA)

Guests:

- **Yael Selfin**, Partner and Chief Economist at KPMG (YS)
- **Anthony Rafferty** Professor in Employment Studies and Managing Director of the Work and Equalities Institute at The University of Manchester (AR)
- **Tony Venables** Professor of Economics at The University of Manchester and Research Director of The Productivity Institute (TV)

BvA: How do we keep our shelves stocked for Christmas? And does the NHS have the staff to reduce the ever-growing waiting lists? Can productivity growth help to face the challenges of rising labour shortages in the economy? Welcome to Productivity Puzzles.

[Music playing 0:00:15– 0:00:29].

Hello and welcome to the ninth episode of Productivity Puzzles, your podcast series on productivity, brought to you by The Productivity Institute and sponsored by Capita. I'm Bart van Ark and I'm a professor of productivity studies at the University of Manchester and I'm the director of The Productivity Institute, a UK-wide research body on all things productivity in the UK and beyond.

Today, we're going to focus on a topic making headlines in the newspapers about every day now, the increased shortage of workers, and especially skilled, so-called blue collar workers, in our economy. Why has this happened apparently so suddenly? Couldn't we have seen this coming faster and be better prepared for it?

For sure, some of the recovery effects from the COVID pandemic on the labour market were hard to predict but the effects of Brexit on migration and the larger effects of an ageing workforce, we've seen those coming for a long time. Is it perhaps because we thought this was a short hiccup? Or did we perhaps expect automation would solve it all and robots would step in wherever we don't have the waiters, the nurses or the truck drivers? Or did we simply assume that rising wages will miraculously increase productivity as well?

It's been often said that we need to get this economy out of the trap of low wages, weak skills and mediocre productivity growth, but how do we get to a world of higher wages, better skills and stronger productivity? Are today's labour shortages the trigger that could perhaps make this all happen?

To unravel this Gordian knot in Productivity Puzzles, we are lucky to have, again, a great panel with us today. First of all we welcome Yael Selfin, who is a partner and chief economist at KPMG in the UK, where she advises clients on the state of the global economy and strategic implications. Her research looks at how major shocks and new technologies impact on the economy and on individual businesses. Yael is a regular commentator on economic issues in the media and she is also a fellow of the National Institute of Economic and Social Research, one of TPI's partner organisations.

Yael, welcome to this podcast. I have a quick question for you, what's been your, sort of, most striking experience of labour shortages in recent months?

YS: Hello Bart. Well, for me, the most striking is the type of change that we've witnessed in the labour market. Usually after an economic downturn we would expect to see a large rise in unemployment but the nature of the COVID shock on the economy, as well as the programmes the government introduced to support the labour market, created almost the opposite effect. We always knew that Brexit will have a negative impact on the availability of workers but the combination of changes in working, in consumption patterns due to the pandemic, together with faster movements of EU workers back home due to COVID, brought about a perfect storm.

BvA: And that's the perfect storm that we're going to talk a little bit more…we're going to be in the heart of that storm for the remaining 40 minutes in this podcast. Thanks for joining us.

Second, we are joined by Tony Venables, who is a professor of economics at the Alliance Manchester Business School at the University of Manchester. He's also the research director of The Productivity Institute and formerly Tony has also been a professor at Oxford University and at the London School of Economics, as well as chief economist at the UK Department for International Development. Tony is well-known for his research on international trade, spatial economics and natural resources.

Tony, also welcome to you on this podcast. Now, a quick question to you, from your own experience, have you seen any signs in recent months of a place where you actually did see a productivity increase happening because of shortages arising?

TV: Well I suppose in the health service. We've seen vaccination, the programme, being rolled out with amazing efficiency in and out – a fiveminute vaccination job – fantastic. But I think we've also seen a reduction in quality of personal service in a lot of areas, which may sometimes masquerade as an increase in productivity but is in fact a reduction. It's shifting some of the work to the customer. It's not a real increase in productivity.

BvA: Our fourth panellist today is Anthony Rafferty, who is a professor in Employment Studies, also at the Alliance Manchester Business School at the University of Manchester. Anthony was also recently appointed as the managing director of the Work and Equalities Institute, with which he has been associated for many years. He's also a researcher in The Productivity Institute, working on how labour market inequalities impact on human capital formation and productivity.

So, Anthony, you look a lot at low-wage labour and precarious labour. Have you seen people out there, at the lower end of the wage scale, to see their take-home pay improve in recent months?

AR: Thanks Bart. Yeah, there's some evidence of increased wages in some areas of low-paid sectors such as retail, hospitality and construction. Although in some case the wage increases aren't necessarily in the lowest paying jobs but where there are some kind of specialised skills, so where HGB drivers might be seeing a little bit of movement, last mile delivery drivers who bring the parcel to the door maybe not so much.

And steeper pay rises also appear to be seen in sectors where there are longer-term skills shortages or where training required provides entry barriers or where there's a reliance on migrant labour historically. I guess another issue, just to come on to that, is about the precarity of work. What we've seen is a comparatively large increase in temporary work and agency work during 2021 as well. And some of those labour shortages are not really across the whole economy, so it's a bit, overall, of a mixed picture.

BvA: Which actually is a really good way into our first segment here.

Yael, I'd like you to take us a little bit through the lay of the land, because from the media one often gets the impression that labour shortages are everywhere and, as we've just heard Anthony saying, that's really not the case. Yes, we hear the horror stories about truck drivers and waiters and nurses and that it will only get worse before it gets better, but what is the situation? Where do we see the labour shortages most? Which sectors of the economy? Are there particular occupations, as we already mentioned, or some regions even in the UK where you see some of these shortages?

YS: Yes, so overall vacancies have risen to over one million for two months running and that's compared to an average of 824,000 in 2019, which represents around a third increase in vacancies in recent months.

In terms of the sectors, distribution...vacancies appear to concentrate in sectors that have recently reopened and are looking to increase capacity. Sectors such as hospitality, retail, health and social care always had, I'd say, high vacancy rates, even before the pandemic. But recent data shows the situation has deteriorated most in hospitality, art, entertainment and recreation than other services, so there's a bit of a change there, really, in terms of the vacancies and shortages that we've seen previously.

But also in the sectors such as information and communication sectors that are potentially higher skills, we have seen a big increase and that could represent growing demand for digital products and services in the post-pandemic economy. So as we change the way we work and interact more broadly. So there's really a mixed story here, that Anthony referred to already.

Now, when we look at the percentage of businesses reporting shortages across all industries, 14 per cent of businesses have seen that they have experienced a shortage of workers and that compares to about 38 per cent in the hospitality sector. So that's quite a big difference between the impact overall on businesses in different sectors. So there is some concentration in some sectors but overall I'd say there has been an increase almost across the board.

So when it comes to regions, just comparing to 2019, there are more vacancies in less productive regions such as the north-east, which is experiencing the biggest rise while the south-east, which is the second most productive region, has experienced the smallest increase in vacancies. And then other regions with relatively high increase in vacancies include Wales, Yorkshire and the Humber as well as the West and East Midlands.

BvA: So on this regions thing, is this mainly a matter of, sort of, industrial structure, just industries that have bigger shortages are over-represented in those regions? Or is there just a bigger skill mismatch happening in those regions, why it's harder to get people to the workforce?

YS: I think it's a little bit early to tell. My feeling is that it's a mixture of the industries… So for example we have Northern Ireland with a relatively smaller increase in vacancies and that's potentially due to the fact that there's a big public sector component there as well as other reasons. But also, it's about the availability and access to a labour pool, with the regions that have access to a larger labour pool, a more flexible labour pool, having less of an issue attracting staff. As well, the regions with naturally the higher wages…because we have seen evidence of online poaching, if you like, of companies based in other regions poaching staff from regions with weaker wages, where workers can stay there but work remotely.

BvA: So do we see also a very strong increase in wages across the board?

YS: So we have seen increasing wages, particularly in specific sectors where there are shortages and also where there is capacity or scope to increase wages more. So that has been the case, to the extent where there were margins and an ability for firms to pass on costs, or margins were higher, we have seen a rise in wages.

BvA: So, Anthony, we've seen a good recovery in employment, we have seen some recovery in wages as Yael just said. We have seen a recent decline in unemployment – it's 4.5 per cent now, from where it was a year ago – but we still look at the participation level in the workforce that is lower than it was before the pandemic. So it doesn't feel like there's been an across-the-board improvement that the entire workforce has benefited from. So how are inequalities in the labour market playing out here?

AR: Yes Bart, I think we know that issues of inequalities have been a big part of the story with the pandemic. For example, black and ethnic minority workers were particularly exposed to negative labour market and health impacts during the initial pandemic. And also more recently, some of the evidence suggests that the gender pay gap in the UK may have worsened slightly during the pandemic.

I think another big issue in terms of equalities, moving forward, is how things are shaping out for, kind of, younger and older workers. So we know, again, in the initial, kind of, pandemic waves, younger workers were affected more badly. But perhaps they've seen a bit more of a better recovery in terms of as those sectors which they had the higher representation in – in terms of retail, hospitality, for example – have opened up again. But there will also be younger workers who are in a more risky labour market situation, have perhaps moved more into education to shelter from the labour market which, at the very bottom, has reduced labour market entry among younger workers.

So in terms of older workers, I think we need to know more about why, particularly over the age of 55, rates haven't recovered in terms of employment as quickly. I mean, there may be some reluctance here for people to go back into work due to greater health risks continuing. Others may have opted to retire earlier because of COVID. Although the extent to which that's a long-term trend we don't know yet.

At the same time, we don't know if some of this is more to do with some discrimination against older workers. For example, if employers are giving preferences to younger workers who are seen as less likely to have employment disrupted due to, kind of, health risks around COVID. So there's some more further issues we need to look into there, I think.

But at the same time, I don't think it's, kind of, just a good news story for younger workers. We know that the experience of precarious forms of employment, such as temporary and zero-hours contracts, are higher among younger workers.

And a lot of employment rise in 2021 has been among, kind of, the temporary or casual labour. This might partly be due to, kind of, organisations having struggled to find employees through their traditional measures. It might be due to them taking a more short-term risk-adverse kind of view on their labour management strategies. But it also may be partly to do with covering sickness leave and temporary leave in the workforce as well.

I guess there's some kinds of issues here for the employment figures because essentially if temporary workers are covering people who are off sick, you know, for example in a school where there's a teacher off sick or who has to self-isolate following being pinged, there may be a supply teacher in the role. In employment figures this could potentially show up as two jobs, where there is actually just one job, and slightly inflate the figures.

But more seriously I guess if there is a longer-term trend towards more temporary work, there's a question of whether, kind of, rather than building back better we're going to end up in more levels of precarious or insecure work in the economy.

BvA: Tony, before we move on to the second segment, any comments from your side on this, sort of, lay of the land situation?

TV: Yeah. More questions than comments, really. I mean, the regional pattern is fascinating because it's not what I would have expected. You know, if it's hitting hospitality, you would have thought it would hit the south-east and London would be hit. I'm seeing that opposite pattern; getting to the bottom of that's going to be fascinating. Whether it's partly demography, older people dropping out of the labour force, so it's a participation story… But there will be questions rather than answers to do that.

BvA: Yael, this is obviously not just a UK issue, right? I mean, you know, Brexit is of course uniquely affecting Britain, at least more than any of the other economies in the Western world, but this shortages problem seems to happen pretty much everywhere in the Western world. So what is your view of the underlying dynamics that we see across the board in the OECD?

YS: Yes, indeed. I mean, looking at the areas that grab most headlines in the UK recently – and Anthony's already mentioned the shortage of drivers – Holland was short of more than 120,000 drivers last year while in Germany between 45,000 to 60,000 were needed. They benefited, though, from being part of the EU and therefore it was easier for them to attract drivers from other countries. But they still had some problems, specifically with that particular profession.

And then more broadly, data from a recent business survey run by the European Commission revealed that about one in four Eurozone businesses in services and the manufacturing sector reported a lack of workers as a factor limiting production in October, which was the highest proportion registered since the start of the survey in 1985.

And then looking at different countries it's really the Netherlands and Germany in particular that are experiencing a high proportion of shortages, whereas France is a little bit better and Italy and Spain are faring better among the larger European economics. And we are also seeing problems in the US, especially in sectors like construction but not just construction.

BvA: Yeah, and that also means that obviously relying on a migration channel, even irrespective of Brexit, would have become more difficult anyway. And it means a great focus indeed on making sure that our own workforce can do the jobs, indeed, more productively. Yes, so you set out the research agenda for us, ahead of us, and we'll definitely have to do a lot more work here, together with many others.

So let's talk a little bit about what's causing these labour shortages. You know, the big stories we hear out there is that this is obviously COVID and the recovery from COVID. We already talked a little bit about that. Also, quite a bit of discussion that Brexit may have created shortages – maybe short-term, maybe longer-term – in the market. And it will be a while before we'll figure out – if ever – what actually mattered most here.

But it seems that we may be missing, Anthony, perhaps the big elephant in the room, which I think you already alluded to in your early answer a little bit. This is demographics. You know, one element is the ageing of the workforce and potentially, yes, you mentioned the accelerated retirement of older workers. But then there's also the slowing growth in new entrants in the labour market and the skills mismatch. So the question really, I think, to you is are we in a bit of a perfect storm here or is there perhaps a bigger underlying explainer here that we need to focus on?

AR: Yeah, it's a great question that and I think it's the billion-dollar question, trying to untangle, kind of, Brexit from what COVID is actually doing at the moment in terms of the labour market. And I guess there are some differences of opinion here.

So if you, kind of, look at some of the commentary or talk to people about current labour and supply shortages, it can still appear that, kind of, remainers and leavers often still find themselves living in parallel universes in terms of what's, kind of, going on. So on the one hand you've got Prime Minister Boris Johnson claiming such shortages are part of a longer-term Brexit success story and a movement to a higher-skilled, higher-wage economy. Whereas I guess some remainers would argue that actually these shortages show some of those negative effects of Brexit that were suggested starting to come. Or that even some of those Brexit chickens are coming home to roost for Christmas – or turkeys at least, if I may.

But I think the picture's probably much more complex and I don't think the fall of inward migration alone without dealing with long-standing issues around skills and infrastructure is going to lead to a quick transition to some high-skilled, high-paid economy. I guess also indeed there are these types of demographic issues, so the ageing workforce, issues around older workers returning to work and so forth. But on top of this, you know, a reduction in inward migration following Brexit probably does mean there are less younger aged people joining the workforce as well.

So I think COVID-19 has contributed to some of the acute skills supplies. We can't just put it down to Brexit. So thinking about HGV drivers, a lockdown prevented many people, new drivers, from getting licences. Or we might have seen, kind of, shifts in people across jobs. So people in jobs before the pandemic have taken on new opportunities that have expanded. Following lockdown there might be some reluctance to move back into those, kind of, customer-facing roles which can be affecting, kind of, retail, hospitality at the moment.

But I guess there's also, kind of, longer-term structural issues. So beyond the longer-term demographics story there are issues around the employment models businesses have used more in the long-term. And in some areas experiencing labour shortages such as food production and meat processing, which have been more reliant on migrant labour, arguably Brexit and COVID has exposed some of those longer-standing fragilities. So for a long time now there's been considerable supply chain pressure on some areas of food production, particularly by big-box supermarkets, which in turn sustains less attractive pay and, kind of, working conditions as suppliers try to minimise those costs.

So I guess there are questions about how much it is a migration issue that suppresses wages or broader supply chain pressures here. And, indeed, it might be a peculiarity of leaving the EU, one year on, that the UK is importing some forms of food for Christmas from Europe more than last year in order to make up for some shortfalls in domestic production.

BvA: Yeah, so I think the gist of your comment, indeed, is that this is not, kind of, a short-term issue that will just go away but there are some underlying fundamentals related to demographics. But also, I should say, very importantly related to the employment models that businesses have been applying that need to be adjusted to this, kind of, new situation. So far we haven't really talked much about productivity yet.

The question is, of course, whether the silver lining of all these labour shortages might be that it can help productivity to recover. And that we are going to find out after this short break in which you can hear about what else is happening at The Productivity Institute.

[Music playing 0:22:00–0:22:07].

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The UK's regional productivity divide is stark by international standards. To investigate why, The Productivity Institute commissioned agenda-setting deep dives into productivity across all English regions and the devolved nations of Wales, Scotland and Northern Ireland. Led by our eight regional productivity forums, these insight papers provide unique analysis of the UK's long-standing productivity puzzle and will be published alongside an easy-to-read executive summary. Together, this research highlights where local and national policymakers can make a positive difference to productivity in their area and help contribute towards increased living standards and wellbeing everywhere.

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[Music playing 0:23:39–0:23:42].

BvA: Welcome back to my discussion with Yael Selfin, Tony Venables and Anthony Rafferty. Before the break we mainly talked about the labour shortages themselves but let's now turn our attention to the productivity side of this. Because perhaps these labour shortages will finally get companies to invest in ways to raise productivity as well.

So, Tony, most economists think about productivity as causing a rise in wages. So if companies produce more and are more productive, they can pay their workers more and this way you get a nice, kind of, virtuous cycle. But implicitly, of course, a lot of the recent rhetoric suggests that we can head start this from the other end, by raising wages so that companies are forced to raise productivity. And the question is how does that channel exactly work. And maybe you can take us a little bit through how rising wages will ultimately get us to the productivity increases.

TV: Yes, thank you Bart. Let me actually stand a little bit further back from it than that. If an economy has labour shortages, how do we think that is going to show up in different aspects of the economy? I think there are basically three ways it can do that and some sectors will go one way, others another way. But what are the three ways?

Well the first one is you stop producing, you shut down, the can't get the workers. Or at least if you did they'd be so expensive you couldn't afford to pay them. Obviously we've seen a little bit of that already. I mean, Anthony referred to it a moment ago and I think some agricultural sectors, you know, meat, whatever, this is going to happen. And that's obviously a loss to the economy, when sectors shut down and we import rather than producing domestically.

The second mechanism is, okay, you're a firm looking for workers so you do pay higher wages to attract staff. Now that may or may not raise productivity but let's think about a sector where it really is hard to raise productivity; then what happens as a consequence of that wage increase? Well obviously first, you know, it's passed on to consumers. So it may be very good for income distribution; we might want to raise the wages of, you know, low-paid sectors. But it is zero sum, there's no productivity increase.

There are a few other 'buts' on that, that I want to say. You know, maybe you're raising wages to attract people into a sector where they really, really didn't want to work. So all you're doing is compensating them for doing something that they didn't want to do. So in that case it's not just zero sum, it's negative sum, right? You're pulling people into jobs they don't want to do.

And there's a, sort of, general point underlying that, which is okay, maybe there are skill shortages, maybe wages get a bit up in a sector, but wages going up doesn't make it a high-skilled job necessarily. If it was a low-skilled job before, it's still a low-skilled job. So some of this is going to be not raising skill levels in the economy but actually shifting some of the labour force into low-skilled jobs that were previously taken, you know, possibly by migrants.

Anyway, that's put the productivity one off until the third. So, you know, you shut down and we import; you raise wages but it's all passed on or, yeah, you raise wages and that has the intended effect, labour has become more expensive relative to other things so, sure, you do innovate in management systems, you automate, you become more capital-intensive, use more equipment. But there are buts on that.

First, that doesn't come free. Automation costs. So, again, there's some price effect there that will be passed on. And also, of course, in some sectors the technology is such that those options are open to you, in others there aren't. You know, some sorts of fruit can be picked by robots, or will be able to, other sorts of fruit won't. Social care; there's not going to be some technological revolution that puts robots by the bedside.

So it's something that's going to be enormously variable across sectors. And I suppose I don't expect to see a very large kick coming out of that for productivity and the economy. I see the first two mechanisms doing more and ultimately that's not benefiting the economy. It's causing some redistribution that we might like, but not yielding aggregate social benefit.

BvA: Yeah, so basically, you know, it's the third channel, the one that rising wages raises productivity, that we would like but I think what you're saying is that the first two channels – this is basically you either shut down or you pass it on to the consumer or you see actually it's affected on your bottom line – are the most likely ones. Now, Yael, let me ask you, from, sort of, past experience, do you see good examples or evidence of rising costs indeed forcing companies to automate and successfully create more productivity? Is this a channel that has some potential or do you agree with Tony, that this is going to be a difficult thing to do?

YS: I mean, I think there's potentially some evidence of increased automation. Yes, absolutely, especially in sectors like manufacturing, where you can automate more. But then there's the trade-off of costs, obviously. But what I think we do see more is how labour shortages are impacting a firms' behaviour.

So I think it does encourage companies to invest more in training and also in retention. Because the cost of hiring another person and…is actually much more expensive now. So there's much more focus on getting people to stay and skilling them and getting them comfortable. And that in itself has a positive impact on productivity, because the people that understand the job and are more motivated to stay in the job potentially can produce more and be more efficient.

BvA: Yeah, so indeed when we, sort of, look at the productivity numbers recently there is no clear sign of a huge uptick. I mean, of course we've seen some improvement happening over COVID but still, you know, the last couple of quarterly numbers show about 1.5 per cent productivity increase over the beginning of 2019 before the pandemic. We don't have third quarter numbers yet but it's unlikely to see another massive improvement because output really isn't growing that rapidly anymore. And probably certainly not more than the growth in employment.

And in the meantime, as we all can notice, we don't see robots running around – yet – to think that there's a productivity boom happening right around now.

So yeah, when you talk to companies, what is it that they are practically doing now to step up on efficiency gains? Are there quick fixes? You know, you already mentioned trainings and skills and that takes a lot of time but are there things, management interventions, that they can undertake to unlock some of the barriers in the business in order to really use the opportunity of these rising wages to create more efficiency, more productivity, in the organisation?

YS: So I think there's probably three things, generally, that companies tend to look at. One is investment in skills. That's really important now, especially when we look at the good jobs argument.

The other one is really better management practices. We have a very wide range of management practice qualities across the UK and there's a lot we can improve there.

And related to that is also what we call operational efficiency. So companies large and small have quite a lot of scope to become more efficient and more productive in the way they operate. And that's partly included machinery but not just; processes can improve and that's fairly straightforward.

But then one of the things that we haven't really talked about a lot today, and I think is really important, is the change in working patterns for a lot of people coming out of this pandemic, where a big chunk of the labour force is now potentially going to work more remotely, or at least partly remotely, and will potentially travel a bit less. So if I think about people like myself or people that work in similar areas, I used to travel the country and do one podcast a day and now I can do ten. So I've become much more productive because the reduction in travel and the increase in online communication is something that has the potential to increase productivity.

And then if you look at the latest studies, we've just seen the Bank of England releasing some numbers on how the impact of the reduction in spend on building and the better working methods and therefore the increase in investment in IT and training could see about 0.5 to 0.7 increase in productivity. We did our own study looking at how the change in working pattern will actually increase the agglomeration effect in the UK and that could see about another 0.5 increase in productivity, based on our calculations.

So I think there's quite a lot going on at the moment that… It's an amazing opportunity for companies to leverage and increase productivity on the back of that.

BvA: Yeah, and I would recommend audience to Productivity Puzzles to also look back at one of our previous episodes, which we did in September with Mark Logan of Glasgow University, called Practical Productivity, where he described in very practical terms what companies can do to unlock some of the barriers to productivity growth. So there are practical things you can do. You don't immediately have to think about, you know, big automation projects or training and skilling – as important as they are, but are more likely to take a bit of time before they translate themselves into productivity.

Anthony, let me go back to see how you are thinking about this. Because again, you know, you are looking, sort of, at the lower end of the wage scale. How would an increase in wages for lower-waged workers suddenly make them more productive?

AR: Yes, it's a tricky question, I think, as both speakers before me allude to. I guess many workers, and low-paid workers, would see a bit of a morale boost if they were to see their wages, kind of, generally rise. Although problems of rising inflation might affect whether that actually feeds through to their living standards.

Also, many organisations – well some, at least – are opting for more temporary financial incentives rather than, kind of, longer-term wage increases. But I guess Yael's, kind of, made some of these points already, about how technology might be used, training and development and retention. So in terms of developing more longer-term relationships and more firm-specific skills, human capital through longer job tenure.

But there are also issues around working conditions in some of these sectors, I think, that need to be looked at, which are more long-standing. So we mentioned things like food production. If we're going to keep our workforce healthy and engaged and perhaps even encourage some people back from retirement, work/life balance issues are there as well. They are not just issues for people with children but they may become an increasing issue for people across the, kind of, age spectrum as we go forwards.

And I guess just to finish off, one issue may be work intensification. So, you know, employers, where they are restricted in other ways of improving productivity, might just look to get more out of workers in that way as well, which isn't necessarily the most positive way.

BvA: Tony, any final comments from your side, having heard this discussion on the potential for raising productivity growth? What is it where you think business or policy makers should focus?

TV: I think the skills point is really important here. We know that skills are a problem through the economy and firms have under-provided skills. So if that were a margin where firms chose to invest then that would be really important. I say if, because obviously the labour shortages create a greater chance your workers are going to quit and be poached by someone else. In which case the incentive to train them is not automatic. However, as part of a policy agenda, just trying to work on the skills side here, I really do think, is very important. You know, I said that just paying more doesn't make a job more skilled but really raising the skills of the labour force does start to get there.

BvA: Yael, a final question to you. You know, we're now gradually beginning to talk about rising inflation and the potential this may have on interest rates. Would rising interest rates make this path towards increased productivity even more difficult, or would it perhaps facilitate it a little bit?

YS: Well, I mean, the disadvantage of rising interest rates is that it does make investment more costly. So in that sense it's not great news. But, you know, that's something we need to live with really.

BvA: Yeah, but an argument could be that rising interest rates may actually make the economy a bit more efficient, because now that we're going to put a bit of a price on capital, we're probably going to allocate it better, to more productive applications.

YS: So obviously there is part of it and we have the whole idea about the extent of zombie firms, if you like. And if we look at the level of insolvencies that we've had during the pandemic, it was at very low levels. We are expecting a rise in insolvencies anyway, as all the support schemes end.

But I think ultimately, just as both Anthony and Tony mentioned earlier, we do need to bear in mind that as a wealthier economy we have a type of economy where we have a relatively large share of people in services that are not particularly productive. So, especially with an ageing population et cetera, we have more need for social care, for services that are more consumption based, and therefore there's a debate about how much we pay for those workers. We probably potentially want to pay them more but the productivity argument itself needs to be looking at different sectors and what we can do in different sectors and really how can we have our industry and our post-Brexit future in the longer-term in a path that is technology driven, at least part of it, that will pay for the rest of it in some ways.

BvA: Yeah, and this brings…economists call this the William Baumol effect and that is that services sectors sometimes struggle more to raise productivity but at the same time we also learn a lot, that particularly digital technology does give services sectors actually quite a bit of opportunity. But it is probably a slower process than what we are seeing in terms of industry productivity growth. In any case, we got a lot covered in this podcast.

I think the most important message is that, you know, while labour shortages are gradually expanding itself across the economy, the impacts of it on productivity will differ quite a bit on how businesses respond to these increases in wages. Whether they pass them on to the consumer, whether they let it, sort of, be eaten up at their bottom line or whether they actually see incentives to productivity growth.

But we also see that the impact on workers can be quite significant. There are cases where, you know, you can incentivise and Anthony talked about low-wage workers to actually become more productive. So there are paths towards dealing with those rising wages. But it's going to be an issue being with us; it's not a short-term hiccup. And it's something that obviously we will continue to follow quite closely.

So thanks to our three panellists for shedding some light on these complex issues. Yael Selfin, Tony Venables and Anthony Rafferty, thank you for joining us.

Our next episode of Productivity Puzzles is our tenth and it will therefore be a special one. I'm going to have a one-on-one conversation with a Manchester celebrity, Sir Cary Cooper, who is a Professor of Organisational Psychology and Health at the Alliance Manchester Business School. Cary is a world-leading expert on workers' health and wellbeing and he is my office neighbour in Manchester. Cary just completed a new book on health and productivity of the workforce, which he co-authored with Stephen Bevan. So I'm looking forward to this conversation with Cary on how a healthy workforce creates a healthy business.

So stay tuned and join us or, better, you can sign up for the entire Productivity Puzzles series through your favourite platform to make sure you also don't miss any other future episodes. If you would like to find out more about upcoming shows or any other work by The Productivity Institute, please visit our website at productivity.ac.uk or follow us on Twitter and LinkedIn. Productivity Puzzles was brought to you by The Productivity Institute and sponsored by Capita. And this was me again, Bart van Ark, at The Productivity Institute. Thanks for listening and stay productive.

[Music playing 0:42:17–0:42:51].

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