

Report

SERV-academy ‘The Future of Productivity’

Brussels, 23 September 2016



1 Executive summary in Dutch

Op 23 september 2016 hield de SERV een SERV-academie over ‘The Future of Productivity’ onder leiding van **Pieter Kerremans** (Administrateur-generaal SERV). De SERV-academie focuste op de bronnen van productiviteitsgroei, de analyse van de determinanten achter de daling in de productiviteitsgroei die kan worden vastgesteld, en de mogelijkheden voor het beleid om daarop te reageren.

Prof. **Freddy Heylen** (Universiteit Gent) stelde een recente studie voor over ‘secular stagnation’, waarbij hij focuste op de vraag of OESO-landen voor een lange periode van lage groei en erg lage interestvoeten staan. Vervolgens presenteerden **Christian Kastrop** (Directeur Policy Studies van het Economisch Departement van de OESO) en **Dan Andrews** (Senior Economist bij de OESO) de studie ‘The Future of Productivity’. Zij toonden welke beleidshervormingen in staat zijn om de diffusie van innovatie te stimuleren, voor een meer efficiënte skills-match te zorgen en aldus bij te dragen tot inclusieve productiviteitsgroei.

Vervolgens gaven **Stijn de Cock** (Voka) en **Pieter Baert** (ACLVB) hun reflecties over het thema vanuit het perspectief van respectievelijk de werkgevers- en werknemersorganisaties. De SERV-academie werd afgesloten met een debat onder leiding van **Tim Buyse** van de SERV-studiedienst en een netwerklunch.

2 Executive summary

On 23 September 2016 the Flanders Social and Economic Council organised its SERV-academy on 'The Future of Productivity'. The academy was led by **Pieter Kerremans** (General Administrator SERV). The academy was aimed at shedding more light on the sources of productivity growth, the drivers of the productivity slowdown and how policy can react.

Prof. **Freddy Heylen** (Ghent University) presented a recent study on the topic of secular stagnation. The main question underlying his study was "Have OECD countries entered a very long period of low economic growth and rock-bottom real interest rates?". Next, **Christian Kastrop** (Director Policy Studies at the OECD Economics Department) and **Dan Andrews** (Senior Economist OECD) presented recent OECD research on 'The Future of Productivity'. They showed which policy reforms can revive the diffusion of innovation and make better use of human talent to clear the path for higher and more inclusive productivity growth.



Next, **Stijn De Cock** (Voka) and **Pieter Baert** (ACLVB) presented their reflections on the topic from the perspective of respectively the Flemish business organizations and trade unions. The academy was concluded by Q&A and discussion under the direction of **Tim Buyse** of the SERV study department and was followed by a networking lunch.

3 Introduction



Pieter Kerremans, General Administrator of SERV, welcomed the participants. He explained that the academy fits within the various ways in which SERV tries to involve stakeholders and experts. Not only to exchange knowledge and information but also to stimulate interaction and debate between policy actors, academics and civil society organizations. Recent SERV-academies dealt with other important topics such as experimental legislation, behavioural economics, economic migration, renewable energy, SME-growth, ...

The future of productivity is an important topic on which among others the OECD has done a lot of work. Productivity growth is the main driver of living standards. But at the same time, productivity slowdown in many countries is one of the

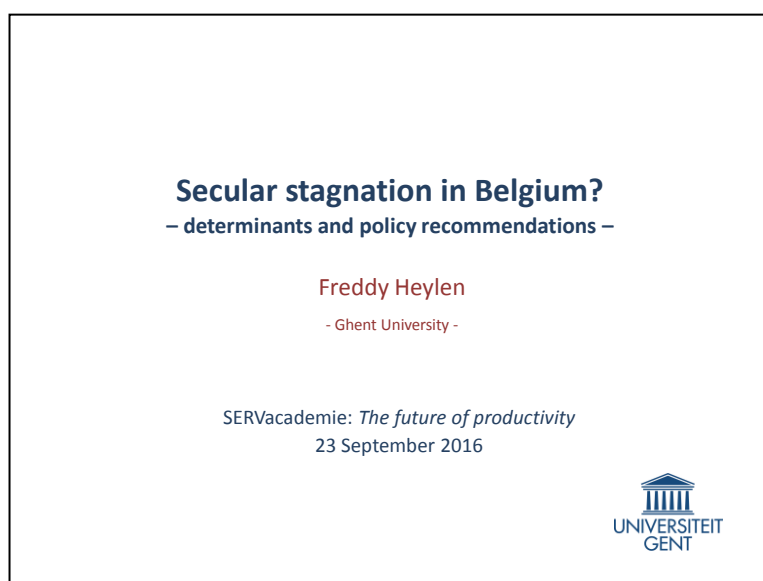
most pressing long-term issues that exist today. Stakes are high for fiscal sustainability, for wage growth, for technological progress, and for all of our well-being.

Productivity has slowed over the 2000s, even before the crisis. Recently, there has been a lot of debate on the issue, going from very pessimistic views on a true technology slowdown or even secular stagnation, to more optimistic views about future technological innovations.

Mr. Kerremans emphasized that The OECD research on ‘the future of productivity’ is important as it shows that policy reforms can revive the diffusion of innovation and make better use of human talent to clear the path for higher and more inclusive productivity growth.

He also stressed that SERV values the work of the OECD a lot: it is often an inspiration and an important source of information for our work. Not only the OECD’s work on productivity, but also on Green Inclusive Growth and on New Approaches to Economic Challenges for example, have been an inspiring starting point for our ‘SERV platformtekst Vlaanderen 2030’, a vision for the future we presented earlier this year to the Flemish government and parliament. Also, our staff participates regularly in OECD-events such as the annual OECD Forum, OECD seminars or working groups of various departments.

4 Secular stagnation



Freddy Heylen (Ghent University) presented his recent study on secular stagnation, its determinants and policy implications. The study reveals that poor growth is especially a problem of potential per capita output which is mainly driven the rate of technical change and demographic change.

Under constant policies, and following the EU Aging Working Group projection for technical change, the expectations are:

- Per capita growth rates significantly below the rate of technical change for two to three more decades.
- Quite flat potential per capita output: growth not higher than 0,5% per year for two to three more decades.

- Record low interest rate (rate of return to capital) for two or three more decades.
- Rising inequality, although this rise as such will not further aggravate future growth.

Added to this, it seems that behavioural effects induced by demographic change are not strong enough to counter arithmetic effects. These arithmetic results imply that when total population grows faster than employment, which is the case in Belgium, lower per capita growth automatically follows. However, mobilizing the employment potential can reduce the decline in per capita growth.

Concerning the possibilities for future policies to tackle low growth, prof. Heylen pinpointed a couple of ways forward:

- Public investment** is key, as its marginal return is much higher than its cost
- Promotion of **investment in R&D** as crucial driver of technical progress. Fiscal policy can contribute with subsidies to R&D investment in firms, tax incentives and formation of high-skilled human capital (tertiary education). Excessive wage moderation, however, is more likely to have negative effects on business R&D investment.
- Mobilising the **employment potential** with
 - Extended and better targeted taxshift (labour tax cut targeted at older workers and *all* low-educated workers is most effective in job creation and in fighting inequality → Heylen, Van de Kerckhove, Buyse (2015).
 - Pension reform with (more) incentives to work longer → Buyse and Heylen (2014), Buyse, Heylen and Van de Kerckhove (2016)
- Policies aimed at promotion of fertility and focusing on the (employment) opportunities of **migration**.

5 The future of Productivity

THE FUTURE OF PRODUCTIVITY

... productivity isn't everything, but in the long run it is almost everything.

Paul Krugman, 1994

Christian Kastrop, Dan Andrews
Policy Studies Branch, Economics Department OECD

OECD
BETTER POLICIES FOR BETTER LIVES



Christian Kastrop (Director Policy Studies at the OECD Economics Department) thanked SERV for the invitation and introduced the OECD study on the future of productivity. The study shows that policy reforms can revive the diffusion of innovation and make better use of human talent to clear the path for higher and more inclusive productivity growth. He also mentioned the current research topics at the department and drew attention to the OECD Global Forum on

Productivity, which aims to foster international co-operation between public bodies promoting productivity-enhancing policies. Mr. Kastrop is very happy that also Belgium is one of the founding members of this Forum.

Dan Andrews (Senior Economist OECD) continued the presentation of the OECD report on the future of productivity. He first reflected on the presentation of Freddy Heylen. He believes this study and the OECD work are complementary. Although Heylen's research may seem depressing at first sight, it seems that policy can do a lot. Previous OECD country studies have for instance indicated that Belgium still has low-hanging fruit such as the high labour tax wedge.



The starting point for the study on productivity is that differences in GDP per capita mostly reflect labour productivity gaps and that weak labour productivity underpins the collapse in OECD potential growth. Moreover, it seems that this slowdown does not have a cyclical nature, but is a structural problem. In addition, multi-factor productivity will become more important as key drivers of growth in the future. A micro-economic analysis lies at the basis of the study, and reveals widespread heterogeneity in firm performance.

Dan Andrews highlighted that in a well-function economy there is ideally innovation among global frontier firms who **diffuse these technologies** to other firms, thus raising within-firm productivity. Moreover, efficient **reallocation** is required to underpin the growth of productive firms, via the downsizing and even exit of less productive firms. The OECD analysis reveals, however, that both mechanisms seem to fail in many countries.



First, although productivity growth of the globally most productive firms remained robust in the 21st century, the gap between those high productivity firms and the rest has been increasing over time. This observation raises questions about why seemingly accessible knowledge and technologies do not diffuse to all firms.

Diffusion is shaped by four factors – global connectedness, experimentation with new ideas, investment in knowledge-based capital (KBC) and efficiency of resource allocation – which are in fact heavily influenced by policies.

Second, there is much scope to boost productivity and reduce inequality by better allocating skills to jobs and fostering the growth of the more productive firms in general. About 25% of workers report a mismatch between their skills and those required to do their job. A better use of talent could translate in up to 10% higher labour productivity in some economies.

Dan Andrews identified four main policy areas to sustain productivity growth

- ▀ **Product market reforms** and bankruptcy laws that do not excessively penalise failure can facilitate diffusion by improving (i) firms' incentives to experiment, (ii) the allocation of resources (e.g. skills), and (iii) the potential benefits of global value chain participation.

- Policies that do not impede **labour mobility** can underpin the growth of productive firms, partly by reducing skill mismatch.
- Public investment in **basic research** is required to support the continued emergence of breakthrough innovations. Knowledge diffusion mechanisms are needed to transfer this research to other actors.
- A **level playing field** that does not favour incumbents over entrants is crucial. Unfortunately, however, this feature is often missing from many policies.

6 Reflection of the social partners



Stijn De Cock (Voka) started his discussion with the statement that perhaps productivity gains are not measured correctly and do not correctly take into account new technologies. Perhaps the productivity slowdown is partly mismeasured? A second remark concerned the services sector, which, according to Stijn De Cock, is less prone to productivity gains. As a result, it is necessary to keep a large enough manufacturing sector, including lead plants, to maintain growth at a substantial level. Related, Voka is in favour of the 'hidden champs' terminology, referring to firms that are n°1 companies in their sector with highly ambitious shareholders. Entrepreneurial culture and shareholders

also influence the outcome of things. Skill mismatch indeed seems to be an important issue for these companies.

Finally, in contrast to the statement by prof. Heylen, Stijn De Cock believes wage moderation is important to keep the innovation engine running and as a means to remain internationally competitive. He referred to recent events of job loss in companies such as Caterpillar. Also, investment in R&D and industry-university cooperation is important to maintain our companies locally embedded. Further, legislation has an important role to play, for instance in relation to new development such as e-commerce. Finally, he stressed that the public sector is also capable of achieving further productivity gains.



Pieter Baert (ACLVB) started his reflection by thanking prof. Heylen and the OECD for two very interesting presentations. Mr. Baert put forward a couple of thoughts on both innovation and skill mismatch.

First, he stated that innovation in itself, at least to a trade union, is meaningless without getting the workers on board. He pointed out that the future of productivity means amongst others digitalisation and robotisation ... Technologies that have the power to help us achieve previously unimaginable levels of efficiency but also imply creative destruction and influence the future of employment and jobs. Pieter Baert held a plea for those workers who are most vulnerable. Government and policy actors must not outlaw innovation, but it must also focus on adequately

preparing current and future workers for what is coming. This means investing in education, training, infrastructure and making sure that the growth we achieve is inclusive.



In addition, the policy suggestions on skill mismatch seem to neglect the period before individuals enter the job market. Increasing productivity and decreasing mismatch begins in school. Mr. Baert finds it very important that government policy focusses on promoting the STEM educations but also on bringing technical education out of its second rate status in the Belgian school system and providing young people with guidance in making the correct choices in education. Part of this is ending the strict separation between school and work and improving work

experience as a way to improve job-worker matching. In Belgium, for instance, the young pick up too little experience in schools. A more vocational focus in school programs can help reduce the mismatch. Mr. Baert added that a possible way of improving the matching process might also be providing adequate unemployment benefits to prevent people to quickly settle for a job not matching their skills. Active labour market policy has an important role to play here to help the (long term) unemployed find a new job.

As for the recommendation to scale up firms, Mr. Baert stated the unions can support this. Many mainstream media focus on start-ups but he finds it important to devote attention also towards the scaling up of already existing Belgian firms thus unlocking their potential on a wider scale by helping them grow and export and hopefully support the future of employment in our country.

Last but not least, the unions support the attention given to lifelong learning policies. According to Mr. Baert, it is the responsibility of all partners: trade union, employer and government to adequately prepare workers for any changes and thus make sure that no man should hear himself or his job being called obsolete.

7 Q&A and discussion

Under the direction of **Tim Buyse** of the SERV study department, a discussion was held about the topic. This discussion further elaborated on the above issues and reflections.

Concerning the way GDP and TFP are estimated, the speakers agreed that there is some degree of mismeasurement. However, there was clear consensus that this mismeasurement was rather small and is also not 'something new'. Moreover, even if there was substantial mismeasurement, this alone would not be able to explain more than a quarter of the total productivity and growth slowdown.



Christian Kastrop agreed on the statements of Stijn De Cock on the importance of the manufacturing sector, hidden champions and the entrepreneurial culture. Nevertheless, he believes that the capacity of the services sector to reach productivity increases generally depends on what part of the sector you consider. Services is a very diverse sector and should therefore be analysed in detail.

Also, the reflections by Pieter Baert were accepted by both Mr. Andrews and Mr. Heylen. As to the focus on low-skilled workers, prof. Heylen repeated that policy should focus on more targeted tax shift on these individuals. Mr. Kastrop referred to ongoing OECD work on 'The Future of Work' that is aimed at analysing how technological change, globalization, demographic and environmental change will shape the world of work.



The final part of the discussion mainly focused on the topic of wage moderation and wage pressure. Part of the audience tackled the idea that wage moderation is bad for innovation and believed it is required to maintain competitiveness with our neighbouring countries. A recent studies by prof. Heylen indicated, however, that, in Belgium, wage moderation in Belgium hampers business R&D investment. He refers to countries such as Sweden which combines high taxes, extensive social security and high wages and does succeed in innovating and remaining competitive.

8 Conclusion

Tim Buyse closed the academy by thanking the presenters for their interesting presentation and discussion and the audience for attending the seminar. The SERV-academy was concluded with a networking lunch.



9 Biographies



Freddy Heylen is a full professor of macroeconomics at the Faculty of Economics and Business Administration at Ghent University. His research interests lie in the macroeconomics of labour market performance, economic growth and the macroeconomic effects of fiscal policy. He has multiple publications in international peer reviewed scientific journals such as *Journal of Population Economics*, *Scandinavian Journal of Economics*, *Journal of Money, Credit and Banking*, *European Journal of Political Economy* ...



Christian Kastrop has been Director of the Policy Studies Branch in the Economics Department of the OECD since 2014. He was formerly Deputy-DG of Economics and Strategy and Director of Public Finance, Macroeconomics and Research Directorate in the Federal Ministry of Finance, Berlin. He studied at the University of Cologne and Harvard University and in 1991 he received a Ph.D. in Economics from the University of Cologne where he worked on several research projects and as a lecturer from 1984 to 1989. Currently he is a Lecturer in National, European and International Public Finance/Institutional Design and Fiscal Policy at the Free University of Berlin and at the Hertie School of Governance, Berlin.



Dan Andrews is a senior economist in the Structural Policy Analysis Division of the Economics Department at the OECD. He leads the department's *Productivity Workstream* and his research generally exploits micro-data to assess the impact of structural reforms on aggregate productivity, with a particular focus on resource misallocation, innovation and knowledge-based capital. He has also written extensively on housing markets and the links between income inequality, intergenerational social mobility and growth. Prior to joining the OECD in 2009, Dan was a central banker at the Reserve Bank of Australia for a decade and undertook graduate studies at the Kennedy School of Government at Harvard University.