National Competitiveness Council Bulletin

NCC (2017), Productivity and Competitiveness, Competitiveness Bulletin 17-1,January

PRODUCTIVITY KEY TO NATIONAL AND FIRM LEVEL COMPETITIVENESS

- **Productivity growth is a key driver of national competitiveness and essential for sustainable economic growth. In the medium-term, it underpins the economy's ability to deliver well-paid jobs and to finance quality public services.**
- **Ireland's labour productivity performance is relatively strong. Performance is, however, built upon a narrow base of sectors and, in some cases, firms. High value-added sectors, such as ICT and chemicals, serve to boost Ireland's productivity and disguise underperforming sectors and firms.**
- **Increasing productivity across all sectors is essential to enhance national competitiveness and support growth.**
- **Trade, management skills, entrepreneurship, innovation and infrastructure are vital in boosting productivity.**

Introduction

Productivity is a measure of how efficiently production inputs, such as labour and capital, are used to produce a given level of output. Measures of productivity are important barometers of the competitiveness of firms, sectors and economies. Productivity growth is a driver of national competitiveness, as it enables firms based in Ireland to compete successfully in international markets by facilitating output to be produced in a more efficient and effective manner. In the long-run, productivity growth is the primary determinant of improvements in national living standards relative to other countries.

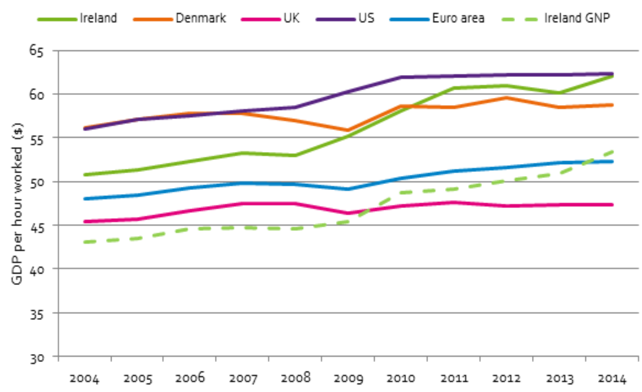
Context

In recent years productivity growth has slowed across the OECD. The slowdown in growth has been attributed to a mix of cyclical factors such as weak global demand and declining capital investment, as well as structural factors such as inefficient markets, low levels of innovation and skills mismatches. At sectoral level, growth is driven primarily by 'modern' manufacturing and services that are traded internationally. At firm level, companies can be classified into three cohorts based on their productivity performance: the globally most productive firms (i.e. firms trading in global markets); the most advanced firms nationally; and laggard firms. Productivity growth of the globally most productive firms is strong but the gap between high productivity firms and the rest has increased.

How Ireland performs

Despite the severe impact of the economic crisis on output and employment levels, Ireland has continued to demonstrate strong levels of labour productivity. Measured in GDP per hour worked, Ireland's output per hour was \$62.02 in 2014. This represents the fifth highest labour productivity level among OECD member states. Overall, Ireland's productivity performance is relatively strong and above the Euro-area average and levels seen in the UK. However, Ireland's performance is greatly influenced by shifts in the composition of employment and the influence of Foreign Direct Investment on output.

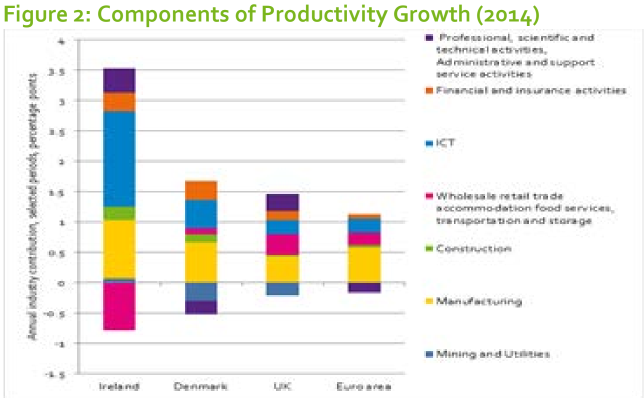
Figure 1: GDP per hour worked 2004-2014



Source: OECD

At 3.1 per cent, the growth rate of Irish (GDP) productivity per hour work in 2014 exceeded the OECD average (1.5%) and growth rates in the UK and Euro area. Over the course of the recession, as output and employment collapsed, labour productivity growth increased at a strong rate. In Ireland's case, the narrow base of enterprises in high value added sectors (particularly in Pharma and ICT) disguises, to a degree, underperforming sectors and boosts Ireland's productivity level. The narrow base of sectors driving productivity performance leaves Ireland vulnerable to shocks and serves to highlight the scope to enhance productivity at sector and firm levels.

Figure 2: Components of Productivity Growth (2014)

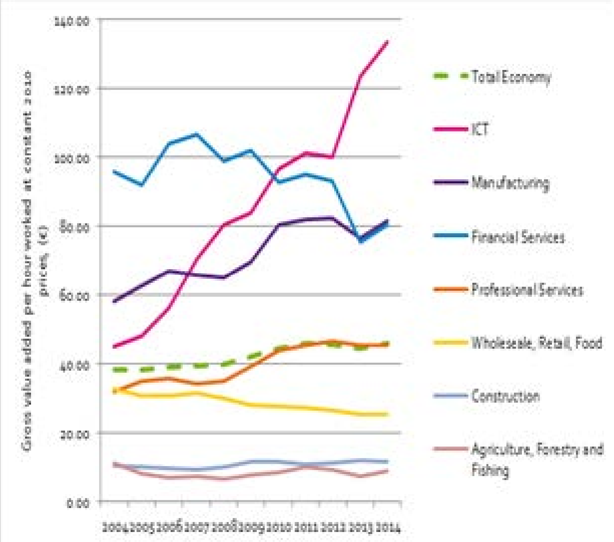


Source: CSO Quarterly National Accounts

Sectoral Trends

Just as productivity performance differs between countries, so too it differs between sectors and firms. Manufacturing accounts for approximately a third of productivity growth in Ireland. The relative contribution of ICT is also strong and the financial services and Professional Services sectors also made positive contributions to business sector productivity growth in Ireland. The Wholesale, Retail, Transport, Accommodation and Food sector contribution to Irish productivity growth is low, in contrast to the trend in the other countries, particularly the UK.

Figure 3: Gross value added per hour trends by sector, Ireland



Source: OECD

In 2014, output per hour worked in Ireland was highest in the ICT (€133) and manufacturing (€81) sectors, and lowest in construction (€12) and agriculture (€9). Ireland's output is more concentrated in Manufacturing and ICT than either the EU or the US. In terms of productivity growth, while many of our large, export focused sectors record impressive productivity growth, performance is weaker amongst domestically focused firms and sectors, particularly in large employment sectors such as Accommodation, Retail, Agriculture and Construction. Assessing productivity in terms of value added per person employed, firm size appears to matter. In most countries there is a significant productivity gap between micro, small and medium-sized firms compared to large firms.

Policies to enhance productivity

Policy must focus attention on various levers at national level which can, over time, enhance the capability of firms and individuals to effect change and boost productivity. In ***Benchmarking Ireland's Productivity Performance 2004-2014***, the Council sets out how improving collaboration amongst firms and sectors, increasing internationalisation, fostering start-ups, and stimulating innovation are required. Delivering **uplift in management skills and quality,** at all levels, is important, as improvements are associated with positive productivity gains. In most countries there is a divergent productivity performance at sectoral and national level between the most productive enterprises and the long tail of relatively poorly performing firms with low or no productivity growth. From a policy perspective, **facilitating entrepreneurship, start-ups and firms of scale** must be seen as the dynamo of productivity growth in the long run. **Trade is vital.** Firms which are more heavily exposed to international competition benefit from a larger market and have a stronger incentive to innovate and find efficiency improvements than businesses which are more sheltered in domestic markets. **Firms that can combine technological change, organisational and process innovation continue to experience growth.** Policies which facilitate technological transfer and which encourage multinationals to develop linkages with indigenous firms could help increase the productivity potential of Irish firms. There are many benefits for firms undertaking innovation and these impact on productivity through faster turnaround times, reduced waste and efficiencies from organisational improvements. The availability of competitively priced **world-class economic infrastructure** (e.g. energy; telecoms; transport – road, public transport, airport, seaports; waste and water) and related services is also critical for productivity growth. Inadequate infrastructure, can lock individuals and firms in low-productivity traps.

Conclusions

- Despite considerable shifts in the composition of economic activity in recent years, Ireland's labour productivity performance is strong in an international context. Starting from a low base, productivity levels and growth rates now exceed those of many of our key competitors.
- Ireland's performance is heavily influenced by the performance of the Manufacturing and ICT sectors. Performance is weaker amongst domestically focused firms and sectors, particularly sectors such as Accommodation, Retail, Agriculture, and Construction. Increasing productivity across all sectors remains a significant challenge. Ireland can take advantage of a sizeable competitiveness opportunity if we can avoid the 'productivity trap' being experienced by many developed economies. Facilitating enterprise and start-ups, trade, access to finance, skills and infrastructure are key to productivity and competitiveness gains.

Further Reading: The data and policy positions here are drawn from **Benchmarking Ireland's Productivity Performance 2004-*2014***. See **www.competitiveness.ie**. The NCC reports to the Government on key competitiveness issues facing the Irish economy. This Bulletin has been issued by the Chair and Secretariat.