BOOSTING BRITAIN'S LOW-WAGE SECTORS

A strategy for productivity, innovation and growth

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60-SECOND SUMMARY

The UK has two related productivity problems. For many years, we have been less productive than our peers in Europe. Since the 2008/09 recession, we have added a second problem: our productivity growth – previously 2.3 per cent a year on average – has stalled.

The UK's low-wage sectors – defined for our purposes as including retail, accommodation, food and administrative services – contribute to both of these problems. They employ a third of all workers, and produce 23 per cent of the UK's gross value-added. But on average they are 29 per cent less productive than the economy as a whole.

The 'national living wage' (NLW), introduced in April, has a disproportionate impact on these sectors. In response to a higher wage bill we would ideally want firms to invest in productivity-enhancing technologies and training, or to review their business models to find more efficient ways of doing things. But there is already tentative evidence that some employers have instead chosen to seek out offsetting reductions in their labour costs, for example by reducing overtime pay.

Our analysis suggests that our low-wage sectors don't need to invent new ways of doing things: there is huge potential for UK firms to boost their productivity by adopting practices and technologies that already exist. But the fact that this hasn't happened to date, even though it would be in firms' interests to do so, suggests a need for public intervention. Our recommendations are intended to promote productivity-boosting actions on the part of low-wage firms.

KEY FINDINGS

- Since 2011 around half of the UK's productivity slowdown can be accounted for by shifts in the structure of the economy away from high-productivity sectors such as manufacturing, and towards those characterised by low productivity, such as accommodation and food.
- Our low-wage sectors are less productive than their equivalents in western Europe. New IPPR analysis suggests that if we were able to raise productivity levels among low-wage firms to the levels seen elsewhere, the UK could close a third of its average productivity gap with Belgium, France, Germany and the Netherlands.
- Workers in our low-wage sectors tend to be less qualified than their peers in Europe, while firms in the UK's low-wage sectors are less likely to offer training to their staff.
- Low-wage sector firms invest less in innovation than both other UK firms, and firms within the equivalent sectors in Europe. In particular, low-wage firms have not fully adopted the available information and communication technologies.
- The UK's low-wage sectors have an unusually high rate of business startups relative to other countries, but this does not translate into a higher proportion of high-growth businesses within those sectors.

On average the UK's low-wage sectors are 30 per cent less productive than Belgium, France, Germany and the Netherlands

Output (GVA) per hour worked in selected OECD countries, 2014 (index 100 = UK)

Source: IPPR calculations using Eurostat, 'National Accounts aggregates by industry', and Eurostat, 'National Accounts employment data by industry'

KEY RECOMMENDATIONS

The evidence suggests that firms are not investing in the adoption of new practices and technologies that would enable them to become more productive. There are two key reasons for this: first, low awareness on the part of firms of the benefits of productivity-boosting actions; and second, limited motivation (prior to the NLW) to act given relatively low labour costs.

The government should take the following measures to help improve low-wage sector firms' productivity.

To activate demand for productivity improvements, and rebalance innovation and growth spend

1. **Innovate UK should use its 'open programme' to expand its funding criteria to innovations in workplace organisation, job design, leadership and management** – drawing lessons from international experience, including Tekes, the Finnish Funding Agency for Technology and Innovation.
2. **Growth hubs should provide targeted advice and information to businesses in the low-wage sectors, and signpost Innovate UK's new 'open programme' to businesses in all sectors of the economy –** growth hubs are being embedded in every local enterprise partnership area, giving local areas control over how they support small businesses to start and scale up.
3. **Local partners should be encouraged to include their plans to prioritise the performance of their low-wage firms when they bid into the Local Growth Fund** – these plans should be taken into account when evaluating bids.
4. **HMT and the FCA should consider aligning the financial reporting requirements for small co-ops with those for small companies.**
5. **BIS should equalise eligibility criteria to ensure that businesses using alternative models of ownership are able to access the government support on offer.**

To boost skill levels

6. **The government top-up to employers' digital apprenticeship service accounts should vary with the level of the apprenticeship: higher for level 4+, and lower for levels 2 and 3** – the variation could be designed such that the overall impact is cost-neutral, or the top-up for higher-level apprenticeships could be paid as a bonus.
7. **Businesses should establish degree apprenticeships for the biggest low-wage sectors, starting with wholesale and retail** – following the model recently developed for aerospace and other high-growth sectors.

For the full report, including all references, data sources and notes on methodology, see:
www.IPPR.org/publications/boosting-britains-low-wage-sectors-a-strategy-for-productivity-innovation-and-growth

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