John B. Taylor

THE GROWTH THAT MATTERS MOST

Productivity—the value of goods or services produced per hour of work—is a very important economic indicator. Taylor argues that, despite the current low levels of inflation and unemployment, productivity growth in the United States has now fallen to levels not seen since before the Industrial Revolution. Why productivity growth matters—and what can be done to reverse the slump.

By the best measure of economic progress—long-term productivity growth—the United States is now performing below the average of the last two centuries. Although not readily visible in short-term business cycle indicators, this poor performance reveals itself as an unprecedented stall in inflation-adjusted pay increases, savings rates lower than at any time since the 1930s, a widening income gap, and surveys showing a lack of confidence in the future. No wonder AFL-CIO president John Sweeney titled his new book *America Needs a Raise*. He's right.

Productivity growth is not a household term, but it should

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be. Many workers think productivity means "the boss wants me to work harder." But actually productivity—the value of goods or services produced per hour of work—grows mainly through timesaving innovations, more and better equipment, greater knowledge, advanced skills, and more efficient organizations.

REVERSING HISTORY'S TREND

History shows that rising productivity is essential to rising wages and incomes. During the nineteenth and twentieth centuries, annual productivity growth in the most advanced countries steadily rose—from less than 0.5 percent before 1820, to 1.5 percent between 1820 and 1890, to an average of 2.25 percent between 1890 and 1993.

Before the Industrial Revolution there was virtually no productivity growth. Vast quantities of wealth were amassed by kings and queens through conquest and exploitation, but most people lived in extreme poverty. Productivity growth has made all the difference: Today the average person's earnings are greater than was ever dreamed of in antiquity.

This transformation did not occur overnight. At the 0.5 percent growth rate of the late 1700s, it took six generations to double a person's income. At 1.5 percent growth, it took two generations. At the 2.25 percent growth of the first three-quarters of this century, it took about one generation.

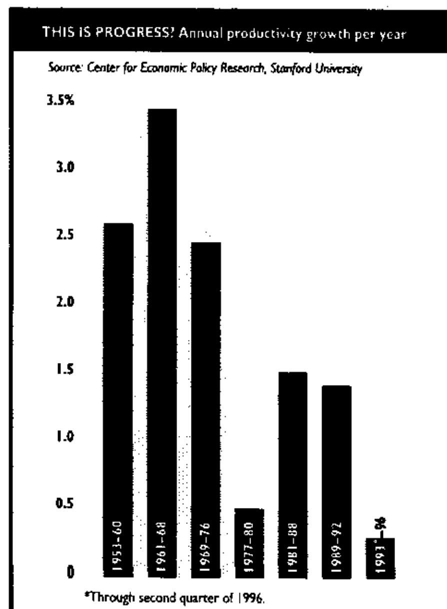
Since the end of 1992, productivity growth in the United States has been only 0.3 percent a year. At that rate it would take ten generations to double a person's income.

During the last quarter of this century, however, productivity growth has begun to slow to well below 2.25 percent. Since the end of 1992 (the last reasonably strong productivity year), productivity growth has been only 0.3 percent a year, close to the zero growth of pre–Industrial Revolution days. At that rate it would take ten generations to double a

person's income. It is not surprising that average real pay per hour has been stagnant.

From the late 1960s to the early 1980s, when inflation and unemployment rose to double digits, it became useful to evaluate economic policy in terms of a misery index—the sum of the inflation rate and the unemployment rate. Ronald Reagan left office having cut the misery index in half, and, thanks to good Federal Reserve policy, it has remained in that vicinity ever since. But, as the cyclical problems of inflation and unemployment have diminished, low productivity growth has become a serious problem, and it is clear that we need another index to measure the economy's progress in improving our standard of living. Productivity growth itself would work well as such an index. On the misery index, a high total value of inflation and unemployment rates would be bad; a high value of productivity growth, by contrast, would be good. Until productivity growth does become a household word, let's call this the *economic progress index*.

THE ECONOMIC PROGRESS INDEX



The accompanying chart shows the economic progress index during several recent U.S. presidential terms. Productivity performance was slightly above the 2.25 percent average of this century from the Eisenhower administration to the Ford administration. It was particularly strong during the Kennedy and Johnson administrations. But it fell precipitously during the Carter administration, and, after rebounding sharply during the Reagan administration, it has now fallen to historically low levels.

But can the president do anything to affect productivity growth? Yes, def-

initely, and, assuming a sound monetary policy, probably much more than can be done to affect the business cycle. A president's stance on tax and regulatory policy, for example, can greatly affect productivity growth. Consider some historical examples. Productivity growth rose during the 1960s when economic policy—including the Kennedy tax cuts—was aimed at higher growth. Productivity growth began to slow in the 1970s with increases in regulations—including wage and price controls. Productivity growth rose again during the Reagan administration as tax rates fell and regulations were reduced. Now productivity growth has stalled again as taxes have been raised and regulatory and litigation reforms have been vetoed.

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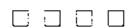
What about the twenty-first century? Will productivity growth be as good as it was during most of the twentieth century? Or will we enter a new age of low productivity growth, continuing the dismal performance of the last few years? □



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