

What's Behind the Recent Productivity Slowdown

A new report shows that competitive product markets are crucial to higher living standards.

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The economic attention of U.S. government and business leaders is fixed squarely on the downturn and financial crisis. Whether or not bailouts are proper short-term medicine, economists agree that the long-run solution for restoring economic growth lies in raising productivity.

The single best measure of a country's average standard of living is productivity: the value of output of goods and services a country produces per worker. The more workers produce, the more income they receive, and the more they can consume. Higher productivity results in higher standards of living.

So how has U.S. productivity grown recently? Unfortunately, very slowly. After averaging 2.7% productivity growth from 1995 through 2002, annual growth of productivity in the nonfarming business sector has slowed dramatically -- to just 1.7% in 2005, 1.0% in 2006, and 1.4% in 2007. At this new average rate of under 1.4%, it would take nearly 52 years for average U.S. living standards to double -- versus just 26 years at the earlier average. Signs of this slowdown are apparent, particularly in the waning competitiveness of U.S. sectors like automobiles, financial services and information technology.

On Monday, we are issuing a new report that details a set of policies the government could implement to boost U.S. productivity growth. Time is of the essence in addressing this challenge because the economy-wide impacts of structural policies tend to appear only gradually, in part because of many-year corporate planning horizons. It is also because faster productivity growth will ease the burden of massive U.S. fiscal deficits now projected for the coming years.

A central theme of this report is the critical role that competitive product markets play in spurring productivity growth and boosting standards of living. One of the great U.S. policy successes of recent decades has been the bipartisan removal of regulations that stifle competition and innovation in product markets. U.S. industries that face strong competitive intensity are more productive than highly regulated or otherwise sheltered industries. This competition, in turn, yields higher incomes and greater choices for consumers.

Maintaining the productivity benefits of product market competition requires sound choices in areas including trade and investment, regulation and infrastructure.

Liberalization of international trade and investment has been especially important because it exposes U.S. companies to global best practices. Global trade has generated -- and has the potential to continue generating -- large gains for the United States. Annual U.S. income could be upwards of \$500 billion higher with a move to global free trade in both merchandise and services.

It is crucial to reverse the current protectionist drift already underway with further liberalization. The president's Trade Promotion Authority, which allows him to negotiate trade treaties with minimal interference from Congress, should be restored. The United States should hold firm on existing trade agreements, and should also strive to negotiate and enact new ones as well. And the United States must continue to welcome the inward investment of foreign companies and support the foreign investment of American companies, both in statute and in practice.

Domestic regulation of product markets plays a legitimate and vital role in areas like consumer protection and worker safety, as well as in the financial system, as a tool for regulating against systemic risk. Indiscriminate elimination of regulation is unwise, but the current need is for sounder regulation -- not more.

We should not return to the days where policymakers micromanage companies and industries. This would dull growth of productivity and overall incomes. Reform of capital markets, for example, should aim to preserve a sound overall system, not necessarily particular companies or practices.

Many parts of the U.S. public infrastructure are deteriorating rapidly. Today, one in seven miles of U.S. highway is rated "not acceptable" by the federal government. This curtails productivity in many ways, such as congestion delays that impede supply-chain networks. Expanded federal spending is only one part of the needed solution (and one that will improve productivity only if based on nonpoliticized criteria and stable funding). At least as important will be to encourage private companies to compete in the provision of public services that, until now, have suffered from rigid and inefficient bureaucracies.

Foreign investment, in particular, can play a vital role here. Many global leaders in private infrastructure are foreign multinationals that could bring their best practices to address U.S. needs. This also means expanded use of market signals in public infrastructure projects, such as market and congestion pricing for transportation services.

Because these forces of product-market competition do not always benefit every single worker, family and community, addressing these pressures is an important government task. But this is best done through means other than stifling competition and its resulting productivity.

It's important to acknowledge that dynamic product markets create dynamic labor markets as well. In recent years, government statistics show that about 25,000 jobs are destroyed and created every hour that America is open for business. All this economic change is essential, but it presents very real challenges to workers. Today's U.S. labor-market programs are well intentioned but because of their design, prove inadequate under current labor-market pressures. Unemployment insurance was introduced in the early 1930s and has not changed in any fundamental way since. We support fundamentally reshaping programs like unemployment insurance with a set of expanded and integrated policies that would include wage-loss insurance, health-insurance coverage while unemployed, and expanded eligibility and incentives for retraining and skills development.

Come Inauguration Day, hundreds of elected and appointed government officials will start their new jobs with much to do. We hope that high on everyone's to-do list will be policies to support productivity growth -- especially through competitive product markets.

Mr. Baily served as the chairman of the Council of Economic Advisers for President Clinton. [Mr. Slaughter, associate dean at the Tuck School of Business at Dartmouth, served as a member of the Council of Economic Advisers for President George W. Bush.](#) Their new report on productivity, published by the Private Equity Council, will be available at www.privateequitycouncil.org.