

President's Message



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Productivity Is the Gift That Keeps On Giving

I do not remember a time in my professional life when uncertainty about productivity growth played such a large role in discussions about the U.S. economic outlook. Surely, some of this uncertainty reflects the fact that, over the short run, rising levels of productivity mean that, even if economic growth is strong, employment gains are harder to come by. Ultimately, though, robust productivity growth means increased real incomes and profits, and lower unit costs—a prescription for rising employment. Given the good job gains over the past few months, it appears that the economy is finally catching up with the theory!

To understand the importance of this point, consider how much larger our nation's future standard of living would be over the next decade if labor productivity continued to grow by 3 percent per year (roughly its annual rate of growth since 1995), vs. the growth of 1.4 percent per year seen from 1973 to 1995. At a growth rate of 3 percent per year, real per capita GDP in the United States would increase from about \$35,700 in 2003 to about \$48,000 by 2013. By contrast, if labor productivity growth were to revert to its earlier subpar performance,

then by 2013 real per capita GDP would rise to only about \$41,050, nearly \$7,000 per person less.

The rise in productivity growth since the mid-1990s raises a couple of important questions that remain unanswered. First, what was behind the increase? Some economists initially believed that faster productivity growth was largely an artifact of the extraordinarily rapid economic growth and tight labor markets that prevailed over the latter part of the 1990s. Thus, when economic conditions cooled, so too would the growth of labor productivity. However, productivity growth not only remained strong through the economic recession of 2001, but has continued to rise into the current business expansion; since the fourth quarter of 2001, productivity growth has averaged about 4.75 percent.

Eventually, most economists came to believe that a good portion of the rise in productivity growth during the latter half of the 1990s could be traced to advances in information technology. In particular, rapid productivity gains in the *production* of semiconductors and computers caused sharp declines in the prices of these types of capital goods, helping to fuel the investment boom of the 1990s and,

ultimately, enabling businesses to expand information sharing and to boost worker productivity. In this vein, more recent research has found that rapid rates of investment in IT goods by industries that are intensive *users* of IT capital, such as service industries, have also been important factors in explaining the acceleration in productivity growth. Put simply, it's doubtful that Wal-Mart could manage the world's largest commercial database using technology from the 1970s or 1980s.

The second unanswered question is potentially more important: Is 3 percent productivity growth sustainable? Sustainability is a difficult issue because labor productivity growth can increase or decrease for long periods of time, for reasons that are sometimes difficult to identify—particularly in real time, when policy judgments must occur. Although projecting productivity growth is hazardous, a projection of about 3 percent seems plausible to me. The nation will benefit enormously if this projection comes to pass.