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THE PRODUCTIVITY SLOWDOWN AND INFLATION

1. What is Productivity?

When economists talk about increasing productivity, they are usually referring to labor productivity or output per worker-hour. Labor productivity is simply the amount of output produced--be it goods or services--divided by the number of hours worked. When productivity increases and more is produced for each hour of work, there is an increase in the total amount of goods and services in the economy. Who gets these additional goods and services depends on how productivity gains are divided. If productivity increases by three percent, and workers get a three percent wage increase, then their share of what is now a larger pie has stayed the same. But that's not all. Employers now have an extra three percent to pay profits, materials, rent and other expenses. (This means that if productivity is increasing, employers can pay for rising costs without having to raise prices or reduce their profits.)

If wages don't go up as much as productivity, profits will rise disproportionately. Consumer buying power will then be growing more slowly than the economy's ability to produce. Sales may fall, inventories may pile up, and the economy would then be in a recession.

Increases in productivity can come from a variety of sources: better educated workers and managers, new inventions, and investments made by business and government. Increases in productivity can occur at all times although productivity rises more rapidly when the economy is growing and expanding. The latest technology is brought "on-line" more quickly when the economy is growing at a healthy clip. Training programs are stepped up, and workers with a variety of skills are able to find jobs in which they may utilize those skills.

During a recession productivity growth slows down. The drop in purchasing power that accompanies a recession leaves equipment idle and workers unemployed. New technology is not introduced as rapidly. In fact, during the 1975 recession productivity actually dropped.

2. The Productivity Slowdown

Lately there has been much talk about a slowdown in productivity growth. It is a fact that productivity has been increasing more slowly this decade than it did during the 1960s. For many economists and politicians (including President Carter), this reduction in the rate of growth of productivity is linked to the high rates of inflation we have been experiencing. However, the idea that the slowdown in productivity is responsible for our current inflationary woes rests upon some questionable economic reasoning.

The main way that reduced productivity could lead to higher prices is if real wages grow more rapidly than productivity. In such a situation profits will fall disproportionately and employers will raise prices to hold their share of the pie constant. This results in inflation. But in the 1970s, real earnings of workers have not risen as quickly as productivity. Output per worker-hour in manufacturing grew at an annual rate of 2.3 percent between 1970 and 1977,but workers' hourly compensation grew by only 1.7 percent per year. What does this mean?

It means that any attempt to increase productivity in the future will not guarantee a reduction in inflation. Throughout the 1970s,increased labor costs have been matched by productivity increases. Any further increase in productivity may simply lead to an increase in employers' share of the pie rather than a reduction of prices. To prevent this shift (which may hold back purchasing power), collective bargaining must be kept strong. And the way to do that is to keep the economy and employment growing strong.

Why has productivity risen less rapidly since 1970 than it did during the 1960s? As mentioned above, productivity grows more rapidly when the economy is expanding, when output and employment are steadily increasing. The chief difference between the 1960s and the 1970s has been the much slower increase in output and employment during the 1970s. Output in manufacturing increased at an annual rate of six percent from 1960 to 1969; since 1970, it has grown by only 2.4 percent per year. Another reason for the productivity slowdown may have been the increase in the proportion of workers employed in the service industries (as opposed to goods-producing industries).

Measured productivity in service industries usually is lower and also increases less rapidly than it does in goods-producing industries. As more workers are employed in service industries, the economy's average productivity rate decreases. However, it is extremely difficult to measure output (and productivity) in the service industries. And the output measures that are currently used take no account of the quality of the services produced--they measure only quantity. For example, the productivity of education rises as the class load for teachers is increased. But at the same time the quality of education is likely to decline since each teacher now has to deal with more students and can devote less attention to each one. Are teachers really more productive in this situation?

3. <u>The Politics of Productivity</u>

We should not allow the current campaign for "increasing productivity" to become a public relations and a political campaign used to support attacks on unions, or to weaken health and safety and environmental laws, or to reduce taxes and expenditures for education and other essential public facilities and services.

If we really want to increase productivity in our economy, the way to do it is to maintain balanced, strong growth in output and employment. As long as workers share in this increased productivity, there will be less likelihood of a recession. A faster-growing economy will provide jobs for the more than six million who are currently unemployed.

The major task for our economy as we enter the third recession of this decade, and the major way to deal with the productivity problem, is to make better use of our productive capacity, especially the skills and talents of our nation's workers.

- Sandy Jacoby