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OUR #1 NATIONAL ECONOMIC PRIORITY: AN "INVESTMENT ECONOMICS" TO BOOST PRODUCTIVITY

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The top economic priority for the rest of this century must be to accelerate the underlying trend in productivity growth from the dismal performance of the last fifteen years. Productivity grew by an average of nearly 3 percent per year in the 1950s, 1960s and early 1970s; since 1973, it has decelerated to an annual average of less than 1 percent. As a result, average productivity is now over 20 percent less than it would have been had the previous trend continued.

Many Reasons for Near Stagnation

Many explanations have been offered for this near stagnation in economic efficiency, but the obvious conclusion from the research that I and many others have done in recent years is that no single factor, such as shifting demographics or any other relatively uncontrollable factor, is responsible. Rather, the evidence suggests that a multitude of factors, each making a relatively small contribution, are at fault.

These factors include 1) the need to absorb large numbers of relatively inexperienced new entrants into the labor force; 2) an increasing share of business investment going toward energy conservation, environmental needs, and other relatively unproductive (although perhaps necessary) activities and needs; 3) declining research and development; 4) a substantial reduction in invested capital per worker; 5) a shifting mix away from relatively high productivity sectors toward those with lower average productivity; 6) a reduced focus on the importance of manufacturing; etc.

Most disturbing is that overall productivity growth has remained sluggish in recent years despite many favorable factors, such as declining oil prices, the relatively long period of economic expansion and the large amount of idle resources when the recovery began.

Results of Slowdown

The dramatic slowdown in productivity growth is the root cause behind the major economic developments during the last fifteen years.

First, the competitive position of the United States in world markets has declined dramatically since the early 1970s, causing sharp declines in the U.S. share of worldwide production in most industries; gigantic trade deficits after many years of surpluses; and, our shift from being the world's largest creditor to its largest debtor in a matter of a few short years. This change in relative competitiveness primarily reflects a shrinking of U.S. advantages in technology, product quality and, mostly, productivity. In industry after industry, the gap in these areas has been narrowed by foreign competitors—in some cases U.S. companies have actually fallen behind. And, most significantly, the slow growth in productivity in the United States made it relatively easy for foreign competitors to catch up.

Second, and directly related, real wages have essentially stagnated since the early 1970s, following an average annual post-war increase of 2.5 percent until then. Although partly due to oil-caused inflation in the 1970s, the major factors have been the widespread wage restraint and the loss of many high-paying jobs (while most of the newly created jobs are lower-paying) that resulted from sluggish productivity growth and deteriorating competitiveness. This slowdown in real wages has meant that an increasing number of families have had to rely on a second income, cutting savings and/or going deeper into debt in order to improve or just maintain their living standards.

Reversing the Trend

A substantial acceleration in productivity growth is essential if these trends are to be reversed, if the tradition of rising real wages and living standards in this country is to be restored and if the current expansion—partly created by a massive debt buildup and by rising labor force participation rates—is to be continued. Higher productivity is also necessary if we are to address the enormous unmet needs that have been building, such as dealing with the drug problem, finding a cure for AIDS, etc.—only in a more productive society can we have the resources to meet these needs.

This, in my view, will require a major national effort. Unfortunately, the opposite seems to be occurring—not only are these unfavorable trends not receiving adequate attention, but, if anything, a sense of complacency seems to have developed because of the decline in the trade deficit since early 1988. However, the trade turnaround has been small at best, and is primarily due to the weak dollar and cost cutting in U.S. industry (and thus is occurring at the *expense* of living standards) rather than reflecting any major change in fundamental competitiveness. Without such a change, real wage gains will

continue to be weak, or nonexistent, at a time when an increasing share of U.S. incomes will be needed to service the enormous and still growing foreign debt—this combination would further jeopardize living standards in the future.

What is particularly disturbing is that the growth in manufacturing productivity has begun to slow in the last two years, following a surge in the mid-1980s. But this is not surprising since the early surge partly reflected widespread outsourcing of various job functions (and thus was not accompanied by a significant acceleration in *economy-wide* productivity growth), as well as many one-time factors such as plant closings and corporate staff layoffs, rather than ongoing improvements in manufacturing efficiency. What is needed is a sustained period of accelerated growth in productivity, not just one-time adjustments, especially since the gains in efficiency in many of the countries with which we compete still exceed that being experienced in this country. And, since the basic factors that influence long-term productivity are not improving, this is not likely to take place unless major changes in government policies, and in our priorities as a nation, are implemented.

Boosting Productivity

That is why I and a number of colleagues at Rebuild America, including Nobel Laureate Robert Solow, recently proposed a comprehensive strategy to boost productivity through increased private and public investment in physical and human capital. Essentially, we believe the only clear way to produce the sustainable, ongoing increases in productivity that are needed is to 1) increase our basic research, 2) embody new technology more quickly in our production facilities through a higher investment rate and a more long-term focus, and 3) educate and train our workers more effectively.

Federal Focus Required

Unfortunately, recent evidence suggests that without a government-led national focus, adequate improvements may not take place, especially since the solutions, like the causes, must be multidimensional. Washington must play an important role in the process by mobilizing the private and public sectors on behalf of such an "investment economics" that 1) raises the national saving rate, 2) provides tax incentives for *productive* private investment and 3) boosts public investment in the workforce and cutting-edge industries of the 1990s.

Specifically, Washington should:

1. Set goals for savings, investment, research and development, educational quality, etc.;

2. Focus attention on the importance of productivity in every seg-

ment of the economy and help create an environment that favors real investment over speculation and financial transactions and moves us away from an excessive short-term focus toward a more long-term orientation.

3. And, most of all, promote policies that create the best possible business environment by:

- Reducing the budget deficit in order to increase national savings.
- Developing policies to ensure that the resulting increase in national savings is used wisely; e.g., for more *productive* investment and more research and development by the private sector.
- Adjusting spending priorities and the tax structure to promote future investment and growth.
- Bringing industry, government, labor and universities together for joint research and other cooperative efforts when appropriate.
- Forging government-business alliances to address specific economic problems.
- Reducing Less Developed Country (LDC) debt to make those countries viable markets for U.S. products again.
- Being more forceful in opening up foreign markets to U.S. goods.
- Reversing the declining quality of education, especially in mathematics and science, in order to increase the skill levels of the labor force.

The Future

Much time has already been lost—the next administration must begin to address these issues as soon as possible and give them the highest priority during the next few years, or the next generation, and those that follow, may suffer the consequences in the form of stagnant, or even declining, living standards.