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The Fallacy of Weak Productivity

Models of the economy are pretty useful tools. And simple models are some of the most useful. They help people envision how the world works. They help organize thinking.

For example, the model that says potential U.S. economic growth is determined by “population (labor force) growth” plus “productivity” is an elegant model that shows how adding workers, or having them become more productive, leads to more economic growth.

But, even an elegant model can lead people astray when the inputs are misunderstood. As they say: Garbage in, Garbage out!

Population growth is relatively straight-forward and doesn’t change much. It’s growing at about 0.8% per year over the last decade. Yes, immigration and the participation rate add some complexity, but labor force growth is the easiest part of the model to deal with.

Productivity growth, on the other hand varies, and is the true key to this model. Non-farm productivity growth, as measured by the government, has averaged slightly above 1% per year lately. That’s slow by most historical standards.

Add these two up (Population, 0.8%) + (Productivity, 1.0%) = 1.8% growth; which is why many economists argue that the U.S. economy has a potential growth rate of just 2% per year, possibly less. And they also say it can’t be fixed.

But, can this really be true? New technologies are boosting productivity everywhere. As recently as 2009 it took over a month to drill and complete a new oil well; now it takes around a week. Farmers have boosted the bushels of corn they get from every acre of farmland by 2.4% per year since the early 1990s – while new tech (drones, GPS, ground sensors) helps save on inputs of hours, water, fuel, and fertilizer.

Smartphones, tablets, apps, the cloud, 3-D printing, drones, and many other new technologies are clearly boosting productivity. And not just in tech industries.

So, why do so many people think productivity is weak? Yes, government data sources say it’s weak. But anyone who goes outside instead of living in the data knows nearly everything is getting better, faster, and cheaper.

That suggests something is wrong with the government data. One problem is that things that are free – like maps, step counters, language translators, radios, or calculator apps on your smartphone – are hard for the government to count.

But there’s a bigger problem. The government is a negative productivity machine. For example, productivity in electric power generation and distribution fell 13% between 2006 and 2016. And commercial banking productivity has risen less than 0.1% per year in the past seven years. How could this be? Why are these industries stagnating despite constant improvements in technology?

The answer: Too much government. The government has subsidized wind and solar electricity power generation, which are far more labor intensive and less productive. And, excessive banking regulations shifted many jobs from profit generation to oversight and reporting in that industry. The tax code itself absorbs millions of hours in non-productive labor.

In other words, while productivity in private activity hums along, big government is throwing a wet blanket over entire industries, and dragging down total market productivity. It’s simply not true that potential growth is as weak as the model says. What is true is that shrinking government burdens will boost real (and reported) productivity, growth, wages, and living standards.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-12 / 7:30 am	PPI – Nov	+0.3%	+0.3%		+0.4%
7:30 am	“Core” PPI – Nov	+0.2%	+0.2%		+0.4%
12-13 / 7:30 am	CPI – Nov	+0.4%	+0.4%		+0.1%
7:30 am	“Core” CPI – Nov	+0.2%	+0.2%		+0.2%
12-14 / 7:30 am	Initial Claims – Dec 9	236K	239K		236K
7:30 am	Retail Sales – Nov	+0.3%	+0.2%		+0.2%
7:30 am	Retail Sales Ex-Auto – Nov	+0.6%	+0.5%		+0.1%
7:30 am	Import Prices – Nov	+0.7%	+1.0%		+0.2%
7:30 am	Export Prices – Nov	+0.3%	+1.0%		0.0%
9:00 am	Business Inventories – Oct	-0.1%	-0.1%		0.0%
12-15 / 7:30 am	Empire State Mfg Index – Dec	18.8	14.7		19.4
8:15 am	Industrial Production – Nov	+0.3%	+0.3%		+0.9%
8:15 am	Capacity Utilization – Nov	77.2%	77.2%		77.0%