Think Like an Enterprise: Why Nations Need Comprehensive Productivity Strategies

ITIF
INFORMATION TECHNOLOGY & INNOVATION FOUNDATION

Virtually all economists agree productivity is the key to improving standards of living, but few believe governments can do much about it. They are wrong to be so skeptical. Policymakers can and must craft national strategies that accelerate productivity. In fact, this should be the principal goal of economic policy.

We are in a deep productivity rut—and it behooves everyone to focus on getting out of it.

In the United States, European Union, and Japan, productivity has grown less than half as fast since 2007 as it did in prior years. Reversing the trend would be the closest thing possible to a silver bullet for the economy.

By adopting national productivity strategies, advanced nations should expect to increase annual labor productivity growth rates by 1 percentage point or more. In the United States, this would produce an economy that is $2.3 trillion bigger in 2026 than it is currently projected to be, while the federal budget deficit would be more than $400 billion smaller.

Everyone would benefit from making productivity the principal goal of economic policy. In fact, contrary to naysayers' claims:

- Periods of higher productivity are associated with lower rates of unemployment;
- Productivity growth has raised median wages; and
- Periods of higher productivity are associated with lower growth in inequality.

We need all industries to adopt better tools—particularly information technology.

Many nations try to boost growth by favoring highly productive industries. But this approach is flawed, because it leaves the rest behind to weigh down the overall economy. A better strategy is to support productivity growth across all industries.

Productivity is a simple measure of efficiency—output per unit of input—and the best way for industries to become more efficient is to adopt better "tools."

Information technology is a particularly important tool for accelerating productivity because it is a general-purpose technology with applications across a wide array of industries and functions.

Productivity has lagged because industries have failed to adopt the best tools in the best ways.

Economists are generally puzzled as to why U.S. productivity growth has slowed in recent years. But the core of the problem has to do with the tools we're using. Productivity appears to be lagging for four main reasons:

1. Inadequate investment: Companies for the last 15 have been reining in their spending on new tools such as equipment and software.

2. Difficulty adopting new tools: Chicken-egg challenges can slow adoption of technologies that serve as standardized "platforms" for many users, such as mobile payment solutions or health IT systems.

3. Failure to take full advantage of what's available: The gap between productivity leaders and laggards in the same industry has grown, suggesting many firms are underperforming.

4. Today's technologies aren't as powerful: Innovation comes in waves, and we appear to be on the tail end of one. Today's new technologies offer only incremental improvements over earlier versions, so it is hard to make leaps forward. The next wave appears at least a decade away.

The future of productivity growth looks neither hopeless nor boundless.

There is a great debate underway about the future of productivity. Stagnationists say we have picked all the "low-hanging fruit," and there are no easy ways left to accelerate productivity. Techno-utopians claim we are on the cusp of a new machine age, and major innovations will fuel momentous change.

But there is no evidence that developed nations are in for either stagnation or hyper-charged productivity growth. The more likely scenario is that productivity will grow slowly over the next decade, especially in the absence of national productivity strategies, but that after that could pick up to somewhat higher rates.

Economies are large, integrated enterprises that require a degree of government intervention.

Neoclassical economics counsels against proactive productivity policies on the theory that organizations have enough incentives to boost productivity, and government policies only distort the marketplace. But the truth is economies face a host of market failures—in fact, the very concept of market failure is faulty.

Rather than conceiving of economies as large markets in which self-interested actors respond to price signals, it is more accurate to think of economies as large, integrated enterprises that work best when governments support activities that individual enterprises will not or cannot undertake effectively on their own.

National productivity policies must do more than optimize market conditions.

The conventional approach to productivity policy goes no further than establishing the right market frameworks, and perhaps supporting inputs such as infrastructure, education, and basic research.

Nations need to get beyond that conventional advice and embrace an array of policies that promote greater productivity in all organizations. Effective national productivity strategies include a number of policies:

- Making higher productivity the principal goal of economic policy;
- Eliminating preferences for small firms over larger firms, because small businesses are generally less productive;
- Increasing capital investment by raising the price of labor (with higher minimum wages, less low-skill immigration, etc.) and lowering the price of capital equipment (with investment tax credits, etc.);
- Reforming corporate governance to provide better incentives for investing in long-term capital projects;
- Expanding science and technology research funding and targeting it specifically toward the development of productivity-enhancing technologies;
- Analyzing opportunities and constraints facing every major industry, and developing sector-specific productivity policies; and
- Developing dedicated productivity agencies to coordinate sophisticated productivity agendas.

To learn more and read the report visit itif.org/productivity