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Productivity growth continues to slow

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Productivity growth continues to slow, but this is actually not a big deal, more like a return to normal. The golden years of post-war economic growth, the *trente glorieuses* for the French, ended on October 16, 1973 when OPEC announced its first oil embargo – and will never be repeated again, says Northwestern University's productivity guru Robert Gordon. Between 1950 and that date in 1973, average American annual real GDP per capita growth was 2.7%, and in Germany an otherworldly 5.0%. If Gordon is right, economic dynamism has largely disappeared and is unlikely to come back: in the 48 years since 1973, America's real GDP per capita growth has slowed to 1.7%, Germany's to 1.5%. The trend is clearly down.

Since the fourth quarter 2019, the period immediately before the Corona crisis, labor productivity has increased at annualized rates of just 1.2 and 1.1%.

labor productivity^{*)} <i>seasonally adjusted, % q/q</i>		
	Germany^{**)}	US^{***)}
19Q4	0.4	0.4
20Q1	0.2	-0.5
20Q2	-2.0	2.2
20Q3	1.7	1.8
20Q4	2.3	-0.9
21Q1	-0.4	0.5
21Q2	0.3	0.8
21Q3	-1.4	-0.9
21Q4	0.0	1.5
22Q1	1.7	-2.0
average annual rate	1.1	1.2

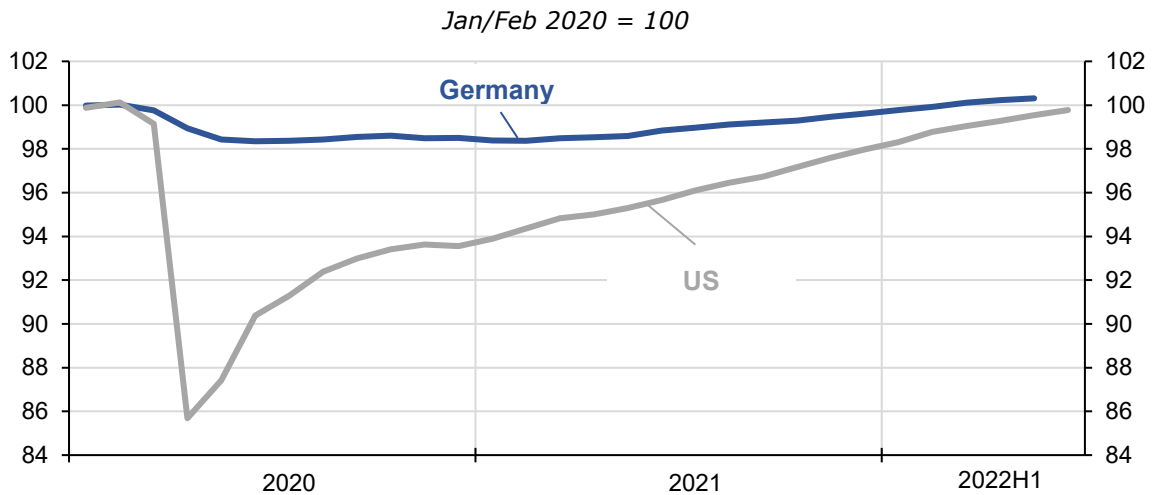
*) real output per hour worked
**) total economy
***) business sector
sources: Bundesbank, Federal Reserve, own calculations

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Remarkably, it had not been an advantage for America that its labor market is extremely flexible, characterized by hire and fire. In Germany, the emphasis is on stable employment conditions and the

preservation of human capital across business cycles. In terms of labor productivity growth there is almost no difference between the two countries.

German and US employment during the pandemic^{*)}



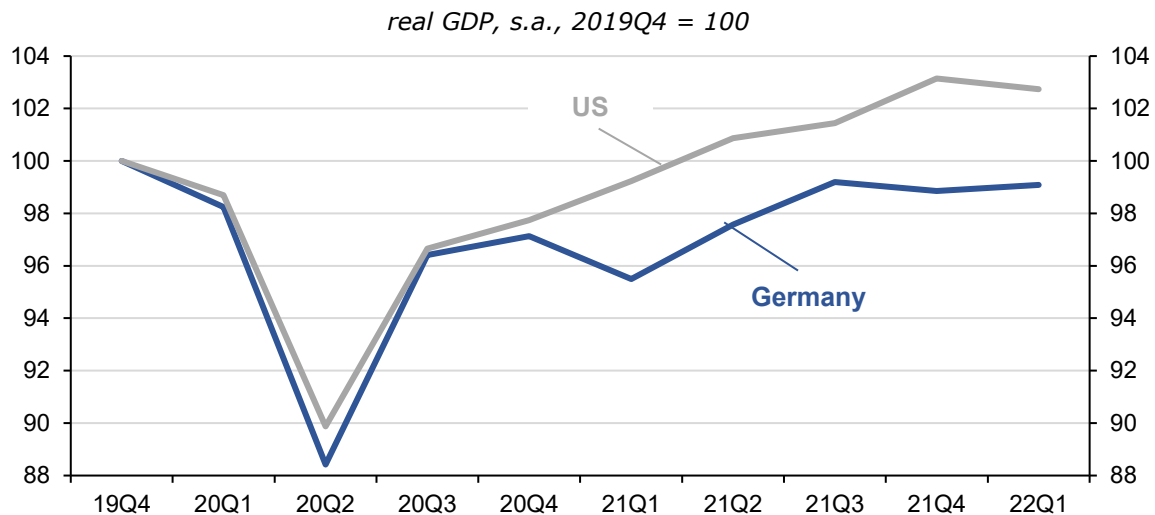
^{*)} persons employed, seasonally adjusted

sources: Bundesbank, Federal Reserve; own calculations, design & research: Uwe Richter

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So why has German GDP growth been so much slower than America's during the pandemic? The main explanation is differences in working hours: while German firms had more or less kept their staff, they significantly reduced per-capita working hours. This had a major negative impact on macro demand and thus on growth. For American firms, by contrast, the main adjustment variable were jobs, not hours worked.

recession and recovery since the outbreak of the pandemic



sources: Bundesbank, BEA; own calculations, design & research: Uwe Richter

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Weaker productivity trends in recent decades have actually been less dramatic than it seems at first sight. As the two Nobel prize winners Banerjee and Duflo report on page 152 of their book "Good Economics for Hard Times", Western real per-capita GDP growth had been just 0.14% per year between 1500 and 1820. Over the course of the following industrial revolution, and through 1900, GDP growth accelerated to an average of 1.24%, and to 2.00% since. In other words, today's slow productivity growth is basically a return to the old normal, and not a big surprise.

As Gordon argues, there have been no innovations in recent decades nearly as groundbreaking as the introduction of electricity and the internal combustion engine in the 19th century. Facebook, computer games, artificial intelligence, GPS or 3d-printing? No match! Gordon actually thinks that the impact of the internet on growth has been negative – people waste too much time doing useless things. They may gain in terms of personal happiness, but since they don't pay for social media, their happiness does not enter GDP calculations. It may sound cynical, but so far no one has developed an alternative to GDP as a measure of a population's wellbeing.

For economists, one of the biggest challenges remains how productivity growth and thus the standard of living can be accelerated. It is undisputed that larger inputs of labor and capital will account for less than half total factor productivity growth. It clearly helps to save and invest, and to work more, but the rest will be determined by "soft" factors such as the professional qualification of the population, the openness vis-à-vis immigrants, the way production is organized (as little waste as possible), the access to cheap commodities and energy, intensive competition, including on foreign markets, or the stability of society and a fair distribution of wealth and income. It is a long list. An inevitable convergence of poor countries with richer ones is not a given, but Japan, South Korea, Taiwan, Singapore and, until recently, China have shown that it can be done.

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Jochen Wermuth founded WAM in 1999. He is a German climate impact investor who served on the steering committee of "Europeans for Divest Invest". As of June 2017, he is also a member of the investment strategy committee for the EUR 24 billion German Sovereign Wealth Fund (KENFO).

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