THE PRODUCTIVITY PROBLEM

Productivity growth is apparently trending downward around the globe. The problem is addressed in Focus Economics, *Why is Productivity Growth So Low: 23 Economic Experts Weigh In*. The author, whose name I can't find, begins by explaining the problem as economists see it.

> Productivity is considered by some to be the most important area of economics and yet one of the least understood. Its simplest definition is output per hour worked, however, productivity in the real world is not that simple. Productivity is a major factor in an economy's ability to grow and therefore is the greatest determinant of the standard of living for a given person or group of people. It is the reason why a worker today makes much more than a century ago, because each hour of work produces more output of goods and services.

It's certainly true that the concept is important. The simple definition gives us the rough idea but the details are very difficult indeed. The text gives us the example of productivity at a branch bank.

> Bill Conerly put it well in an article for Forbes: "Take banking, for example. Your checking account is clear as mud. The bank provides to you the service of processing checks, for which you don't pay (aside from exorbitant fees for bounced checks and stop-payments). However, the bank does not pay you a market rate of interest on the money you keep in your checking account. It's a trade: free services in exchange for free account balances. Government

> statisticians estimate the dollar value of the trade, so that the productivity of bankers can be assessed, but the figures are not very precise.

At least in that example, we can see how productivity improvement at a bank might improve your standard of living, perhaps indirectly by enabling the bank to pay a bit more interest on your checking account. Here are three different kinds of examples, in which we can see how improvements in reported productivity result in worse outcomes for us.

Productivity is defined as the ratio of output to hours worked. Output is measured by receipts to the producer. Hours worked are collected by the Census Bureau.

1. A pharmaceutical company raises the price of its generic drugs with no change in its costs. Its receipts go up while hours worked remain the same. Under the definition, productivity goes up.

2. A high frequency trading company inserts itself into an increasing number of purchases of securities on stock exchanges. The purchaser pays a higher price. The HFT company has higher revenue but hours worked remain the same. Again, by this definition, productivity goes up.

3. Two dominant corporations in the same industry merge. The new company fires a lot of people. Hours worked go down. Prices remain the same in the short run, and rise as the new entity exercises oligopoly power. With hours down and receipts up, productivity rises by definition.

Are these examples realistic? In the medicine example, this article lays out the issues. For those interested, this chart shows the value of pharmaceuticals and medicines shipped by manufacturers beginning in 2000. It shows that there was a steady rise, with a sudden jump in 2013. This chart shows that per capita expenditure on pharmaceuticals and other medical products has nearly doubled since 2000.

It's likely that there are several causes for this, not least the startling prices sought for new drugs. Government productivity figures do not take into account any improvement in the results that new drugs bring, although quality adjustments are made in calculating inflation figures. Given the increased pressure from insurers and doctors to switch to generics, and increased focus on drug prices as a problem, it's reasonable to see this data and various reports as support for my drugs example. But it's hard to put a dollar value on it.

On the second example, here's an article from CFA Magazine written in 2011, detailing the costs of high frequency trading. More recent reports say that the problems are going away, and who knows because it's hidden behind a wall of words mostly from the people who run the systems and their friends at the exchanges, and the captured SEC. Here's a review of the literature (behind a paywall), which concludes with this: "This suggests that the identified economic benefits of HFTs (market making, venue competition, more trading opportunities) outweigh their economic costs (large-order predation and run games)." For my purposes, it's clear that the older article tells us that initially, at least, HFT operated as my example suggests, raising productivity without doing anything useful.

As to the third example, the impact of private equity on employment is everywhere, and the concentration of economic power in oligopoly control of most industries is obvious. Dave Dayen has been writing about it for some time; here's a recent example. Oligopolistic control also reduces paychecks for the remaining workers.

In these examples, and I could produce many more, productivity as defined by economists goes up but individual consumers are worse off. That is maddening. Once upon a time, we might have thought we could just ignore this kind of thing as an insignificant part of GNP, but that's not true today, either in the US or globally. The economy, measured by output, is growing, but it is the opposite of the notion of productivity as good for society: it makes people's lives worse. Except, of course, for a few rich people.

My three examples are exercises of market power. Here's a long but worthwhile discussion of the harm it does and its increasing presence in the economy. Market power is not the same as rent-seeking, which is usually defined as an effort to get the government to give special treatment to one of a number of competitors. Both are damaging and both inflate productivity figures.

My examples show that reported productivity growth is most likely higher than the kind of productivity growth that the author discusses, the kind that increases the amount of goods and services available in the economy. It's not unusual for an economics writer to assume only good people operate in the capitalist economy, and ignore the crooks and the cheats. Suppose the author is right that rising productivity that makes for a better life. If real productivity growth is even lower than the low reported productivity growth, his logic explains why life is getting worse for most of us.