

PERSISTENT MISREADING OF U.S. ECONOMIC PERFORMANCE

By Alan Reynolds

Many people have been led to believe that the US economy ended the decade of the 1980s in worse shape than it began, requiring future years of austerity and suffering to atone for a time of "excessive greed" and "debt binge." Other countries, by contrast, are widely believed to be much stronger and more competitive, particularly in manufacturing. Even our own political leaders, as well as observers abroad, share this gloomy view. In the campaign book, *Putting People First*, for example, President Clinton wrote that "in Europe and Japan our competitors' economies grew three and four times faster than ours," and "Japan and Germany...threaten to surpass America by 1996."

What Do the Numbers Show?

The data simply do not show this to be so. In fact, the US is by far the strongest, most competitive economy of the seven major industrial nations. After a prolonged period of "stagflation" from the end of 1978 through 1982, US manufacturing output subsequently surged nearly 40% by 1990, declined very little in the 1990-91 recession, and was once again hitting record highs by the start of 1993, despite coping with difficult cuts in defense-related industries (Figure 1). Even if the 1981-82 recession is included, the growth of manufacturing output and gross domestic product in the US was much stronger than in Germany in the 1980s. It was also much stronger than it had been in the US in the 1970s. Over the entire 1980-87 period, industrial production in Germany rose by only 4.1%, while the rise in the US was nearly ten times as large. Japan did continue to experience rapid manufacturing growth until 1991, but then suffered a severe downturn. In 1992, industrial production fell by 3.7% in Germany and by 8.3% in Japan.

It is particularly odd that Americans continue to fret over "competitiveness"—when in fact US exports have doubled in real terms since the mid 1980s (Figure 2). Were it not for the fact that so many of our customers are broke, thanks to the slump in Europe and Japan, we would be exporting even more.

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The US Leads in Labor Production

A major study of productivity by McKinsey & Co. showed that increases in labor productivity in US manufacturing were not far behind those in Japan in the 1980s, before Japan slipped into its 1991 decline. West Germany lost ground to both the US and Japan. More important, it is much easier to catch up to the leader by copying technology than it is to move into the lead by inventing new techniques. Japan and Germany are still far behind the US in the level of output per worker (Figure 3).

Output per worker in Japanese manufacturing, according to the McKinsey study, is only 77% of that of the United States. And Japan is far from catching-up to US productivity in huge sectors other than manufacturing. Productivity in Japanese retailing, for example, is only 40% of the US level, indicating a lot of wasted labor time. The McKinsey study utilized a novel concept of "market GDP," which deals with output per worker in the market economy (as opposed to government or nonprofit services whose value is not re-

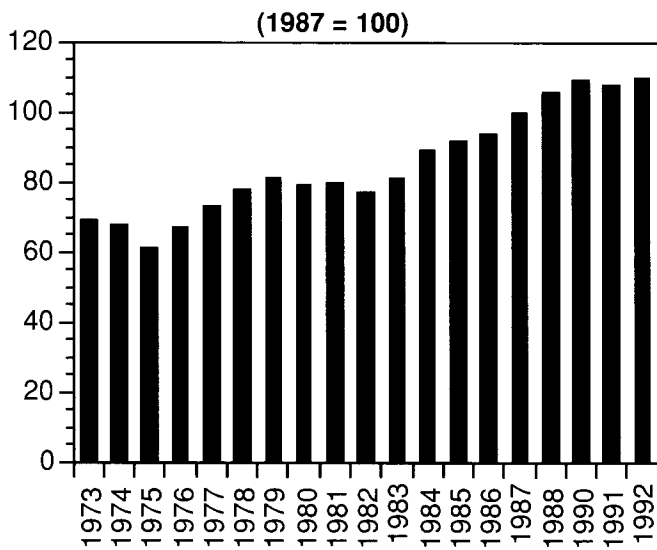
ally known). On this basis, Japanese productivity is only three-fifths as high as it is in the US (Figure 4). This productivity measure also excludes real estate, since overpriced office and factory space made Japan's "investment," and therefore GDP, look stronger than it really was. The fact that Japanese businesses have to pay exorbitant prices for office and factory space certainly does not make their companies more efficient or profitable. Indeed, it is one reason that many of them have built their newest and best factories in the United States.

Productivity in US Manufacturing Has Been Rising Sharply

The usual overall productivity figures greatly understate industrial productivity gains, because they include developments in the financial sector (including S&L failures). While output per hour rose by 9.4% between 1980 and 1991 for all nonfarm businesses, it rose by 16.4% among nonfinancial businesses—doubling the 8% increase from 1970 to 1980. In manufacturing, the total productivity increase was 41.4% from 1980 to 1990, more than 4% per year. Thanks to big productivity gains, unit labor costs in manufacturing have risen only about 3% since 1985 in the US, but by 10% in Japan and 19% in West Germany.

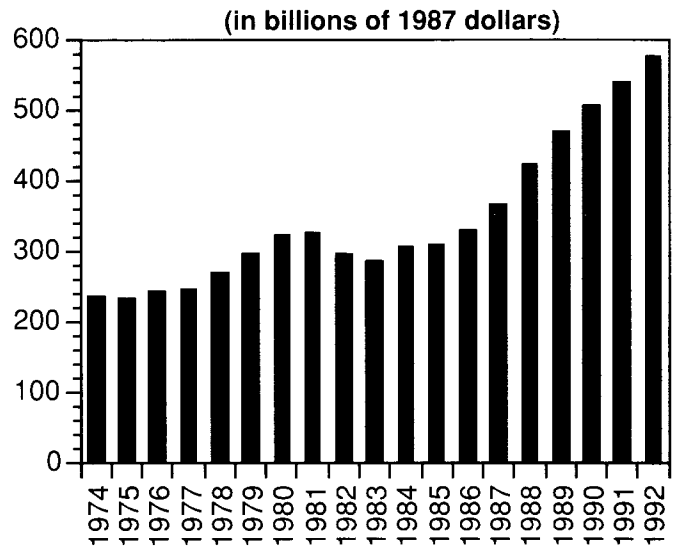
The cumulative gains in the already unequalled level of US productivity in the 1980s were particularly impressive since, unlike the 1960s, they were also combined with rapid growth of employment. From 1983 to 1989, US employment grew by 2.4% per year—twice as fast as in Japan, and four times as fast as in Germany. Increases in the percentage of the population employed (to a record 63.3% by 1989) were well above the postwar trend.

Figure 1
Index of U.S. Manufacturing
Output, 1973-92



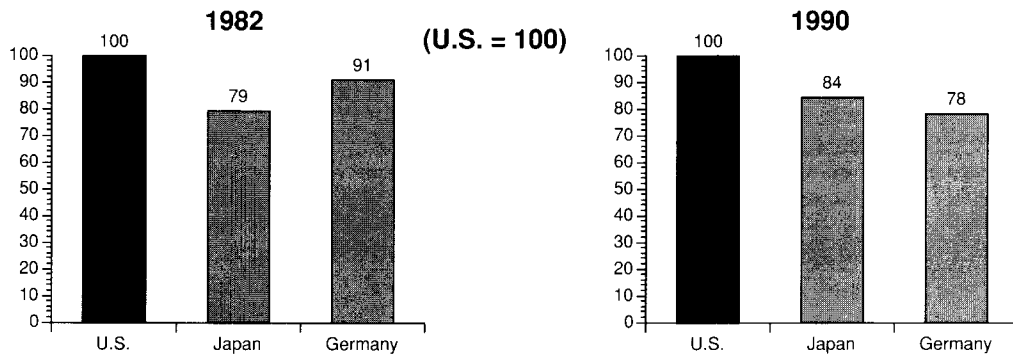
Source: The Federal Reserve.

Figure 2
Real U.S. Exports 1974-1992



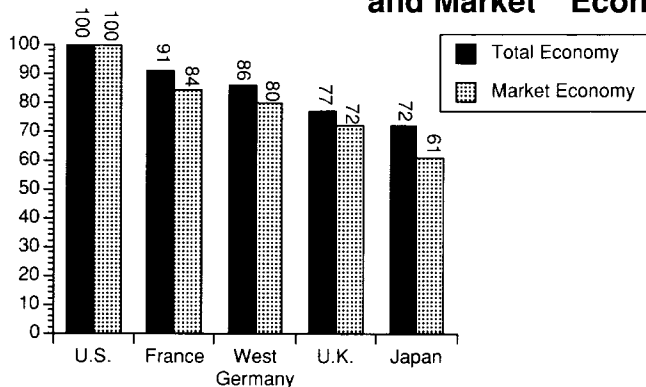
Note: The 1992 data are for the third quarter.

Figure 3
Value Added Per Hour Worked in manufacturing: U.S., Japan, and Germany



Source: D. Pilat and B. van Ark, "Productivity Leadership in Manufacturing; Germany, Japan and the United States, 1973-1989," Research memorandum nr. 456, Institute of Economic Research, Groningen (revised version).

Figure 4
GDP Per Person Employed Full-Time* for Total and Market Economy—1988**



*Part-time employees counted as 0.5 full-time employees.

**Market economy excludes government, health services, education, real estate and nonprofit organizations.

Source: "Service Sector Productivity," McKinsey Global Institute, Washington, DC, October 1992

“Multifactor” productivity for *both* labor and capital was even stronger than labor productivity alone. That means the US has been getting a lot of “bang for the buck” from capital investments since 1980, while comparable figures from the Organization of Economic Cooperation and Development (OECD) show falling capital productivity in Japan. The superior efficiency of capital is one reason the US stock market has on the whole been looking much better than most others.

Income Has Been Rising As a Result of Production Gains

Increases in real output brought increases in real income. Between the cyclical peaks of 1979 and 1990, real after-tax income *per capita* rose by 17.6%. These gains in incomes have often been obscured by extremely misleading fig-

ures on “average wages,” which were diluted by larger numbers of young and part-time workers. Wage statistics also exclude increasingly costly health care and pension benefits, and include only nonsupervisory workers, though many previous wage-earning jobs were upgraded to salaried lower management positions. One-third of all US workers (up from one-fourth in 1980) now receive no “wages” at all; they are instead salaried professionals and managers. Many people also stopped receiving either wages or salaries in the 1980s, and instead started their own businesses. Total real income of nonfarm proprietors rose by 45% from 1980 to 1990, and was 59% as large as all wages and salaries in manufacturing by 1990. By the end of 1992, more people were employed in generally high-paid government jobs than in manufacturing, though not everyone would consider that a sign of progress.

In a longer-term perspective, the 1980s actually scored a number of impressive achievements, not the least of which was a substantial increase in the quantity and modernity of the nation’s physical and human capital, which will increase real output and income in the decades ahead. Some of the new plants and equipment have foreign names, but those foreign-owned firms account for one job out of twenty and pay relatively high wages. The fact so many foreign enterprises choose the United States as a place to locate is ample refutation of the idea that modern businesses want to move to places where labor is cheap. Sophisticated, high-wage industries need the best labor, not the cheapest. And the US labor force—our invaluable “human capital”—is by far the most productive in the world.

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