

Financial Page Summary March 2024

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Productivity of U.S. workers increased by 2.7% in 2023, well above the average annual rate of 2.1% since the end of World War II, and a dramatic change from 2022, when productivity dropped by 2.0%. It's also a big improvement over the 0.9% growth rate in 2021. The productivity surge in 2023 may help explain why the U.S. economy was able to grow at a strong pace while inflation dropped.

Broadly, productivity is the ratio of outputs to inputs. A productivity increase means that output increases faster than inputs, essentially producing more with less. The most commonly cited productivity measure for the U.S. economy is labor productivity for the nonfarm business sector (the data cited above). In simple terms, this is the value of goods and services produced per hour of labor. The non-farms business sector comprises most U.S. business activity, excluding farms, general government, and non-profits. The 2.7% increase in 2023 means that, on average, 2.7% more value was created for each hour of labor. This helps boost gross domestic product (GDP), while also helping to control inflation by holding back the wage-price spiral, which can push inflation out of control.

In a tight employment market, as we have had for some time, a shortage of workers can force businesses to offer higher wages, which they pass on to consumers as higher prices. Because consumers are then earning more at their jobs, they demand more goods and services and are willing to pay higher prices, which pushes businesses to hire more workers at higher wages, continuing the cycle. Increased productivity allows businesses to keep prices lower even as they pay workers more. This seems to have occurred in 2023, with average hourly wages rising by 4.3% while inflation dropped to 3.4%, the first time since the pandemic wages increased faster than inflation.

Increasing productivity is especially important for the U.S. economy because of lower birth rates, the aging of the population, and more young people staying in school. The labor force participation rate, which measures the percentage of people age 16 and older who are working or looking for work, peaked in early 2000 and has trended downward since then. Higher productivity enables a smaller workforce to drive economic growth on a level that would require a larger workforce without productivity gains.

Increases in labor productivity are typically driven by improved tools and technology, more efficient processes, and increased worker experience, education, and training. The proliferation of computers in the workplace spurred a productivity surge in the 1990s and some analysts point to artificial intelligence as contributing to the 2023 increase but any large-scale impact may take years. A more immediate explanation may be adjustment and experience with the hybrid work model. Many workers feel working from home makes them more productive. New businesses can spur productivity through innovation, filling specialized niches, and producing specific goods and services more efficiently. A less positive factor may be that some companies laid off employees and made other changes in 2023 in anticipation of a recession that never materialized. While this "lean" model is not always sustainable, it can boost productivity in the short term. Technology and more efficient processes may enable some businesses to stay lean.

Measuring productivity is difficult, especially in service industries, which now comprise the largest sector of U.S. economic activity. For this reason, productivity data can be volatile and often changes with revision. Even so, the surge in 2023 seems solid and enhancements such as artificial

intelligence, hybrid work, and new business innovation could usher in a sustained period of productivity growth. The Bureau of Labor Statistics releases productivity data quarterly, with first quarter 2024 data coming in May. You might want to keep an eye on this for confirmation of a trend.