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How the U.S. Has Kept the Productivity Playing Field Tilted to Its Advantage

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Americans' anxiety level over competitiveness with other nations has grown in recent years. A large number of Americans appear to believe that the United States will not be able to succeed in an open world market, and they argue in favor of reducing our exposure to the outside.

Paradoxically, when many of the people in these same competitor nations look at our economy, they are rather anxious about us.

And the latest evidence coming out of the Center for Economic Performance at the London School of Economics suggests that they may be the ones with the right idea.

For all the collective hand-wringing, the United States is still home to the most productive workers of all the major economies -- more than Japan, more than China, more than Germany, Britain, France or most any other nation on earth.

Granted it started from the pole position, but the United States still kept the lead in what some economists have come to call the productivity miracle of the 1990s.

Normally, because it is easier to copy someone else's innovation than to generate new ideas, as countries get richer and more productive, their growth rates slow. Other countries may have much faster growth than the United States, but once their income gets close to ours, their growth slows substantially. This is the law of convergence.

The data has mostly backed up the notion of convergence among rich countries for decades. The United States miracle of the 1990s was that our productivity began growing faster than that of other countries, even though we were the richest to start with.

The popular explanation, of course, pointed to information technology and, specifically, to the fact that the price of semiconductors began falling at an even more rapid rate than they had been, starting in the 1990s.

Rather than a traditional drop of 20 percent a year, computer prices began falling more like 30 percent a year. This may sound subtle, but it couldn't be more dramatic. After 10 years of such declines, the 20 percent rate would have left computer prices almost four times higher than the 30 percent rate did. Low computer prices drove mass adoption of technology and, hence, the productivity miracle was born. Or so the story goes.

The only problem is, the explanation doesn't work, according to John Van Reenen at the London School of Economics. Professor Van Reenen is a leader of a new generation of economists studying the differences in economic performance across countries and businesses.

He said that the prices of information technology fell in Europe, too. And Europeans bought information technology. But they had no productivity miracle.

To explain the experience in the United States, one would have to believe that Americans have some better way of translating the new technology into productivity than other countries. And that is precisely what Professor Van Reenen's research suggests.

His paper "Americans Do I.T. Better: U.S. Multinationals and the Productivity Miracle," (with Nick Bloom of Stanford University and Raffaella Sadun of the London School of Economics) looked at the experience of companies in Britain that were taken over by multinational companies with headquarters in other countries. They wanted to know if there was any evidence that the American genius with information technology transfers to locations outside the United States. If American companies turn computers into productivity better than anyone else, can businesses in Britain do the same when they are taken over by Americans?

And in the huge service sectors -- financial services, retail trade, wholesale trade -- they found compelling evidence of exactly that. American takeovers caused a tremendous productivity advantage over a non-American alternative.

When Americans take over a business in Britain, the business becomes significantly better at translating technology spending into productivity than a comparable business taken over by someone else. It is as if the invisible hand of the American marketplace were somehow passing along a secret handshake to these firms.

Companies like Wal-Mart seem to be more adept at translating technology into productivity than anyone else. The Asda supermarket chain in Britain, for example was a middling fourth in its home market before it was taken over by Wal-Mart in 1999. Asda proceeded to grow, sharply, and has taken the No. 2 spot.

Throughout the service-based economy, American companies have proven remarkably adept at adjusting to new conditions and incorporating technology.
Since these industries represent a large majority of our economy, the news is rather good.

The real question is whether this advantage will last. In an interview, Professor Van Reenen observed that there are two possible outcomes. One is that the last 10 years were an aberration, a one-time happenstance whereby the United States took advantage of the drop in computer prices to pull away from the competition. Under this theory, the United States will soon return to its normal long-term productivity growth rate as the rest of the pack catches up and copies what the American companies did -- the same old convergence story.

But there is a chance that the 1990s represent a fundamental shift in the global economy. Perhaps the greater amount of uncertainty and churn in the world economy in the 1990s is the new norm. Perhaps the 21st century will continually favor those who adjust best to changes. As Professor Van Reenen put it, "If the world has become one in which everyone is trying to hit a moving target, it certainly helps to be the best at changing one's aim."

But that is, of course, the paradox of the American position. We hate experiencing major adjustments and industry transformations that force people to look for new jobs. That experience has made many skeptical about the future of the United States in the world economy. Yet the evidence seems to show that for all our dissatisfaction, we are the most flexible economy around and may be best poised to take advantage of the coming changes on a global scale precisely because we are so good at adjusting.

Perhaps the lesson from the research can be boiled down to something most Americans clearly understand: The world economy may be tough on your industry but look on the bright side: you could be French.