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Five misconceptions about productivity

As the US economy begins to recover, addressing some of the myths on productivity is more important than ever.

Vikram Malhotra and James Manyika

President Obama recently used his weekly radio address to insist that the United States can outcompete any other nation on earth if only we "unlock the productivity" of American workers. But the president's advocacy of productivity—getting more or better value for each hour worked—as the key to competitiveness may fall on deaf ears in some quarters. Longstanding misconceptions continue to undermine rational debate on productivity. Here are a few of the most pervasive.

Productivity is not a priority. The United States relies more than ever on productivity gains to drive GDP growth. Productivity generated 80 percent of total GDP growth in recent years compared with 35 percent in the 1970s. Now, due to our country's shifting demographics, we'll have to do even better.

In the past, productivity gains and an expanding labor force made equal contributions to economic growth. But this is changing as baby boomers retire and the number of women entering the work force levels off. If labor-force growth slows as projected and productivity increases at the average 1.7 percent annual rate posted since 1960, annual GDP growth will fall to 2.2 percent from its historic average of 3.3 percent. Americans on average would experience slower gains in living standards than did their parents and grandparents. To prevent this, productivity growth needs to increase to an annual rate of 2.3 percent—a rate not achieved since the 1960s.

Productivity is a job killer. Many Americans suspect that productivity is a job-destroying exercise. They point to the period since 2000, when the largest productivity gains in the United States came from sectors that have seen large job cuts, such as electronics and other manufacturing. But when looking across the economy overall, as opposed to the ups and downs of individual sectors, productivity and jobs nearly always increase together. More than two-thirds of the years since 1929 have seen gains in both. It is simply untrue that there is a trade-off between productivity and jobs in a dynamic economy.

Productivity is only about efficiency and is designed to bolster corporate profits. Productivity can come either from efficiency gains (such as reducing inputs for given output) or by increasing the volume and value of outputs for any given input (for which innovation is a vital driver). The United States needs to see both kinds of productivity gains to experience a virtuous growth cycle in which increases in value provide for rises in income that, in turn, fuel demand for more and better goods and services.

In the second half of the 1990s, the United States saw productivity gains come from both sources. Two sectors—large-employment retail, and semiconductors and electronics—collectively contributed 35 percent to the acceleration in productivity during this period and, at the same time, added more than two million new jobs. In contrast, the largest productivity gains since 2000 have come from sectors that experienced substantial

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employment reductions. The challenge for the United States is to return to the balanced productivity growth of the previous decade.

Productivity is just for laggard sectors and companies. Not so. As a critical component of competitiveness, rising productivity is essential to the overall health and wealth of the US economy and to its ability to compete globally. Even the best-performing companies and sectors still have headroom to boost productivity by emulating the best practices of others and developing new innovations of their own. Even a productive sector such as retail, for instance, can broaden its use of lean techniques from the stockroom to the storefront and continue to innovate.

It is true that the opportunity for gains may be larger in industries such as health care that today have relatively low productivity. Our hospitals, without the driver of competition, have only just begun to embrace efficient practices and lean techniques in the purchase and delivery of services. Clearly, the public sector—at all levels—also needs to become more efficient. Boosting public-sector productivity will be critical to reducing the US budget deficit without simply slashing public services.

Productivity gains have reached their limits. Some say that economic development and technological innovation in the United States have plateaued and that our productivity engine is running out of steam. We disagree. Our research suggests that the private sector can deliver three-quarters of the productivity gains that the United States needs to match historic growth rates simply by applying best practices across the economy and tapping into the next wave of innovation.

But to obtain the last one-quarter of what's required, federal, state and local governments need to tackle economy-wide barriers that have long hampered productivity growth—including our deteriorating infrastructure and the abiding burden of red tape. Government should also see to it that companies with a strong record of innovation have access to the talent and the right incentives to expand their US-based operations. Working together, the public and private sectors can set a new global standard for productivity and competitiveness, while ensuring that future generations enjoy gains in living standards similar to those their parents experienced.

Vik Malhotra is a director in McKinsey's New York office; **James Manyika** is director of the McKinsey Global Institute and a director in the San Francisco office. This article is reprinted from "Productivity and growth: The enduring connection," which appeared in the February 16, 2011, edition of the *Wall Street Journal*. Copyright © 2011 Dow Jones & Company. All rights reserved.