VIEWPOINT

The Productivity Boom Is Only Just Beginning

BY JOHN RUTLEDGE

A tidal wave of productivity growth, caused by advances in communications technology, is raising output per hour of work and driving a resurgent U.S. economy.

Business sector productivity rose at a 4.5% rate in the first quarter compared with the previous quarter, and 5.5% from the year-ago first quarter.

Manufacturing productivity rose 3.1% (5.3% over a year ago), and durable goods manufacturing rose an incredible 5.9% and 7.4% from a year ago.

Increasing productivity lowers costs and increases profits. And it reduces an employer's need for workers unless matched by an increase in customer demand.

In the last year, business sector employers have increased output by 5.8%, and have increased hourly wages by 4.2%, with no increase in worker hours (0.2%). This pushed unit labor costs — labor costs per unit of final product — down 1.3% for the year.

In durable goods manufacturing, the results are even more striking: Output increased by 5.7%, and employment (employee hours worked) fell 1.6%, which drove costs per unit down by 2.4%.

Not all companies are created equal. Big companies — those which have been most able to take advantage of high-speed telecommunications and most able to deploy fast communications networks within their company — knocked the cover off the ball.

New data show that in the fourth quarter of 2003, nonfinancial corporations increased productivity by 6.2% and increased output by 5.4%, while shrinking employment by 0.7% and reducing labor costs per unit of product by 1.9%. As a result, profit per unit increased at an incredible 27.1% rate for the quarter.

The full-year numbers are even better. During 2003, nonfinancial corporations increased productivity by 5.7%, the largest increase in the history of the series, which dates to 1959.

Output grew 4.2%, employment fell 1.5%, unit labor costs fell 1.5% and profit per unit increased by 20.5%.

This report is extremely important for two reasons. First, it shows why the fears about strong job growth, rising inflation and rising interest rates that pushed bond yields up by 50 to 70 basis points last month are unwarranted. Demand isn't growing fast enough to offset the incredible growth of productivity that is driving the growth of the U.S. economy.

Output will continue to rise, but job growth will remain subdued, labor costs will continue to fall, inflation will remain under control and profits will continue to grow.

We are going to see a second great wave of productivity growth in the next five years as small companies become more competitive.

Second, this is only the beginning of the productivity story.

As the numbers above show, productivity gains to date have been concentrated among large corporations. The high-speed communications systems the big companies used to improve operations simply were not available to small companies.

That is changing dramatically. President Bush has announced that he will make universal broadband access a national priority by 2007. The Kerry campaign has similar plans.

Congress is gearing up to rewrite the telecom law to improve incentives for telecom investment once the elections are over.

Every major telecom company has a business plan that focuses on bringing broadband to small towns, small businesses and homes. We are going to see a second great wave of productivity growth in the next five years as small companies become more competitive.

This means rising output, falling costs, low inflation, rising profits and low interest rates are going to be with us for a long time — becoming a great environment for equities.

John Rutledge is chairman of Rutledge Capital, a Greenwich, Conn.-based investment firm, and worked with the Treasury Department under President Reagan.