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# Has Economic Growth Accelerated?

Productivity growth, the principal impetus to a higher standard of living, nearly came to a halt from 1986 to 1991. A key measure of productivity, business sector output per hour, rose at only a 0.1 percent annual rate from mid-1986 to mid-1991. In the past year, however, this hiatus ended as productivity rose 2.6 percent, its largest annual increase since early 1986. Productivity is cyclical, rising with cyclical increases in labor and capital services like a rising capacity utilization rate and a falling unemployment rate. Since these measures have changed little for the past year, recent productivity gains appear to mark a significant shift in the trend of economic growth.

The recent period of stagnant productivity growth followed the 1986 Tax Reform Act, which substantially raised taxes on capital income. This act ended the investment tax credit, lengthened depreciation schedules and raised the capital gains tax rate. These changes raised firms' cost of capital services, which, in turn, lowered the efficient mix of capital use relative to the use of labor services. Temporarily, investment in plant and equipment declined to adjust the existing capital stock to the lower demand for capital services. The adjustment to such changes usually lasts several years. In the 1986 case, investment fell sharply: real nonresidential fixed investment fell from a record high of 12.2 percent of real GDP in 1985 to 11.1 percent at the business cycle peak in III/1990 and declined further during the recent recession, reaching 10.2 percent by the end of 1991. The share rose to 10.5 percent in II/1992, providing some indication that this adjustment process may have ended.

The recent experience was worse than the earlier and better-known episode from the end of 1973 to the second quarter of 1981, when productivity rose at a 0.6 percent rate. This episode was associated with two oil price shocks, which reduced the nation's economic capacity by altering production methods and reducing the pace of of capital formation. Changes in tax policy in 1981 created stronger incentives to invest, encouraging firms to change production methods to employ more plant and equipment per worker. Partly as a result, productivity growth climbed to a 1.7 percent rate from II/1981 to II/1986.

Despite the adjustment of the nation's capital stock and productivity to the 1986 tax changes, productivity growth was still substantially higher for the past 11 years than during the earlier period of stagnation. From II/1981 to II/1992, it rose at a 1.1 percent rate, almost twice as fast as during the 1973-81 period. The recent surge in productivity growth suggests that the adjustment to higher taxes is ending and that economic growth has resumed; it could also put to rest concern about a return to the dismal performance of the 1970s.

— John A. Tatom



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