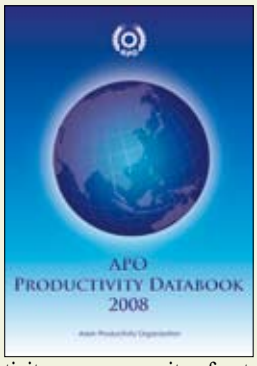
Reading productivity and economic trends

The APO News *started this new series of short columns on specific topics closely related to the analyses contained in the* APO Productivity Databook 2008 *from the June 2008 issue. Presented in a bite-sized, reader-friendly format, focusing on pertinent topics and expanding on their implications for productivity measurement, this column will help readers to maximize the use of the* APO Productivity Databook 2008. *This series in 12 columns will continue until the May 2009 issue. Dr. Koji Nomura and Ms. Eunice Y.M. Lau contributed this article.*

Part 2. Why labor productivity matters



"For the fact is that the key both to long-term economic growth and to sustained differences in economic performance between countries seems to be the ability to get more for less—to have output grow faster than input." Paul Krugman (*International Affairs,* 1995; 71(4): 717–732)

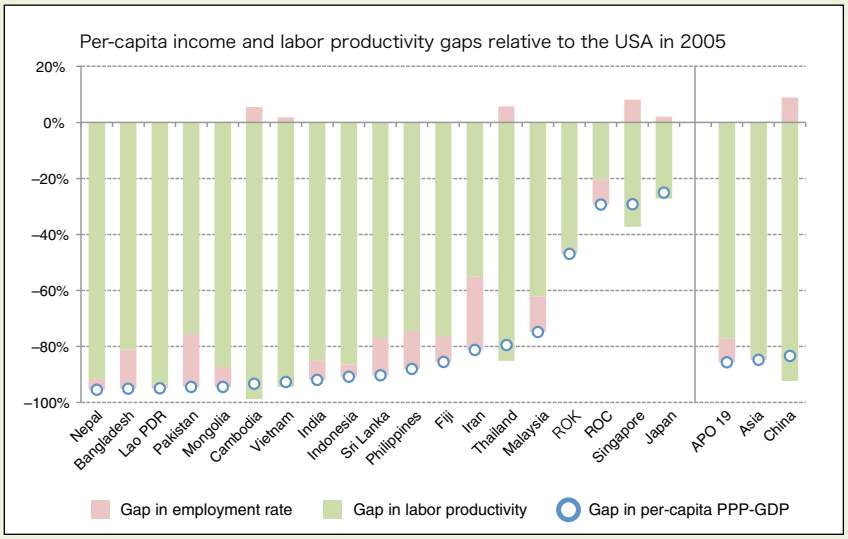
Productivity is one of the main economic performance indicators that government policymakers often monitor. In simple terms, productivity measures units of output per unit of input. As resource constraints are prevalent in all economies in one form or another, whatever the income level, the capability of an economy to drive productivity growth, i.e., output growing faster than input, is seen as cardinal for ensuring future prosperity.

In 2005, GDP per capita (adjusted for purchasing power parity [PPP]) of APO member countries as a whole was only around 15% of that of the USA. Despite rapid economic growth of the group in recent years, the gap persists. The accompanying chart shows that for most APO countries, the substantial per-capita GDP gaps with the USA are predominantly explained by their relatively poor labor productivity performance. This is why identifying the sources of labor productivity growth is crucial to a country's development efforts.

There are different techniques for productivity analysis. The *APO Productivity Databook* uses the growth accounting framework, the international standard for compiling productivity estimates. In this approach, economic growth is decomposed into contributions of input growth and total factor productivity (TFP) growth. Within the same framework, labor productivity growth can be traced back to its sources in capital deepening, improvement in labor quality, and TFP growth. Although full analysis of these sources was not performed in the *Databook 2008* (the current plan is that sources of productivity growth will be analyzed at least for some countries in *Databook 2009*) as theoretically established channels of labor productivity growth, they highlight areas where potential policy levers could be applied to raise labor productivity.

Another perspective is the industry origins of productivity growth, which offer insight into the dynamics of an economy and the sectors contributing most to the productivity drive. Furthermore, productivity growth for the whole economy can be decomposed into the intrasectoral effect (productivity gains within the industry sectors) and the intersectoral effect (the change in the resource allocation of production). The latter is positive when high-performance industry is growing relative to other sectors in the economy.

Empirical evidence of the "Asian Miracle" has suggested that input growth (especially capital accumulation) was behind the success story of Asian Tigers, i.e., Hong Kong, Singapore, Republic of Korea, and Republic of China, that experienced more than a four-fold increase in per capita income over the 35-year period from the mid-1960s. Labor productivity growth was largely explained by capital deepening with TFP growth playing a surprisingly small role in its success. The lessons to be learned are therefore why those countries can mobilize input better than other countries and how they can achieve and sustain high rates of saving and investment. Nelson and Pack (*Economic Journal*, 1999; 109(457): 416–436) highlighted that among other factors, the possibility to shift into highly productive sectors is a crucial element of this productive assimilation of factor inputs.



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