Editor's Letter

Productivity and Prosperity

"PRODUCTIVITY ISN'T EVERYTHING," Paul Krugman wrote in his 1990 book, *The Age of Diminished Expectations*, "but in the long run it is almost everything."

Productivity is a foundation of prosperity. The only way a country can raise its standard of living sustainably is to produce more with existing or fewer resources. You cannot do that without improving productivity. It's that simple.

Everything else about productivity is surprisingly complex, however. It is difficult to explain, difficult to measure, and, as the past couple decades show, difficult to improve.

We know that productivity must play a more important role in driving sustained growth as our societies age. But there's no consensus on how to reverse the broad slowdown in productivity growth seen across almost all countries over the past 20 years.

Especially vexing is the sluggish growth of what economists call total factor productivity—a way of measuring how efficiently businesses turn capital and labor into output—the part that basically captures innovation and technology.

Slower gains in total factor productivity account for more than half the deceleration in economic growth since the global financial crisis, IMF analysis shows. Another decade of weak productivity growth could seriously erode living standards and threaten financial and social stability.

This issue of F&D brings together leading researchers to help explain the withering of productivity gains, how to counter these trends, and how to spark economic dynamism.

Yale economist Michael Peters sets the stage by delving into the causes of slowing productivity growth in the US. Declining dynamism in the world's largest economy threatens to reverberate around the globe. Greater immigration to offset a shrinking workforce and stronger competition rules to encourage innovation by smaller, younger, hungrier enterprises could be part of the solution, he concludes.

These small companies can drive productivity gains, writes the University of Chicago's Ufuk Akcigit, who explores why increased US spending on research and development isn't necessarily boosting productivity. He shows how small firms are more innovative relative to their size, suggesting that they use R&D resources more efficiently. As companies grow and dominate their markets, they often shift to protecting their market position, rather than fostering innovation.

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But while innovation is exactly what's needed to revive productivity growth, it is not sufficient on its own. New technologies and digital transformation, notably artificial intelligence, have the potential over time to underpin a major surge in productivity, writes Nobel laureate Michael Spence. For AI to achieve its full economic potential, however, it must be accessible to all sectors of the economy, and to companies large and small, he notes.

Policies matter, too. Here our contributors suggest that measures should encourage more effective reallocation of resources away from low-productivity firms and support smaller businesses and start-ups—not just large incumbents. This could include targeted tax credits, grants for early-stage innovation, workforce retraining, and policies that encourage competition and reduce barriers to entry for new players.

Understanding productivity growth more fully is crucial because it plays such an outsize role in economic growth—which, as Daniel Susskind of King's College London writes, also demands a renewed approach to help improve people's lives. Ultimately, as Nobel laureate Edmund Phelps writes, a productive society should allow people to enjoy "mass flourishing" from the grassroots up.

There is much more to explore in these pages. I hope these articles stimulate fresh thinking and further the debate. F&D

Gita Bhatt, editor-in-chief