Productivity Advanced 2.4% in Fourth Quarter

By Nicholas Kulish
Staff Reporter of The Wall Street Journal
WASHINGTON—The U.S. economy continued to make productivity gains last quarter, but at a slower rate consistent with the cooling in overall growth.

The Labor Department said nonfarm business productivity rose at a seasonally adjusted annual rate of 2.4% in the fourth quarter of 2000. That is slower than the third-quarter increase of 3%, revised downward from an initial estimate of 3.3%, and significantly below the 6.3% gain reported in the second quarter.

Economists have credited rising productivity—defined as output per hour worked—with allowing the longest economic expansion in U.S. history to continue without the kind of inflationary pressures normally associated with rapid growth. For 2000, productivity gains reached 4.3%, the fastest yearly pace since 1983, including the entire decade-long economic boom.

In the midst of a sharp slowdown, however, the fourth-quarter productivity rate still managed to beat analysts' estimates that it would come in below 2%. "It's easy to get productivity growth when the economy is booming. This is almost more impressive," said Jim Glassman, senior U.S. economist at J.P. Morgan & Co. in New York.

Economists debated whether productivity gains were part of a lasting, structural change or a cyclical reflection of temporary, rapid growth. "The underlying rate is still very favorable," Mr. Glassman said. "It validates a lot of the new economy themes of structural improvement in productivity."

The report showed signs, however, that employment costs have begun an upward march, albeit slowly. Unit labor costs, a measure of wage pressures, rose 4.1% in the fourth quarter, the second consecutive quarterly increase and the largest since the second quarter of 1999.

Hourly compensation was up 6.6% last quarter, the third increase in a row. Normally a harbinger of inflation, the rise in labor costs is less likely to drive consumer prices higher in the context of a broader economic slowdown. With consumers cutting back on spending, businesses will be forced to absorb the blow.

"What will concern [the Federal Reserve] now is the negative implication that higher unit labor costs have for profit margins, potentially generating more layoffs and cutbacks in capital spending," said David Orr, chief economist at First Union Bank Corp. in Charlotte, N.C.

Employers did cut back significantly on worker hours, which fell at an annual rate of 1.1%, on the heels of a 0.7% decline in the third quarter.

The drop was led by a 6.6% plunge in Please Turn to Page A10, Column 6 manufacturing hours. The sector has been hammered by falling sales and an excess of inventories in recent months, leading many analysts to declare a manufacturing recession.

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Separately, the Federal Reserve said consumer-credit outstanding rose $3 billion in December, or at an annual rate of 2.4%. That is down from November's revised $13.9 billion advance, or 11.1% pace, initially reported as a $12.9 billion increase.

The December advance was the smallest monthly gain since September 1999 and below analysts' expectations, which had called for a gain of around $7 billion. Economists had been expecting some slowing in borrowing, given outsized gains in prior months and a sharp slowing in auto sales in December.

Nonrevolving debt—for big-ticket items such as cars or school loans—rose $1 billion in December, lower than the $7.9 billion gain in November and the weakest pace since an outright decline in April.

Revolving debt, which includes credit-card, retail and bank-card borrowing, expanded $2 billion in December, down from the previous month's $6 billion gain. On a seasonally unadjusted basis, consumer-credit outstanding totaled $1.560 trillion in December.

Losing Ground
Nonfarm business productivity and unit labor costs percentage change from previous quarter at a seasonally adjusted annual rate.

Source: Economy.com/Freelunch
E.2

Read the article entitled "Productivity Advanced 2.4% in Fourth Quarter," taken from the Wall Street Journal, February 8th, 2001. Use the information contained in the text and in the adjacent graph to address the following questions:

E2.1 Write down the equation that represents the production function, and the growth accounting equation. Complete the following table:

<table>
<thead>
<tr>
<th>GDP growth rate</th>
<th>Productivity of Capital</th>
<th>Output elasticity of Capital</th>
<th>Growth rate of Labor</th>
<th>Output elasticity of Labor</th>
<th>Growth rate of Labor</th>
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<tr>
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<td>0.7</td>
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<td>0.7</td>
<td>1.9</td>
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</tr>
</tbody>
</table>

E2.2 How much of a difference in terms of GDP growth rates did it make for productivity to grow at 2.4% instead of the 4.4% from the previous year?
Apply the rule of 70 in both cases and calculate how many more years will it take the US to double its level of GDP if productivity growth remains at 2.4% instead of 4.4%.

E2.3 The article mentions another possible reason for further economic slowdown. Identify that reason in the article and comment on the fact that the US had a historically low unemployment rate for the last two years. In other words, how would a tight labor market affect economic growth? *(extra credit)*