

The Importance of Productivity, Wages, and Shared Prosperity

State economic policy should first and foremost seek to improve the standard of living of the state's residents. Counting jobs, population, or economic output is not enough; none of these measures guarantee that incomes and prosperity are increasing for the average family.

In the long run of economic history, the only way to improve the living standards of working people is to increase productivity. Only if more goods and services are produced per unit of labor and other economic inputs can the economy generate a rising standard of living through either increased consumption of goods and services or reduced work hours and more leisure time.

Productivity gains can be achieved in three ways: by increasing capital investments, by increasing the skills of the labor force, or through technological advances. All of these strategies have one thing in common: they give workers more or better tools to be more productive. Investments in capital—buildings, machinery and equipment, infrastructure—can increase the output of workers per labor hour, or reduce the quantity of resources consumed in production. Investments in “human capital”—such as education and training—increase the skills of workers, which results in greater production per worker. Technological advances can increase the efficiency of production, allowing for lower prices for customers and/or higher wages for workers, or create new products and services that directly raise the standard of living.

This is not the end of the story, however. A healthy economy requires both that workers are productive and that workers are working. When workers are unemployed or not healthy enough to work that reduces the productivity of the economy.

Government has important roles to play in enabling rising productivity and incomes. State and local governments have major responsibilities for maintaining and improving infrastructure. Roads, bridges and public transit are part of the capital an economy needs, as are water and sewer systems, ports and waterways, and airports. State and local governments are also the primary providers of K-12 and post-secondary education, and play an important role in worker training. They provide emergency medical and fire response, insurance regulation, and criminal justice. Businesses need all these things in order to thrive.

States are also significant players in providing public health services that allow people to keep working, including Medicaid and children's health insurance. And their responsibilities for regulation in the interest of the public health, safety and welfare help to ensure that material gains bring with them genuine improvement in well-being. Together, education, infrastructure and health services account for over half of state and local budgets. The damage done to these critical services due to a tax cutting approach

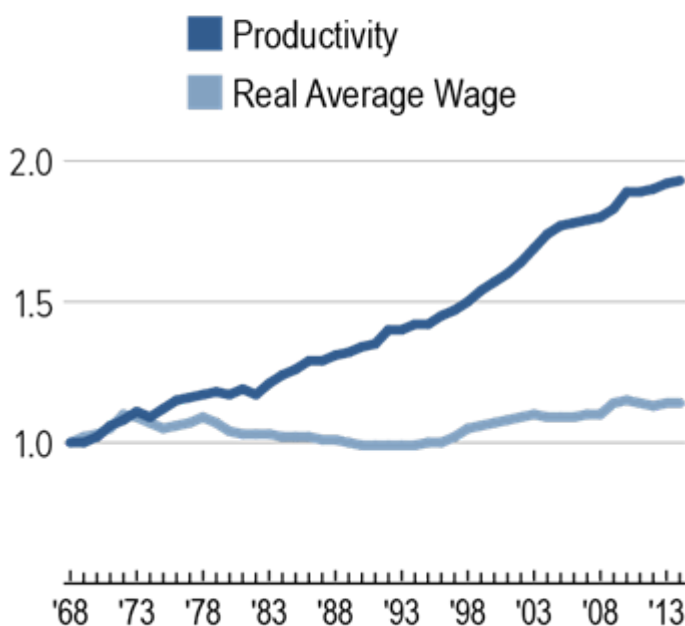
would thus guarantee that states and localities reduce their commitment to providing the very public services that generate greater economic productivity.

While increasing productivity is a prerequisite for rising prosperity, it does not guarantee that prosperity will be broadly shared. In fact, the period from 1979 to 2014 was characterized by growing productivity but also rising inequality: 70 percent of the gains in income during this period were captured by the richest 1 percent of the population.¹ **It is up to public institutions to help ensure that the gains from greater productivity are spread broadly and not captured entirely by those at the top.** They can do this through regulations that mitigate corporate power and abuse, providing a quality education to all children, creating laws that strengthening the bargaining power of workers, and establishing a tax system based on ability to pay.

Over the past 40 years, the stagnation of real wages (adjusted for the rising cost of living) has left many workers little better off than they were in the early 1970s. Real wages did not grow at all from 2008 to 2014, and were just 4 percent higher than they were in 1972; yet over this period, the productivity of American workers nearly doubled.² The minimum wage, on the other hand, has declined to only 75 percent of its 1968 value when adjusted for inflation, meaning that a full time minimum wage worker makes \$5,000 a year less today than in 1968. If the minimum wage had grown with productivity it would be more than double what it is now.

Productivity Has Nearly Doubled, But Real Wages Have Not Grown

Productivity and real average wage* 1968 - 2014



*Real wages in 2014 dollars

The share of the labor force represented by labor unions that help them bargain for fair wages and benefits has fallen drastically since the 1960s. As union representation has fallen, income inequality has risen, a pattern repeated state by state and for the country as a whole. Unions, which represented around 30 percent of the labor force in the 20 years following World War II, played a major role in the building of a more prosperous middle class during that period.

The competitiveness indexes reviewed here all pay homage to a very narrow and false view of how the world works: that state economic growth comes about in only one way, and that is by attracting business investment. It is a dog-eat-dog world in which state economic policy is reduced to a single-minded competition with other states through recruitment, incentives, tax cutting, regressive taxation, and by weakening the bargaining power of workers. As a result of this mentality, **the indexes promote policies that boost profits and income for the wealthy and large corporations, often at the expense of policies that can create improved productivity and income gains for working people.**

State economic strategy should focus instead on enhancing productivity *and* ensuring the broad sharing of gains. States can do this through policies that focus on the education and skills of workers, top-notch infrastructure, a healthy workforce, and entrepreneurship and innovation.

1.□ These statistics are based on cash income and come from Emmanuel Saez, spreadsheet updated June 2015 at <http://eml.berkeley.edu/~saez/#income>. If non-cash benefits and government transfers are taken into account, as they are in the data generated by the Congressional Budget Office, the share going to the top 1 percent is substantially lower. For the latter (through 2007), see Josh Bivens, *Failure by Design: The Story behind America's Broken Economy*. Washington, D.C., Ithaca, N.Y.: Cornell University Press, 2011, p. 67.

2.□ Real average wage of non-supervisory production workers, 1972 to 2014, adjusted for inflation using the CPI-U-RS; analysis provided by David Cooper, Economic Policy Institute, July, 2015.