

Example Undergraduate Economics Essay

Why has OECD TFP growth been so much slower in the 1990's than in the 1960's?

TFP (total factor productivity) growth is calculated as the residual from the growth accounting form of the Solow-Swan model, and as a mathematical function represents anything that changes the relationship between labour and capital, and GDP. It is clear from the statistics that TFP growth in the 1960's was significantly faster than in the 1990's, with decade averages falling across Europe and Japan from 2.6% and 4.9% respectively, to 0.7% and 1%. The USA here is a slight outlier. It did suffer a decline in TFP growth between the period – from 1.9% to 1.2% - but this is by far the smallest fall observed in the OECD. Further the USA has gone from the nation lowest ranked in TFP terms (in the 1960's) to that with the highest TFP growth in the 1990's. I will thus analyse in this essay the reasons for such a sizeable decline in TFP growth in Europe and Japan, and the reasons why the American experience has been broadly different.

In the academic literature 7 major explanations have been put forward for the high levels of 60's TFP growth. It will emerge that in fact it is the 1960's which is the unusual period of TFP growth, not the 1990's, and as such it is this that requires explanation, with the 1990's best seen as merely an absence of such exceptional circumstances.

The 1950's and 60's was a period of major trade liberalization in the aftermath of World War Two. Across the OECD countries trade volumes grew at 9.2% per annum between 1950 and 1973, compared to just ½% per annum growth in the period 1913-1950. The source of this was the series of GATT initiatives resulting in a wide scale reduction of trade barriers to negligible levels. The creation of the EC further accentuated this process in Europe. Trade liberalisation can partly explain the much higher rate of European growth compared to America as European trade and industry were much worse hit during the war period, and thus had more ground to

regain. Olsen has also argued that, especially in Europe, trade liberalism played a significant role in breaking down national interest group barriers to growth, but the size of this 'Euroscelerosis' effect has been widely questioned.

Secondly there was significant structural change occurring in the composition of the labour force throughout this period. There was a sizeable shift of labour from low productivity agricultural sectors (agricultural labour's share of the total labour force fell from 64% - 34% from 1913 to 1987 across the OECD countries) to high productivity manufacturing and service sectors. This significantly boosted overall labour productivity and was an important component of the continuation of high TFP growth through the Golden Age. The effects were greatest in Japan and least in the USA due to the relative sizes of their post-war agrarian labour forces, and thus the potential for productivity increases from structural switches.