President's Message

William Poole

The driving force behind economic growth is productivity, a product of embodied technological progress and capital deepening. A number of other factors can affect productivity and, thus, the trajectory of the economy, including demographics and labor force participation. Structural change in the labor market, spurred by innovations in communication or changes in regulations, can also dramatically alter the landscape. Understanding these factors is critical to economic policymaking.

As is well known, U.S. productivity growth has been far from constant. Prior to World War II, productivity growth averaged about 2 percent per year. From the end of the war to 1973, productivity growth averaged about 3 percent per year. Then we suffered the *Great Productivity Slowdown*, during which productivity growth fell precipitously to an average of 1.5 percent per year from 1973 to 1995. A revival started in 1995; from that year to date, productivity growth has averaged 2.9 percent per year. Remarkably, the recent recession and slow recovery has not dampened productivity growth, which has averaged 4.0 percent since the first quarter of 2001.

Compound interest is the eighth wonder of the world: If labor productivity continues to grow at 3 percent per year, real per capita gross domestic product (GDP) in the United States will increase from $35,700 in 2003 to $48,000 by 2013. Conversely, at the slower 1.5 percent growth rate, real per capita GDP will rise to only $41,400, nearly $7,000 per person less.

Fluctuations in productivity growth give rise to a number of important questions, some of which we hope to address in this conference. Specifically, what factors lead to shifts in productivity growth and how these are different from the forces that create cyclical fluctuations. We will investigate whether these factors we know to be key determinants of long-run growth can also be the primary influences for cyclical fluctuations.

Many economists have argued that the shift in productivity growth in 1995 occurred because of a recent increase in investment in, and implementation of, information technology (IT). The share of GDP tied to investment in the IT sector is now more than 50 times what it was in 1975. Increasing productivity in the IT sector has spurred sharp declines in the prices of computers, helping to drive investment in the late 1990s. Aside from the direct impact this IT capital investment has on enhancing labor productivity, the rapid rate of investment leads to a rise in productivity growth through capital-deepening.

But increased investment in IT alone cannot fully explain all of the business cycle phenomena we have experienced throughout the postwar period. As we will see over the course of this conference, a myriad of other factors can influence the behavior of both long-run growth and cyclical fluctuations. For example, the structure of the labor market and the rate of organizational restructuring during booms and recessions can affect the cyclicality of key business cycle indicators and perhaps help explain the occurrence of the recent "jobless" recoveries. We will learn whether these jobless recoveries represent, in fact, aberrant business cycle behavior or whether we can draw inference from economic history to explain their

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existence. Finally, we will investigate how the reaction of monetary policy in the presence of such a changing environment influences real outcomes and that, perhaps, the familiar Taylor-type monetary reaction functions we have become used to as policymakers might lead to results different from what we expect.

So, I welcome you to the St. Louis Fed's annual research conference and will now get out of the way so the fun can begin.