

Growth and Renewal in the US

This document is a summary of a report from McKinsey published on February 2011. It was released by InterInnov on 12 March 2011.

To deliver economic prosperity to the next generations, the US needs to retool the economy's engine for higher, sustainable, growth rate. The key to achieve this is productivity.

The US needs to rely on productivity to deliver growth and competitiveness

Increases in labor and productivity have always powered growth. Labor has contributed to 1.6% to annual GDP growth since 1960. At the same time, productivity rose at an average 1.7% annual rate as new technologies emerged. Together, they contributed to an annual GDP growth of 3.3%. In the first decade of the 21st century, productivity gains have contributed 80% of the total GDP growth, compared to 35% in 1970s.

The US is not alone in facing this productivity and growth challenge. Japan and Western Europe are too. Indeed, in the EU-15, the working-age population is projected to fall by 4% over the next 10 years. As a result, the EU-15 will need to accelerate productivity growth by more nearly 60% if they are to sustain their past growth rates.

GDP and productivity growth are vital for competitiveness, ensuring that the US remains more an attractive place in which business can operate, invest and expand. The correlation between productivity and competitiveness is well established. Productivity is the key to ensuring competitiveness and growth, for sectors and individual companies at a national level.

Accelerated productivity growth must include both efficiency gains and increases in the value and quality of goods and services produced

The necessary acceleration in productivity can come either from efficiency gains (reducing inputs for given output) or by increasing the volume and value of outputs for any given input. The US needs to see both kinds in order to experience a sustainable growth.

In the second half of 1990s, two sectors (large-employment retail, and very high-productivity semiconductors and electronics) collectively contributed 35% to that period's acceleration in productivity growth. In contrast, the largest productivity gains since 2000 have come from sectors that experienced substantial employment reductions. Computers and related electronics, the rest of manufacturing and information sectors have contributed around half of overall productivity growth but reduced employment by almost 4.5 million jobs.

The US has large untapped potential to increase productivity and growth

The US productivity engine is not running out of steam. Tradable sectors such as manufacturing will need to keep improving their productivity in the face of intense global competition; domestic sectors such as retail will need to do the same to cope with strong domestic competition. Sectors that have been persistent productivity laggards (public sector and regulated sectors such as health care) have the potential for dramatic productivity gains.

These identified opportunities can diffuse best practices and implement emerging business and technology innovation that could achieve three-quarters of the productivity growth acceleration needed by the US. The rest of the acceleration can come from making structural changes in regulated sectors and strengthening productivity enablers.

The US needs to tackle seven priorities to achieve the remaining productivity acceleration

The American economy continues to fall short of creating 200,000 jobs required each month to bring unemployment down to 5% by 2016. Government and consumer deleveraging will bear down on GDP growth. The US needs to address issues of weak aggregated demand, debt and deleveraging, the stability of the financial system and the deficit. The US needs to meet seven major imperatives to achieve the productivity growth that is required to sustain its historic pace of GDP growth and continued prosperity:

- Drive productivity gains in the public and regulated sectors. These sectors represent more than 20% of the US economy but their low productivity growth slows the economy growth. Application of managerial innovations and productivity best practices learned from the private sector are consistent with the broader goals of improved health and education outcomes.
- Reinvigorate the innovation economy. Innovation can increase the quality and quantity of goods and services produced. US policy and regulation should provide the right incentives for private companies. The US needs to ensure that the IT infrastructure and technologies are in place to capture fully the transformational potential of digital technology.
- Develop the US talent pool to match the economy of the future and harness the full capabilities of the US population. The US may face a shortfall of almost 2 million technical and analytical workers over the next 10 years. In the aerospace sector, 60% of the workforce is over 45 years old. The US could improve incentives to technical and analytical training. It could also remove barriers to older workers staying in the workforce longer. Another front for action is immigration of skilled workers.
- Build 21st century infrastructure. US infrastructure is inadequate to meet the needs of a dynamic, growing economy. Multinational companies rank infrastructure among the top 4 criteria they use to make decisions about where to invest.
- Enhance the competitiveness of the US business and regulatory environment. Their competitiveness is declining. The US needs to reduce regulatory complexity, streamline the process of resolving disputes and eliminate remaining sector –level barriers to more robust competition.
- Embrace the energy productivity challenge. Global demand for energy is predicted to rise over the next 20 years, imposing increasing environmental costs. The global focus needs to shift to how to use existing energy supplies more productively. Clear long-term policy could encourage the market discipline that drives productivity.
- Harness regional and local capacities to boost overall US growth and productivity. Cities and regions in the US have different growth and productivity trajectories and there is insufficient sharing of best practice among them. All levels of government should seek cross-regional alliances in economic development.