
Special Debate Section

Beware the Fallacy of Productivity Reductionism

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Drawing from classical economics and his own insights as a Saint Lucian, Arthur Lewis (1954, p. 442) tackled the question as to ‘why tropical produce is so cheap’:

Take for example the case of sugar. This is an industry in which productivity is extremely high ... [with] a rate of growth of productivity which is unparalleled by any other major industry in the world – certainly not by the wheat industry. Nevertheless workers in the sugar industry continue to walk barefooted and to live in shacks, while workers in wheat enjoy among the highest living standards in the world.

To answer this question, he focused on factoral terms of trade in the open-economy version of his famous model of economic growth with unlimited supplies of labour. He argued that because wages are set in what he called ‘subsistence sectors’ rather than in capitalist export sectors, the benefits of increasing productivity in the latter accrue chiefly to the (Northern) importers of these exports by way of lower prices. Hence, he contended that ‘the prices of tropical commercial crops will always permit only subsistence wages until, for a change, capital and knowledge are put at the disposal of the subsistence producers to increase the productivity of tropical food production for home consumption’.

Later in his life, Lewis (1978, p. 36) similarly predicted that even as developing countries would move into manufacturing exports, these new exports would function in a manner similar to the previous agricultural export commodities, in the sense that increasing productivity would simply reduce the prices of such manufacturing exports. If we are to believe the evidence regularly laid out by UNCTAD,¹ for instance, this prediction appears to have proven true in the three decades since he made this prediction, at least for the huge increase in Southern manufacturing exports that are integrated into international production networks dominated by transnational corporations.

This usually overlooked dimension of Lewis’ theorisation takes us to the core of what might be called the fallacy of productivity reductionism. The fallacy is based on the assumption that monetary valuation can be used as an accurate approximation of productivity in a complex modern economy. Similar to early neoclassical theory in the late nineteenth century, which collapsed the distributional concerns of classical economics into a calculus of market allocation, this modern neoclassical assumption contributes to the myth that the rich are rich due to their greater productivity than the less rich, and thus, by implication, that their wealth is a fair and just reward for effort. This assumption arguably lies at the heart of ideological efforts to legitimate the inequalities of the current world economic order and must be addressed as part of any politics of poverty and inequality reduction.

In this respect, UNRISD's (2010) recent flagship report represents an admirable effort to shift the global agenda towards a much more progressive politics. It revives an older tradition of structuralist analysis in combination with seminal advocacy for universalistic agendas in poverty alleviation and social policy. On these matters, the report offers vision and perspective to the mainstream consensus that has reigned over development policy for the last three decades. At the same time, however, elements of the UNRISD report nevertheless appear to adopt this fallacy of productivity reductionism. The continual emphasis in the report on the need to raise productivity, without necessarily framing this emphasis within a broader understanding of the monetary valuation of output, appears acquiescent to contestable mainstream approaches to measuring productivity and, hence, to underlying justifications for the structural foundations of inequality at both local and global levels. Moreover, the issue of transnational ownership – which is closely connected to the monetary valuation of output – is mentioned on page 4 of the overview of the UNRISD report as one of three highlighted factors that undermine efforts to adopt employment-centred growth strategies, although even on the same page, this issue is not elaborated in the list of four deliberate policies to be pursued as antidotes. Indeed, throughout the rest of the report, the issue is mostly treated under the rubric of the price (or terms of trade) effects of global integration or else corporate social responsibility, but not in terms of the institutional mechanisms of accumulation that increasingly operate through transnationalised structures and networks in the Global South today.

Notably, terms of trade do not necessarily explain the full causality by which global integration has been associated with the anaemia of employment generation in most developing countries over the last 30 years. This requires a deeper understanding of how global integration has been related to the extension of transnational networks and the rerouting of monetary flows (and, hence, the circulation of aggregate demand) towards the centres of these networks, mostly concentrated in the Global North (with perhaps recent and debatable exceptions related to the rise of India and China). These transnationalised networks arguably undermine the effectiveness of the more proximate policies recommended in the UNRISD report, in terms of eroding the ability of governments to retain within their national economies the value generated by increasing productivity together with the distributive and redistributive potential of these productivity increases. They also crucially underlie the erosion of progressive taxation systems in the North and the obstruction of similar systems from emerging in most countries of the South, and hence are central to the discussion of the possibilities of universalising social policy in the current context.

From this perspective, the fallacy of productivity reductionism points to a little recognised convergence between earlier traditions of structuralist and post-Keynesian economic thought. From the post-Keynesian side, perhaps the most practical insight that can be distilled from the otherwise highly abstract 'Cambridge capital controversies' of the 1960s is the point that, in a monetary world with heterogeneous goods and services, 'capital' is effectively almost impossible to measure in any coherent aggregate sense, in contrast to mainstream (broadly neoclassical) approaches that treat capital as substitutable and, hence, more or less identical to consumption goods (such as corn for planting and corn for consumption). Similarly, aggregate 'productivity' can only be understood in terms of monetary valuation (that is, through prices), not in physical terms (this point should be obvious with respect to services). It should be recalled that Paul Samuelson (1966) implicitly conceded defeat in these debates to Joan Robinson and Piero Sraffa. His concession was subsequently ignored by most mainstream economists,

particularly from the 1980s onwards,² who continued to assume that complex modern industrial economies essentially function in the manner suggested by the one-good (or identical two-good) world imagined in the production functions of standard neoclassical theoretical models (and the so-called New Keynesian variants). In these models, capital and productivity are treated as if they can be measured in physical terms, such as in the total factor productivity measures derived from one-good moneyless growth models of the Solow variant. It is in this sense that the bulk of contemporary economics can be described as a faith-based discipline.

In consequence, most mainstream approaches to measuring productivity almost always rely on value-added national accounting data in various ways as a means to approximate aggregate productivity, whether at industry, sectoral or economy levels. The justification for this has been partly based on early econometric work by Kenneth Arrow, Hollis Chenery, Singh Minhas and Robert Solow. Starting with the 'empirical observation that the value added per unit of labour used within a given industry varies across countries with the wage rate', these authors concluded that most of 'the variation in labour productivity is explained by variation in wage rates alone' (Arrow *et al*, 1961, pp. 225 and 228). In other words, the implication is that variations in wage rates are mostly due to labour productivity. However, as pointed out in the meticulous theoretical work by Felipe and McCombie (2001, p. 1222), these results were essentially the product of tautology – that is, 'the estimations of production functions [are simply] capturing an underlying accounting identity [that value-added equals the wage bill plus profits] Hence, regressing output on the inputs is bound, almost by definition, to give a very good statistical fit'. To the extent that this contention is true, it undermines the whole edifice of aggregate productivity measures that have since been elaborated on the basis of the results of Arrow *et al* (1961), as noted in subsequent work by Felipe and McCombie (2003, 2006).

The problem with using value-added as a proxy for productivity is that value-added represents a combination of output (tangible and intangible) and prices/wages. 'Productive' employment in the tertiary sector, for instance, is as much a reflection of wage rates in that sector as any notion of productive output *per se* (for example, what is the output of a lawyer or a bureaucrat?) Hence, the use of value-added as a shorthand for productivity leads to absurd logical implications, such as the suggestion that a barber in the United States is 30 or more times more productive than a barber in India even though they both 'produce' the same number of haircuts per hour (according to the tastes and expectations of their clients), simply because the wage of the barber in the United States is 30 or more times higher. Or else, within the United States, that the 'productivity' of a lawyer is 20 times higher than that of a barber. The lawyer's labour is certainly more valued than the barber's, whether or not for good reason, but this has little to do with productivity (unless we consider that the power to leverage higher value for one's labour is, in itself, a form of productivity). In other words, much of what we are picking up in most conventional measures of productivity actually amounts to price or wage differences, not actual effort or output, especially in economies that are increasingly based on services.

The idea that such differences in wage rates can be explained by obstructions to the free flow of goods, services and capital across borders also becomes increasingly absurd the more the global economy liberalises (and becomes increasingly unequal as well). This fallacy becomes especially pertinent when considered in light of the increasing transnationalisation of production and distribution in the post-war era (although it was also very pertinent during the colonial era for similar reasons as well). For instance, when an increase in the value-added of the tertiary sector is recorded in the United States or

Europe – such as in the categories of management, finance, marketing, trade or research and development – this is usually interpreted as increasing productivity in this sector (and increasing economy-wide productivity if this results in overall economic growth). Yet, at least part of such an increase might well represent processes of financialisation, whereby levels of remuneration in the financial sector are allowed to rise to unheard of heights. Or else, expansion in these categories might partially represent inflows of profits through a wide variety of channels from Southern subsidiaries to the headquarters of Northern-based transnational corporations (often via various offshore laundering centres). When a transnational corporation practices transfer pricing – or equivalent practices that have become standard in international accountancy – as a means of transferring profits from a Southern subsidiary to a head office in New York or London, the subsidiary appears less productive as a result, whereas the head office appears more productive (insofar as productivity is measured in value-added terms). Ironically, the actual producers of goods – who are increasingly located in the Global South – might well be accused of being inefficient (in value terms) and in need of extra structural adjusting as a result of such appearances, even though they might be working very diligently and investing in a whole myriad of ways in order to keep up with the competition. In such circumstances, the precise meaning of ‘being productive’ is difficult to pin down, except in cases of physical output of comparable goods.

Indeed, this was a key insight in the work on transnational corporations in Latin America by earlier structuralists such as Osvaldo Sunkel (1972) and Constantine Vaitsos (1973). These authors had increasingly highlighted the often deleterious effects of rising transnational ownership structures on domestically oriented forms productive accumulation, including problems of polarisation (that is, increasing inequality) and marginalisation. We would presume that their insights hold even more relevance today given the subsequent and mostly unregulated proliferation of the practices that they were analysing at that time.³ Even in the case of China, it is probable that a large proportion of the current trade surplus represents transfer pricing by foreign corporations, as one among several illicit means of moving capital into China, which in turn is facilitated by the fact that foreign corporations officially account for over half of China’s trade surplus.⁴

These issues also highlight the importance of ownership and/or control over processes of value circulation in monetary economies, and the insidious siphoning of wealth that usually results from a dominance of foreign ownership in the peripheral economies of the Global South.⁵ Effective outflows of wealth, whether through licit or illicit capital flows or else through subtle processes such as transfer pricing, undermine the monetary aggregate demand in these economies that would otherwise contribute towards enhancing employment generation, as well as the fiscal revenues required to finance comprehensive social policies. It is also in this sense that national ownership plays a hugely important role in efforts to retain wealth within national economies, thereby capturing the benefits of productivity increases when and where these take place. For similar reasons, national ownership has been one of the principal targets of ideological attack under the last 30 years of neoliberalism, with the front line currently targeting China under the guise of accusations of currency manipulation.⁶

Raising productivity in the Global South is obviously an important component of poverty alleviation and efforts to reduce inequality, particularly if the resulting wealth is used in ways that genuinely improve well-being among the poor. For instance, small-scale farmers would obviously benefit from raising their output on both their existing plots of

land and, ideally, on enlarged land holdings (which, by implication, would require land reform). However, such self-evident examples are often used to simplify and legitimise the more generalised patterns of inequality in our world today, which are much more obscure in terms of a direct connection between physical effort or output and poverty. The underlying fallacy of productivity reductionism is imperative to recognise because, otherwise, an obsession with raising productivity risks being turned into a powerful ethos for disciplining an increasingly Southern global workforce together with nationally based productive capitalists, both subordinated into global networks of production and distribution that increasingly control the most lucrative flows of value in our world economy.

In other words, contemporary poverty and inequality reduction in our monetary world cannot necessarily be addressed by making poor people work harder and better, but by addressing how their work is valued. Valuation in turn is often only marginally related to productivity, particularly as populations move out of agriculture, bypass manufacturing and enter the service sectors. By clarifying this point, we can gain insight into some of the fundamental challenges that need to be faced in order to achieve just redistribution at a global level, and into some of the fundamental political economy processes that have been undermining equitable development in both North and South over the last three decades.

Notes

1. For instance, see UNCTAD (2007, pp. 11–12) or UNCTAD (2002, pp. 113–138) for more detailed discussion.
2. See Cohen and Harcourt (2003) for an excellent discussion of this point.
3. For instance, see Bernard *et al* (2008).
4. See Fischer (2010b) for further discussion.
5. See Ndikumana and Boyce (2011) for some interesting estimates of capital flight from sub-Saharan Africa.
6. See Fischer (2010a).

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