

MAY 31, 2005

VIEWPOINT: BLONDER

By Greg Blonder

# Policy That Rewards Productivity

**The theory that governments should encourage the wealth creation is sound. The means of reaching that goal, however, tends to be faulty**

One day an Army friend of mine was assigned to KP duty, peeling potatoes by tossing them into a rotating, barrel-shaped grater. His sergeant made it clear that if even one speck of brown skin spoiled his mashed potatoes, KP duty would become death by KP. So my friend -- no fool -- grated sacks of brick-size Idaho potatoes into handfuls of pure white golf balls -- oblivious to the waste of time, money, and carbs.

The machine was efficient, but the sergeant's policy wasn't. And so the Army had a most unproductive day.

Similarly, America, while also an efficient "machine," is letting poorly conceived economic policies erode its vast productive capacity at a dangerously competitive moment. Unfortunately, these policies are based on an inadequate understanding of wealth creation.

Real wealth emerges only when we discover ways to produce something vital for less. That means, for example, selling higher-performance computers, which once cost \$3,000, for \$300. Or it could entail using half as much coal to refine the same ton of steel.

**GOOD, BAD, AND STUPID.** Such transformations work almost magically as they free scarce resources and raise the average standard of living. People who would have spent \$3,000 for a computer now have \$2,700 to invest in something else, say, in their savings or toward improving early childhood nutrition.

But the goal has to be vital as well. Merely halving the cost of shipping bottled water from Hawaii to New York may be efficient, but drinking local tap water is a much more productive use of resources.

Unfortunately, most of America's current governmental incentives don't encourage wealth creation. They confuse spending money with creating value. Not all jobs are equally productive, and not all subsidies are equally vital.

What governmental incentives do I include in this category? The list covers farming subsidies, enterprise zones that encourage locating factories or apartments in blighted neighborhoods, mortgage deductions, and even R&D tax credits. Such policies merely kidnap economic activity from one region to another or foolishly reward effort instead of results.

**"PHANTOM PRODUCTIVITY."** A new stadium may entice a team across state lines, but for every new job and new box seat created, it leaves a perfectly good stadium and perfectly good jobs behind. A crop subsidy keeps the family farm alive, but reduces the incentive to raise the yield per acre, thus increasing the price of food for everyone and making imported food even more attractive. A mortgage deduction encourages home ownership, but does nothing to make housing more affordable or reduce onerous real-estate fees. And it certainly does nothing to improve energy efficiency.

These kinds of subsidies only encourage what I call "phantom productivity."

But what if the government were to institute genuine productivity-enhancing incentives? Such incentives could kick in, for example, whenever a company demonstrates that it could profitably make and sell a product with the potential for broad economic impact for 10% less than one that is already on the market. The greater the productivity improvement, the greater the subsidy.

**A RISING CHALLENGE.** This is, of course, is a radical proposal. Instead of taxing the increased profitability that often flows from better productivity, we would be reinforcing success -- giving creative innovators a double boost of profits, plus subsidy. Companies that boost productivity significantly could grow faster. Marginal companies that still manage to enhance productivity would survive and have a better shot at long-term profitability. Overall, real wealth would expand, and our society would become more vibrant.

But what could possibly induce us and our various governmental bodies to abandon decades upon decades of the unproductive, but politically satisfying policy fostering phantom productivity? Only the recognition that U.S. economic competitiveness faces what is probably the greatest threat in its history. As I have argued in previous columns (see BW Online, "[Getting America's Groove Back](#)" and "[America Needs Unchained Spectrum](#)"), we're U.S. is in serious danger of losing our entrepreneurial and technological edge to faster growing economies.

There are nations whose citizens routinely work 6 days a week, 12 hours a day, who are turning out several times the graduate scientists and engineers we are. These countries are not shying away from adopting the latest in genetic engineering to lower the cost of food. And they remain largely unburdened by supporting a superpower-style military, and they certainly don't have to repair an aging infrastructure.

**SOME MODEST PROPOSALS.** Facing up to this challenge would require enlightened, energetic political leadership. But given that, I think we would find that a policy of promoting genuine productivity would prove easier than we might, at first, imagine.

The goals of such a policy would be straightforward and clear, and it would encourage a spirited public debate, one less distorted by politics. It's one thing to distribute a military program across 17 states and 50 companies. It's quite another to reward any contractor that brings in a product under budget and over spec.

The evaluation process for rewarding productivity could be relatively transparent:

- An energy incentive, for example, could be awarded if the energy used to manufacture a product declined by 20% every year, something that would be easy to measure.
- A construction incentive could be awarded if apartments of similar or better quality could be built for \$10 less per square foot than what's currently on the market. This would make housing more affordable because it really is less expensive, rather than subsidized.

The government wouldn't be "picking winners." It would reward winners picked by the market and would do so by using transparent criteria. And those that fail would do so on their own nickel, not the government's.

No country can long afford to squander precious resources, even cheap potatoes and buck privates. But America's incumbency can be our strength -- if we leverage today's economic engine into tomorrow's productive enterprise.

Greg Blonder is a general partner at Morgenthaler Ventures and is based in Princeton, N.J.  
*Edited by Ira Sager*

Copyright 2000-2004, by The McGraw-Hill Companies Inc. All rights reserved.  
[Terms of Use](#) [Privacy Notice](#)

