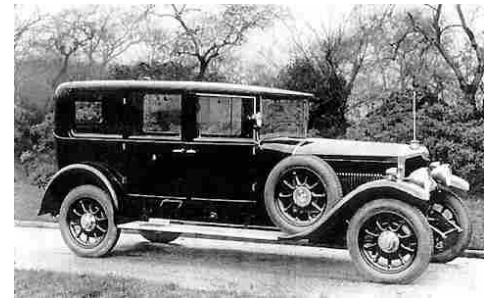


# The Productivity Premium

(aka Baumol Effect, Cost Disease, etc)



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- But our alarm may be misplaced: As our collective productivity grows we can actually afford more than ever before. Thus I prefer to call this phenomenon the “productivity premium”.

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- But our alarm may be misplaced: As our collective productivity grows we can actually afford more than ever before. Thus I prefer to call this phenomenon the “productivity premium”.
- I illustrate this effect with the following “toy model”

# Productivity Premium Toy Model

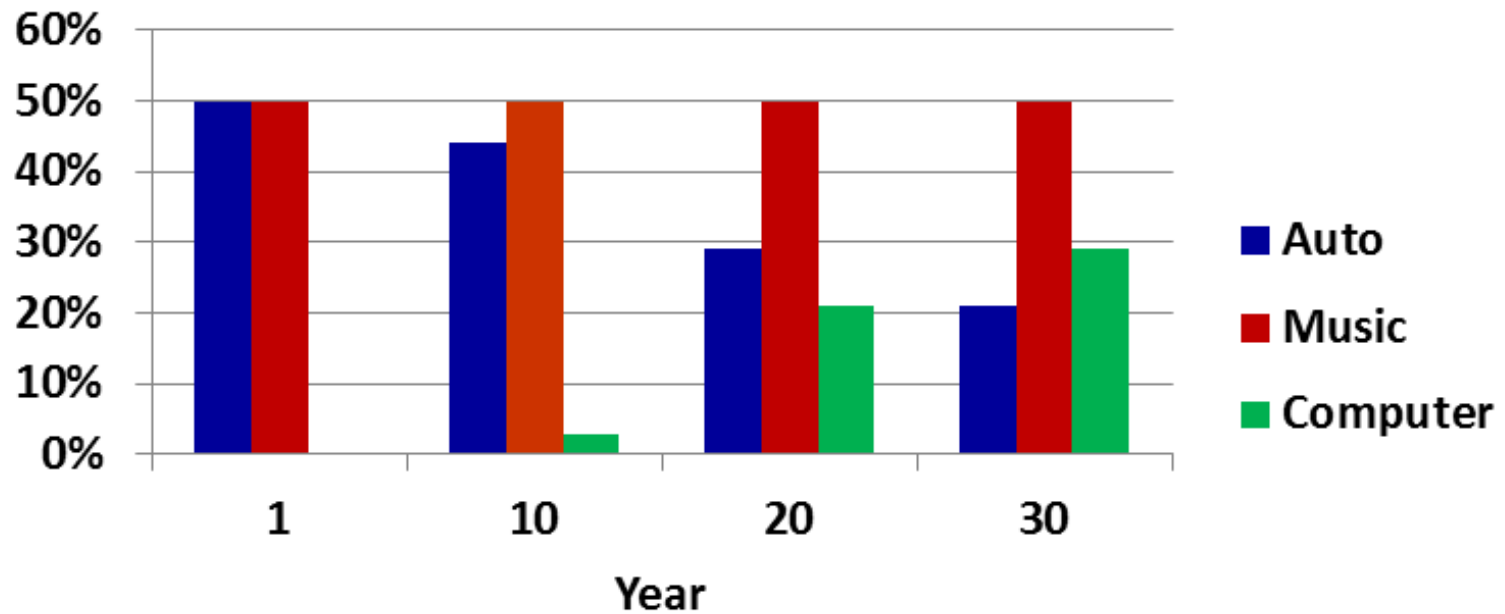
- Only two sectors of the economy:
  1. Auto worker
  2. Jazz musician (live)
- Productivity increase per year:
  1. Auto worker: 3%
  2. Jazz musician: 0%



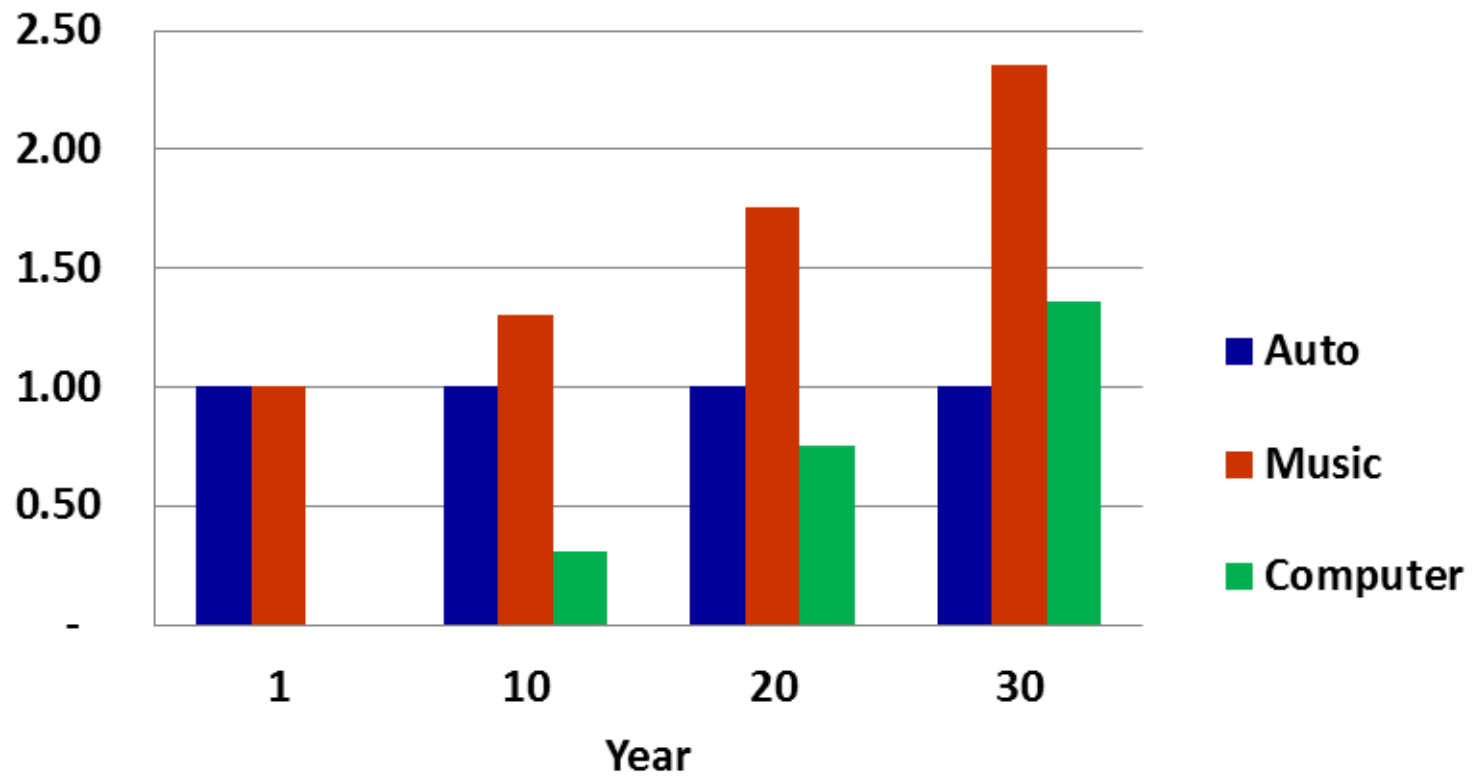
## Productivity Premium Toy Model

- Other assumptions:
  - The population does not change
  - The demand for live jazz and autos does not change
  - Increased auto productivity translates into higher wages
  - Jazz musicians successfully negotiate wages that track those of auto workers
  - Worker no longer needed to build cars find new jobs in a new sector of the economy (“computers”), which has productivity that also increases at 3% per year.

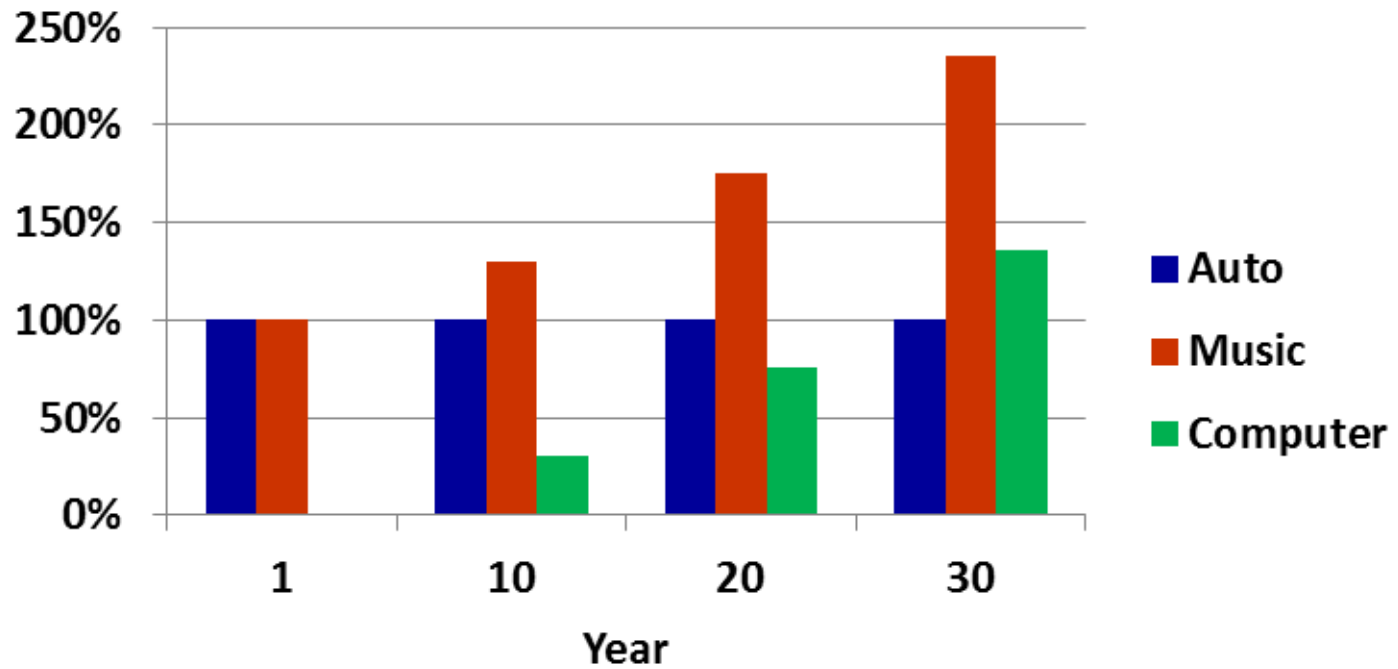
## Fraction of total labor used in each sector



## Total labor costs

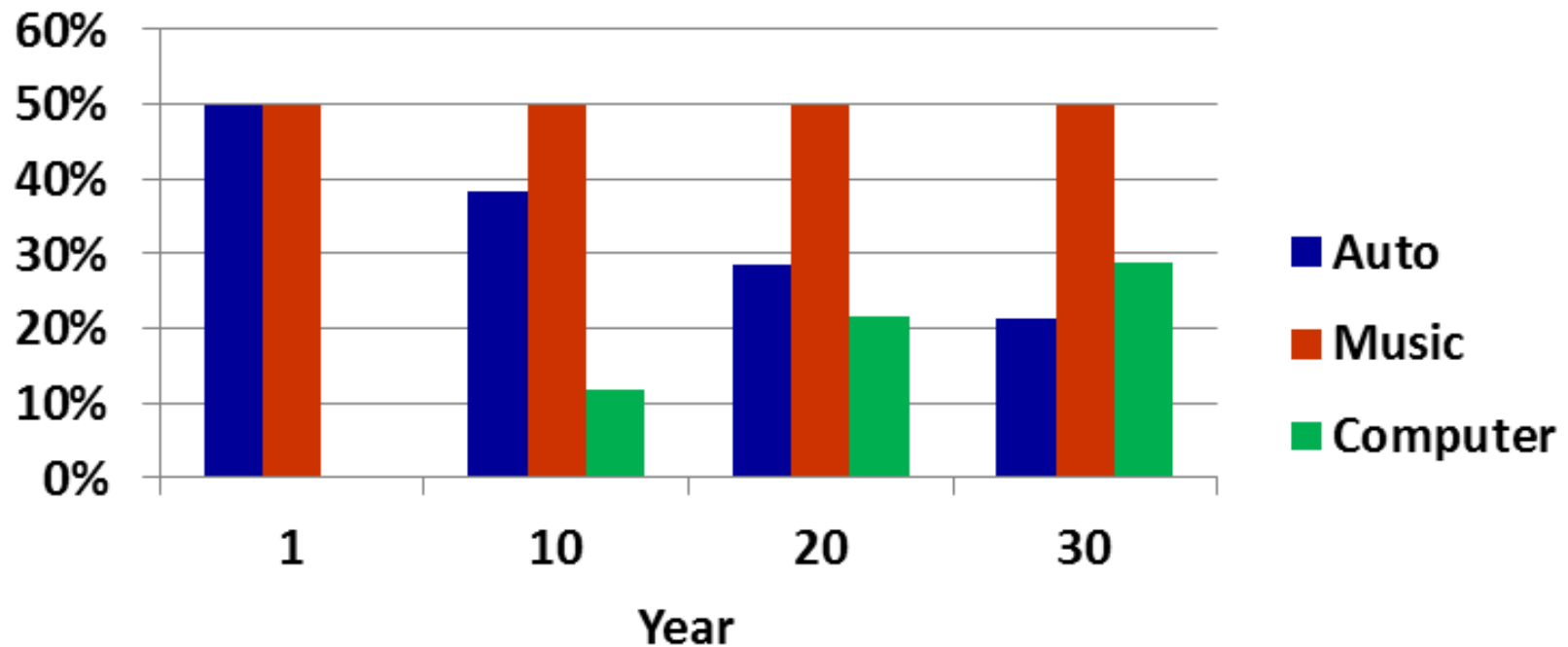


## Product costs





## Expenditures on each product as % of income



*Even though the cost of live jazz is skyrocketing, it remains just as affordable as ever (in fact it is more affordable, since you can choose to spend your “computer money” on jazz performances instead).*