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# Labor Productivity & Creating Wealth

by Matt Hagny

PERSPECTIVE

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Photo by Tony Downns.

Everyone has heard of the work ethic, and hard-working people are often esteemed in many cultures. While a certain amount of wealth can be created by working hard (and saving), throughout history, by far the largest driver of wealth creation has been technology. (Lest the point be missed, it is wealth that improves living conditions, including health.) For instance, comparing amongst countries down through the centuries, the large majority of any increase in income per person (adjusted for inflation) came from *growth in productivity* per worker, and almost all of this was from technology.<sup>1</sup> (Technological advances have completely eliminated some types of work, such as switchboard operators, prompting an editorial a few years ago in *Forbes* magazine rejoicing over job *destruction*—yes, we should celebrate all the things we don't have to do anymore, for that indeed is progress.)<sup>2</sup>

How does this relate to farming? The point I'm making is that *improvements in farm profitability will have very little to do with 'working harder'* (i.e., working lots of hours per year on increasingly trivial things), and a *great deal to do with making better decisions*, including deploying your work hours for the year at the most important tasks, as well as investing in appropriate technologies. In other words, having good labor productivity, which we might define as returns to labor divided by hours worked ('returns to labor' would be net farm profit minus 'fair-market' returns to equity, say 8% or whatever.)

If not already engrained, you as the farm manager and/or laborer should get in the habit of thinking about how much return *per hour* is being generated by the activity at hand. Don't get too fanciful with your estimations, however—yes,

such and such *could* have great implications and returns, or it may not make one whit of difference and the return is zero (or negative). Perhaps it's best to think about what the market value would be for that task—if you hired someone to do the task (operate your machinery, or shop tools), what would it be worth? Many will fuss and say, "But they won't do it right," although this is just an excuse—it is management's problem to figure out how to keep employees on track, and what parameters of the task are truly important and need to be monitored, and what things get less attention. It isn't a contest to see who can drive the straightest or whatever; this is a business. And besides, who's to say whether the way you want it done is really the absolute 'best' way? (None of us is that perfectly rational and far-seeing.) Being a control-freak isn't all bad, so long as you have a healthy dose of self-doubt to go along with it.

**Farmers and ranchers should think of themselves as management first, and labor secondarily.**

Other excuses for not hiring labor include lack of availability. This is indeed a concern in some of the least-populated areas, but there is always somebody out there if you bid up.<sup>3</sup> Can't pay enough? Again, this could be viewed as a management shortcoming: maybe you should scrutinize your activities more closely, or perhaps you are poorly positioned and need to re-evaluate overhead and other expenses per unit produced, or even whether you should *be* in the business.

It should be obvious that skilled labor commands a higher price per hour than unskilled labor. But management would command a higher price yet in the marketplace, with good reason (fewer people can do it well). And generally we see that some of the most profitable farms retain

<sup>1</sup> We are accustomed to thinking of returns on capital (ROAs) and returns to labor (salaries and wages, or the opportunity cost of working for yourself), but these are both income sources *for persons* since all capital is ultimately owned by someone. And any increase in per person income (adjusted for inflation) for a society ultimately depends on: A) capital accumulation invested, or, B) gains in productivity per worker, which is to say, deployment of technology and skills. Changes in hours worked per year may have some effect, but over long stretches of time the only substantial gains in modern societies are from greater productivity per hour worked. Capital markets, and capital itself, are human innovations, and can thus be viewed as technology. See generally W.J. Bernstein, 2004, *The Birth of Plenty*, McGraw-Hill. See also G. Clark, 2007, *A Farewell to Alms*, Princeton (Clark shows that essentially all of the economic gains since the Industrial Revolution derive from improvements in labor productivity, and about 3/4 of this is due to greater efficiency from know-how ["production knowledge," i.e., skills and technology] and only 1/4 from greater physical capital deployed per laborer).

<sup>2</sup> W. Baldwin, 1 Nov. 2004, In Praise of Job Killers, *Forbes*.

<sup>3</sup> That (inflation-adjusted) wages continue to increase is a wonderful thing: It means the standard of living has risen in your society.

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