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Structural Change within the Services Sector and the Future of Cost Disease

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Abstract:

In his seminal work, Baumol observed that developed economies suffer from cost disease, i.e., aggregate productivity growth falls because structural change reallocates production to services with low productivity growth. We document that cost disease importantly contributed to the productivity growth slowdown in the postwar U.S. To assess how severe cost disease may become, we build a model of structural change among the goods sector and broad services sectors. Calibrating the model to the postwar U.S. implies that broad categories of services are substitutes and the services with low productivity growth do not take over production. Simulating the calibrated model forward implies that future cost disease will be less severe than the past one.

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Full text

