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Productivity in crisis – short-term development and long-term prospects

Lunchtalk, Bruegel, 8 Apr 2013

This lunchtalk provided an insight on the evolution of productivity in Europe. Productivity is an important topic of interest, since it represents a sustainable force of economic growth with positive implications for wages and consumption.

Bart van Ark presented an overview of supply and demand trends in Europe since the crisis. He outlined that, on the one hand, aggregate and sectoral growth analysis shows that the productivity problem has spread across sectors in the economy but, on the other, market services further increased their contribution to global value chains, both in terms of job creation and productivity.

Analysing the long term supply side, productivity growth in the EA has continued to weaken since the mid-1990s. Moreover, by decomposing GDP growth, Europe shows a high volatility in TFP (the sustainable component of productivity growth), with a measured contraction in 2012. According to van Ark, the United States are just marginally better than the EU, with the second slowest labour productivity growth after WWII, and with a declining trend in TFP growth from 2011, suggesting that the productivity effects from ICT applications have begun to erode.

High heterogeneity is observed among European countries with Germany, for example, showing an increase in GDP and GDP per capita and a decline in output per hour, while France exhibiting a steeper decline in GDP per hour, as a result of a fast deceleration in GDP growth and hours worked. Another interesting comparison is between Spain and Poland, they both accelerated their productivity growth in terms of labour productivity, but in the case of Spain is the result of a more substantial reduction in labour than in output, while in Poland is due to an expansionary productivity path.

Europe as a whole is displaying a negative total factor productivity growth, giving the theoretical implication that Europe is reversing on technological growth. The reasons for that, in addition to the negative effect driven by recession, are to be found in a weak technological progress, misallocation due to rigidities in labour, product and capital market, and a negative reallocation effect with resources going to less productive sectors in the economy.

The demand side analysis is based on World input-output tables (WIOD) for global production structure and final demand. Employment in goods sector due to foreign demand has increased in Germany and Poland but stalled in France and Spain from 2000 to 2009. In the non-goods sector changes are even more dramatic: Germany and Poland are contributing more of their employment to the global value chain type of production, while France and Spain show a big decline. From a comparative perspective, Europe lost a small amount of jobs contributing to the foreign demand in the goods sector, but in the case of the non-goods sector EU increased the number of jobs in GVC, with an overall better situation than US and East Asia.

Putting the demand and the supply sides together, van Ark outlined a new grouping of countries emerging from trends: "Integrated value chain" (Germany and Central & Eastern Europe) have created a strong value chain amongst themselves, and are tied into global value chain, providing potential for strong innovation, but demographics are projected to be weak and growth is coming from external sector; the "Global niche players" (Nordic, Baltic, Benelux countries and Ireland) have a narrow but highly competitive export sectors, and strengths in the services sector of economy; the UK "deindustrialization model" displays a larger range of services (mainly financial) and a low share of employment dedicated to foreign production; and the "Inward looking" Mediterranean group (France, Italy, Spain, Portugal, Greece) are more dependent on slower growing domestic economies, with faster demographics and domestic sector as main drivers of growth, but with slow productivity. In the case of the employment share in good sectors to the GVC-type of production, the integrated value chain is the only one showing acceleration; in contrast, in the case of non-goods sectors, also the global

niche and UK show an improvement. In sum growth projections are more favourable to the "Integrated Value Chain" group, in which the TFP growth offsets the negative effects from demographics. For Inward Looking group and UK, instead, there is no TFP contribution to GDP growth.

The implications of the above are that productivity is necessary to sustain growth and jobs, manufacturing production for foreign sector is most beneficial when integrated in global supply chain and that the services sector creates the biggest scope for productivity gains.

In the Q&A session, a relevant issue raised was related to policy implications. The most relevant ones are innovation technology policies, facilitating the most productive use of technology and the single European market within the service area. The comparative position between US and EU was also investigated; according to the speaker, US is doing marginally better than the EU, the better performance is related to the fact that they get more TFP growth from market services but, however, US showed a significant slowdown in TFP. The key issue both in US and EU is the deceleration in technology and innovation trends, as technology is not well translated in innovation and hence in higher productivity. Another important concern was related to the diverging path of European countries, and if it is better to focus on convergence or allow specialization. The divergence derived from differences in economic structures, but there is room for learning from countries' specificities; moreover, mobility in capital and labour market will help convergence at the European level.

Event notes by Michael Blanga-Gubbay