

## Recent Changes in Europe's Competitive Landscape and Medium-Term Perspectives: How the Sources of Demand and Supply Are Shaping Up

by Bart van Ark, The Conference Board and University of Groningen, Vivian Chen, Bert Colijn, Kirsten Jaeger, Wim Overmeer, The Conference Board, and Marcel Timmer, University of Groningen

This paper revisits the issue of Europe's growth slowdown in the light of the developments of the first decade of the 21<sup>st</sup> century, including the devastating effects from the 2008/09 recession and the subsequent economic and financial crisis on Europe's growth performance. From a **supply side perspective**, using a growth accounting approach, there are virtually no signs of even the beginnings of a reversal in the slowing growth trend, which is primarily driven by a weak productivity performance in most European countries. Recently, low productivity growth has broadened from the services sector to the goods producing sector for most European economies as well. However, the manufacturing sectors have begun to recover from the recession, and the most troubled economies even show signs of improved cost competitiveness. But the manufacturing sector on itself is too small to force an economy-wide reversal in productivity.

From a **demand perspective**, using a global value chain-type analysis, it turns out that activities contributing directly or indirectly to production for the global market, account for roughly a quarter of employment as well as a quarter of labour productivity growth in Europe. Employment in goods production accounts for a significant share of this, but in many European countries market services have increased their contribution to global value chains, both in terms of job creation as well as productivity.

Projecting growth out to 2025, using **growth accounting projections**, productivity remains the critical factor for a recovery of Europe's future growth performance. At the aggregate level demographics will contribute negatively to growth and investment seems maxed out given its historical performance. At the sector level, higher productivity in services for both the domestic and foreign sectors are key to an economy-wide growth revival.

Large differences between individual European countries have emerged. The paper identifies **four groups of European economies** emerging, including (1) Integrated Value Chain, including Germany, Austria and much of Central and Eastern Europe), (2) Inward Looking, including the Mediterranean countries, (3) Global Niche Players, including most small economies group in northwestern Europe, and (4) Deindustrialisation Model, which refers to the United Kingdom

The paper sketches four possible **growth scenarios** which describe the possible "states" Europe may find itself in 10-12 years' time, using a strengthening of supply-side capabilities, including productivity and innovation, and global demand for goods and services at the key dimensions defining the future states of the union. These scenarios provide the setting for a discussion of policy choices for Europe's growth and competitiveness agenda.