I.4  Factors determining real convergence

Productivity, competitiveness and economic performance

Competitiveness is often viewed as a key indicator of the success or failure of policy. The term literally refers to producers competing with each other in the same market. However, there is a related concept of the economic performance of regions and countries, which can also be termed ‘competitiveness.’

Despite the fact that there are competitive and uncompetitive firms in every region, there are common features which affect the competitiveness of all firms located there. These features include physical and social infrastructure, the skills of the work force, an institutional framework and a culture conducive (or not conducive) to innovation and the efficiency of public institutions (especially managerial capacity at the regional level). In addition, success breeds success; the presence of strongly competitive firms in a region tends to stimulate other firms and to encourage further investment.

Over recent years, a standard definition of regional and national competitiveness has begun to emerge, which relates to the achievement of ‘high and rising standards of living and high rates of employment on a sustainable basis.’ Although traditional measures of competitiveness tend to focus on GDP per head, there are other important factors affecting economic performance. The Lisbon summit underlined the crucial link between Europe’s economic strength and its social model. Effectively targeted social protection helps economies adapt to change. By promoting greater social cohesion it can help reduce the underuse of human resources. It is also important to keep in mind the contribution of other factors such as the quality of the natural environment, quality of healthcare, social services and so on. Indicators of this type help enrich our understanding of economic development, though further work is needed to develop better measures of progress in these areas.

In practice, GDP per head can be broken down into two main components: the employment rate, or the proportion of working-age population in work, and productivity, or GDP per person employed. Since a high level of one does not necessarily go with a high level of the other, they are considered separately below, both in aggregate and by sector, before examining investment and other key factors underlying productivity.

Trends in regional economic performance

For the EU as a whole, economic performance over the past 25 years has tended to be stronger in terms of productivity and often weak in terms of employment. This has sometimes led to concerns about ‘jobless growth,’ though, in practice, employment has always increased when GDP growth has been more than 2% a year or so. The problem has been maintaining this rate of growth over the long-term. Over the decade 1989 to 1999, for example, annual growth averaged 1.9%, but because GDP per person employed rose by 1.4%, employment increased by only 0.5% a year. In the long-term, achieving high employment growth and high productivity growth are not necessarily in conflict with each other. Indeed, to the extent that productivity growth increases competitiveness and, therefore, enables higher growth of GDP to be achieved, they are complementary. The challenge in lagging regions, however, is to develop a mix of policies which boost productivity without adversely affecting levels of employment.
While in most, but not all, lagging regions, employment levels are less than in the rest of the EU, in all of them, productivity is below average. Two main groups can be distinguished:

- **those with employment rates similar to, or in a few cases above, the EU average, which need to catch up in terms of productivity, measured by GDP per person employed. These are mostly in Portugal, Greece and the eastern part of Germany, where in the first, productivity is typically only around 40% of the EU average and in the other two, around 60% of the average.**

- **those lagging in terms of both productivity and employment. These include most regions in Spain and southern Italy, where employment rates can be as low as 40% as against an EU average of over 60%. In these cases, low employment is, exceptionally, a more important reason for low GDP per head than low productivity.**

**Sectoral analysis: low productivity in agriculture**

The sectoral structure of economic activity shows an interesting pattern, if sectors are divided into agriculture; industry (mainly manufacturing); distribution, transport and hotels and catering; business and financial services and non-market and other services (principally health, education and public administration) (see Table A.18 and Map 8). Productivity is highest in business and financial services, gross value-added per person employed in the EU being over twice the average for the economy as a whole.² It is slightly above average in industry and just below average in distribution, transport and hotels and in non-market and other services.³ In agriculture, productivity is only around half the average for all sectors.

**Poor performance often linked to concentration in less productive sectors**

In all three of the cohesion countries, overall employment rates are low to a large extent because of low employment in business and financial services, where productivity is relatively high (though this should be interpreted with caution because of high value-added in the protected financial services sector). On the other hand, the share of employment in distribution, transport and hotels and in non-market and other services is similar to the EU average, as is the level of productivity. Employment is much higher than elsewhere in agriculture where productivity is very low.

This pattern is reflected at the regional level (Map 9). Three sets of regions can be distinguished in the EU of 27 Member States (though not all fit the classification neatly):

- **lagging regions with a high employment in agriculture, often an above average share of employment in industry and low employment in services. These are notably in the southern Member States and in Central European countries, except for the Czech Republic, Slovakia and Hungary. While agricultural employment in the EU is under 5% of the total, in some regions in Spain and Portugal, it is over 15% and in regions in Greece and the most eastern parts of the applicant countries, over 20%;**

- **regions with high employment in industry. Many of these are concentrated in a central arc, stretching from the West Midlands in England, eastern France and northern Spain, through southern Germany and northern Italy to the Czech Republic, Slovakia and Slovenia. Although many of these regions are prosperous, many are not, reflecting the significant variation in value-added between manufacturing industries;**

- **regions with high employment in services. These are regions where the share of employment in this sector is 70% or more. Most of these regions are prosperous and include a number of capital cities in the north of the EU, but the group also includes regions in southern France, Spain and Italy, which have relatively low levels of GDP per head and where employment is concentrated in basic services, many of them catering for the tourist trade.**

**The long-term trend towards services and the restructuring required in lagging regions**

Over many years, there has been a tendency in the Union for employment in agriculture and industry to decline – though in the latter, the number employed has stabilised in recent years, even if the share has continued to fall – and for employment in services to expand. This trend, however, as noted above, has some way to go in many regions, particularly in
I.4 Factors determining real convergence

8 GDP per person employed, 1998

Agriculture

Index, EU15 = 100

- < 9
- 9 - 39
- 39 - 69
- 69 - 99
- ≥ 99
- no data

Source: Eurostat

Industry

Index, EU15 = 100

- < 57.5
- 57.5 - 76.5
- 76.5 - 95.5
- 95.5 - 114.5
- ≥ 114.5
- no data

Source: Eurostat

Services

Index, EU15 = 100

- < 68
- 68 - 84
- 84 - 100
- 100 - 116
- ≥ 116
- no data

Source: Eurostat
9 Regions with highest agricultural, industrial or service employment, 1999

- Agriculture (top 10%)
- Agriculture (top 25%)
- Industry (top 10%)
- Industry (top 25%)
- Services (top 10%)
- Services (top 25%)

Top 10% and 25% of total population
EL, RO, SK: 1998
BG, LT, LV: 1997
D (Saarland): NUTS1
Sources: Eurostat and NSI

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lagging ones. Indeed, even in the most prosperous regions, employment in services is still growing. Between 1990 and 1999, employment in services in the EU increased by some 12 million, while in the rest of the economy it declined by 9 million. Most of this decline occurred during the recession years of the early 1990s, though during the recovery since 1994, agricultural employment has continued to fall (by around 1.3 million), while employment in industry has remained broadly unchanged. In the lagging regions, there will be a continuing shift of employment out of agriculture on a substantial scale in future years, though not necessarily job losses in industry. Indeed, in some regions, employment in manufacturing, especially where it is still below the EU average, might well increase, as it has tended to do in recent years. In the central industrial regions, on the other hand, employment in manufacturing in many cases could decline, at least as a share of the total, though in many of these a shift has already occurred to high value-added activities, as noted below.

The restructuring of employment in future years is likely to be even greater in the candidate countries, where jobs in many regions remain concentrated in agriculture and/or industry.

It should be noted in this context (see maps of employment and productivity by sector) that the shift in employment out of industry, and to a lesser degree out of agriculture, in the more prosperous regions in the EU has not necessarily been accompanied by a similar decline in the share of value-added generated in these sectors. Indeed, in many cases, productivity has increased significantly in industry, as employment has concentrated in high value-added activities. This demonstrates the potential for maintaining a small but highly competitive manufacturing sector as a key part of the regional economy.

**Shifts of activity within sectors as important as shifts between them**

An important aspect of lagging economic development in the less prosperous regions in the EU is the concentration of activity in low value-added sectors (though, it should be emphasised, productivity in the same sector can vary significantly across the Union). This reflects differences in both the efficiency of performing the same activities and the degree of concentration in higher or lower value-added parts of the broad sectors concerned.

For example, business and financial services have relatively high value-added per person employed in the cohesion countries (as in some of the candidate countries), which partly reflects high interest rates (which push up value-added in financial services) and low competition, but also perhaps the under-developed nature of these services in relation to potential demand. On the other hand, manufacturing, which has an above average level of value-added per person employed in most countries, has relatively low productivity in the three cohesion countries (as well as in most of the candidate countries). This difference in part reflects a tendency for high value-added and high-tech parts of manufacturing to concentrate in the more prosperous Member States.

In agriculture, value-added per person employed is around 80-90% of the EU average for all sectors in the more prosperous countries, but only 40% of this in Spain, 25% in Greece and just 13% in Portugal (and 16% in Austria). (In the candidate countries, the figure is even lower.) These figures reflect both the need for diversification into higher value-added activities and the long-term potential for significant productivity growth in the sector.

**Demography and migration**

**Population in the EU is set to decline**

At the beginning of 2000, the population in the EU stood at 376 million, substantially less than in China (1.2 billion) or India (1 billion), but significantly more than in the US (272 million) or Japan (126 million). Assuming trends in birth and death rates and in migration continue, EU population is projected to grow very slowly between 2000 and 2005 (by only 0.2% a year) and then hardly at all (by under 0.1% a year) from then until 2022, when it is expected to start declining. In 2010, therefore, population is forecast to reach 385 million and in 2025 to be only slightly higher (388 million). From 2008, population is set show a natural decline but this will be offset for a few years by net inward migration.

Trends in population, however, vary markedly between different parts of the Union. While population is...