European productivity and standard of living: a long-term perspective

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1 Introduction

Ladies and gentlemen, it is as always a pleasure to be at the European Banking Congress and speak to such a distinguished audience. This year's theme – investing in Europe – is especially timely given the major challenges our continent is currently facing.

First, Europe's security is under increasing pressure. In response, Europe needs to spend much more on defence.

Second, the global trade environment has become much more challenging. As a result, external trade will no longer drive European growth as strongly as it did in previous decades.

Third, Europe is about to undergo a major demographic shift, as the baby boomer generation retires. This means that labour supply will be scarce for the foreseeable future.

Finally, Europe is transitioning to a carbon-neutral economy. This transition will require major investment.

Taken together, both labour and capital for productive investment will be in increasingly short supply. With limited resources, our only way forward is to become more productive. In my speech, I would like to take a long-term perspective on Europe’s productivity and – since productivity is a mean to an end and not an end itself – on its standard of living.

I will structure my remarks around two key questions: First, how have productivity and the standard of living in Europe developed compared to the United States over the past thirty years? And second, what can Europe do to boost productivity?

2 Productivity growth: lagging behind

Let us begin by examining how productivity has evolved in Europe and the United States over the past thirty years. As my measure of productivity, I will use the ratio of real GDP (gross domestic product) to hours worked. I have chosen 1995 as the starting point for my comparison. Why 1995, you might ask?

The reason is simple: In the decades after World War II, productivity growth in Europe consistently outpaced that in the United States. However, this process of catching up ended in the mid-1990s.[1]

Between 1995 and 2024, labour productivity in the United States increased by almost 61 per cent. By contrast, in the European Union it only rose by a little more than 39 per cent.[2] As a result, a productivity gap of around 21 percentage points opened up over these 30 years.

When we look at such a long period, it might seem as if the gap just kept widening steadily, year after year. But a closer look reveals that is not what actually happened.

Between 1995 and 2002, productivity growth was relatively lively in both economies, with the United States only slightly ahead. But starting in 2003, a gap began to open, with the United States pulling ahead of Europe. One important factor was that US (United States) firms benefited much more from the efficiency gains in information and communication technologies (ICT (information and communications technology)).[3]

The gap widened sharply in 2009, following the global financial crisis: US (United States) productivity surged, while European productivity declined. This jump in US (United States) productivity has been linked to “excess layoffs” – meaning firms cut hours and jobs even more than output fell.[4]

From 2011 onwards, the productivity gap actually began to narrow again, as US (United States) growth slowed markedly. One reason for slower US (United States) productivity growth may have been a post-recession “rehiring effect”: As firms brought back workers, the earlier productivity gains from excess layoffs gradually faded.[5]

All in all, by 2019, US (United States) productivity was less than 12 percentage points higher than in Europe, compared to 1995.[6] So, where did the current productivity gap of 21 per cent which I mentioned before come from?

Enter the COVID (coronavirus disease)-19 pandemic and Russia’s attack on Ukraine. In just five years, the productivity gap widened by almost 10 percentage points.

Let that sink in for a moment. Almost half of the productivity gap that has opened up over the past thirty years stems from just the last five years.[7]

Four main factors seem to have driven this recent divergence.

First, by 2019, the United States had likely returned to a structurally higher path of productivity growth. By contrast, structural impediments continued to weigh on European productivity.

Second, the first year of the COVID (coronavirus disease)-19 pandemic brought with it another productivity boost in the United States, similar to what we saw during the global financial crisis.[8]

Third, Russia’s attack on Ukraine caused an adverse terms-of-trade shock for energy-dependent Europe.[9]

Fourth, US (United States) fiscal policy was much more expansionary than in Europe, giving a bigger boost to real GDP (gross domestic product) growth.[10] To give you a sense of scale: Between 2020 and 2024, the average US (United States) fiscal deficit was 8.3 per cent of GDP (gross domestic product) – more than three times that of Europe.

To sum up: While the European productivity gap has been growing for some time, it has widened significantly only in recent years. It is the outcome of a complex mix of persistent trends and recent shocks.

3 Standard of living: better than expected

Ultimately, productivity is just a means to an end – a higher standard of living. So, how has the standard of living in Europe relative to the United States evolved over the last thirty years? Given the modest productivity growth, one might expect Europe to have fallen noticeably behind.

Of course, I am well aware that individual well-being depends on more than just GDP (gross domestic product). Think of social security, health or equality. But even when looking at output alone, the reality is more nuanced.

If we look at growth in real GDP (gross domestic product) per capita instead of per hour worked, the gap between the United States and Europe is less than half the productivity gap. From 1995 to 2024, real GDP (gross domestic product) per capita increased by 58 per cent in the United States and by 50 per cent in Europe. This corresponds to annual growth rates of 1.6 per cent for the United States and 1.4 per cent for Europe.[11] Until 2019, real GDP (gross domestic product) per capita grew by 45 per cent in the US (United States) and 44 per cent in Europe, remaining nearly on par.

The reason for the divergence between productivity growth and per capita growth is quite simple: Europe successfully managed to activate previously untapped labour reserves. Accordingly, the lower growth in labour productivity was partly compensated for by an increase in labour input.

So far, I have focused on real GDP (gross domestic product) figures from national accounts. They show how much economies have grown, adjusted for changes in the respective price levels over time. But to compare the standard of living between the United States and Europe, we need to account for how price levels differ between regions.

A well-established method for adjusting GDP (gross domestic product) figures for price level differences across countries is the use of purchasing power parities. However, this approach comes with its own statistical challenges.

For example, purchasing power parity calculations have to rely on a common basket of goods and services. However, this common basket may not be fully representative for all of the countries under consideration. In addition, prices are collected less frequently than in national accounts. As a result, they have to be interpolated or extrapolated. Therefore, I will refrain from presenting exact numbers here, as different calculation methods yield different results.

But one thing we can say with great confidence: When price level differences and their changes are taken into account, Europe's standard of living relative to the United States has developed less badly than suggested by the unadjusted figures.

Still, this is no reason to be complacent. If Europe wants to raise the standard of living for future generations, we need to boost productivity growth.

4 Policy measures: room for improvement

How can we make this happen? Some of the reasons for Europe's productivity gap can only be addressed over the long term. For example, our fiscal policy constraints due to high levels of public debt, or the lack of access to cheap energy.

Moreover, Europe is unlikely to fully catch up with the digital transformation of the 2000s. One priority should be to ensure that we reap the benefits of the next IT (information technology) revolution, driven by artificial intelligence. Furthermore, we can act immediately where it matters most: at the level of our firms, where innovation and growth actually happen.

When we compare the business landscape in the United States and Europe, some striking differences stand out.[12] In the US (United States), the business ecosystem thrives on a dynamic duality: On the one hand, there are many small, innovative start-ups that disrupt entire industries. On the other hand, there are large, productive corporations that dominate global markets and benefit from economies of scale.

In Europe, the picture looks different. Here, our economies are usually dominated by small and medium-sized companies. On the one hand, quite a number of those firms are what we call hidden champions, which are market leaders for a specific product. But on the other hand, many firms are neither small enough to be truly agile and highly innovative, nor large enough to fully benefit from economies of scale.

So, how can we encourage the emergence of innovative start-ups – and help productive incumbent firms continue to grow? Given the European focus of my speech, I will concentrate on what can be done at the level of the European Union. However, these measures need to be complemented by targeted reforms in the Member States.

4.1 Simplify and harmonise regulation

One important step to boost productivity growth is to make it easier to do business in Europe. This means simplifying and harmonising European regulation.

Right now, entrepreneurs and companies face a patchwork of rules and procedures that vary from country to country. To tackle this, the EU (European Union) has launched a major simplification initiative, including the OMNIBUS packages. These packages aim to cut unnecessary bureaucracy, streamline procedures, and remove outdated or overlapping rules. By making rules clearer and more consistent, they could reduce compliance costs.

One promising solution to harmonise regulation is the “28th Regime” – an optional EU (European Union)-wide legal framework that companies can choose, instead of navigating 27 different national systems. This would make cross-border operations easier, cut compliance costs even more, and help businesses scale up faster. In effect, it would remove some of the remaining barriers across our internal market, which encompasses 450 million customers. And by helping small and medium-sized companies to expand across borders, we could turn hidden champions into global leaders.

4.2 Improve access to equity market financing

But even the best ideas need the right kind of financing in order to grow. Europe still lags behind when it comes to market-based equity financing. This is why it is essential that we swiftly complete the Savings and Investments Union.

For start-ups, better access to venture capital is crucial. For one thing, Europe needs to build the necessary infrastructure to deepen and integrate its venture capital markets. For another, we need to encourage institutional investors to put more money into venture capital.

But also for medium-sized and large companies, we need deeper and more integrated capital markets. Right now, Europe’s capital markets are still fragmented and underdeveloped compared to those in the US (United States). This lack of integration means less depth and liquidity, making it harder for companies to raise the funds they need to grow.

Taken together, important European initiatives are already in motion. To realise their full potential, we must implement these European initiatives with speed and ambition – and reinforce them with targeted national policies.

5 Conclusion

Ladies and gentlemen, let me summarise and conclude. I began by highlighting Europe’s significant productivity gap with the United States that opened up over the past three decades.

A closer look suggests that Europe’s standard of living compared to the US (United States) has developed less badly than productivity figures alone would suggest. This indicates that Europe’s starting position may not be as dire as it is often portrayed to be.

Nevertheless, Europe could and should do better. The policy measures discussed before could help Europe to boost productivity growth and restart its convergence process.

Ladies and gentlemen, Europe faces major challenges.

Let’s turn them into something productive.

Thank you very much for your attention.

Footnotes:

1. See Bergeaud, A., G. Cette and R. Lecat (2016), Productivity Trends in Advanced Countries between 1890 and 2012, Review of Income and Wealth, Series 62, No. 3.
2. Data source: European Commission, AMECO database, May 2025.
3. See Deutsche Bundesbank (2023), The impact of digitalisation on labour productivity growth, Monthly Report, March 2023.
4. See Gordon, R. and H. Sayed (2024), New Interpretation of U.S. Productivity Growth Dynamics, 1950-2023, CEPR Discussion Papers, No. 19569.
5. See Gordon, R. and H. Sayed (2024), op. cit.
6. See Deutsche Bundesbank (2021), The slowdown in euro area productivity growth, Monthly Report, January, for a detailed account of developments in the euro area prior to the COVID-19 pandemic.
7. Up to 2019, the productivity gap increased by 11.8 percentage points, which is around 55 per cent of the increase of 22.1 percentage points up to 2024.
8. See John F., H. Li, B. Meisenbacher and A. Yalcin (2024), Productivity During and Since the Pandemic, FRBSF Economic Letter No. 31.
9. See Dias da Silva, A., P. Di Casola, R. Gomez-Salvador and M. Mohr (2024), Labour productivity growth in the euro area and the United States: short and long-term developments, ECB Economic Bulletin, Issue 6.
10. See Romer, C. (2022), Lessons from Fiscal Policy in the Pandemic: The ODE Distinguished Economist Award Lecture, The American Economist, 67(2), pp. 164-182 for an overview of the macroeconomic impact of the US fiscal policy response to the COVID-19 pandemic.
11. In the euro area, annual growth of real GDP per capita averaged 1.2 per cent per year, adding up to 40 per cent over the entire period from 1995 to 2024.

12. See IMF (2024), Europe’s Declining Productivity Growth: Diagnoses and Remedies, Regional Economic Outlook Notes – Europe.