Factors affecting the productivity of European Economies

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Abstract

The 2008 financial crisis in Europe highlighted the importance of productivity growth as a vehicle to economic growth and stability. This paper estimates and compares productivity growth in European countries. It also investigates factors that directly or indirectly affect productivity growth with a view to reaching policy conclusions. The data used in the analysis are drawn from Eurostat, European Commission, OECD, and World Bank sources, and cover the period 1995-2014.

We find that productivity growth exhibits substantial variation over time. Cross-country differences in productivity growth are also observed, indicating changes in the countries' competitiveness. To explain the observed productivity differences, we apply simple regression analysis to link productivity growth with factors found in the literature to be among the main drivers of productivity growth: Research and Development (R&D) and Patents; Foreign Direct Investment (FDI); Information and Telecommunications Technology (ICT); and human capital, as measured by gross enrolment ratios in primary, secondary and tertiary education. The results obtained suggest that R&D expenditures and the number of patents have a positive and statistically significant effect on productivity growth. Thus, both process and product innovations contribute to the growth of an economy. The effect of ICT capital on productivity growth is also positive and significant, as is the effect of human capital - as measured by people entering tertiary education.

These findings conform to those prevalent in the literature, suggesting that to increase their productivity and, thereby, enhance competitiveness and economic growth, the EU countries should initiate reforms to promote R&D and encourage investment in ICT and human capital. Such reforms should be designed around measures creating new business opportunities, while tackling anti-competitive product and labour market regulations.

Keywords: Productivity, Competitiveness, Growth Accounting, EU Economy

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