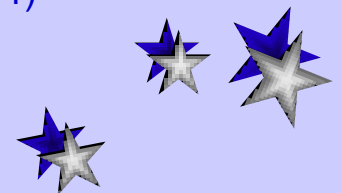


**Comments on “Living standards in an ageing,
greener, knowledge economy : Towards a period of
lean cows ? “
by Jorgen Mortensen (CEPS)**

Kieran Mc Morrow – DG ECFIN, European Commission

(INNODRIVE Final Conference : CEPS, Brussels – 22-23 February 2011)



Essential messages from paper

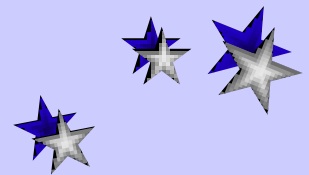
- TFP, rather than labour productivity, is the main driver of long run changes in living standards & TFP growth rates have been slowing down
- 2010-2030 : Lower TFP growth rates, as well as higher dependency ratios, will mean that living standards in the developed economies will only grow, on average, by $\frac{1}{2}$ % per annum
- Skeptical that the policy approach advocated by the « Brussels consensus » of protecting living standards via productivity increases will be successful
- Key conclusion is that a « prolonged period of lean cows » in the post-crisis world may warrant a broader reconsideration of economic & social policies based on more sustainable consumption patterns, quality of life & social capital issues
- Paper calls for more research on both the links between the evolution of living standards & TFP and on the prospects for a severe shock to living standards over the coming decades





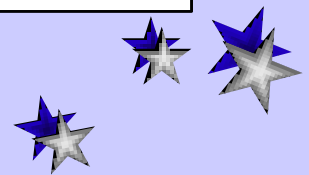
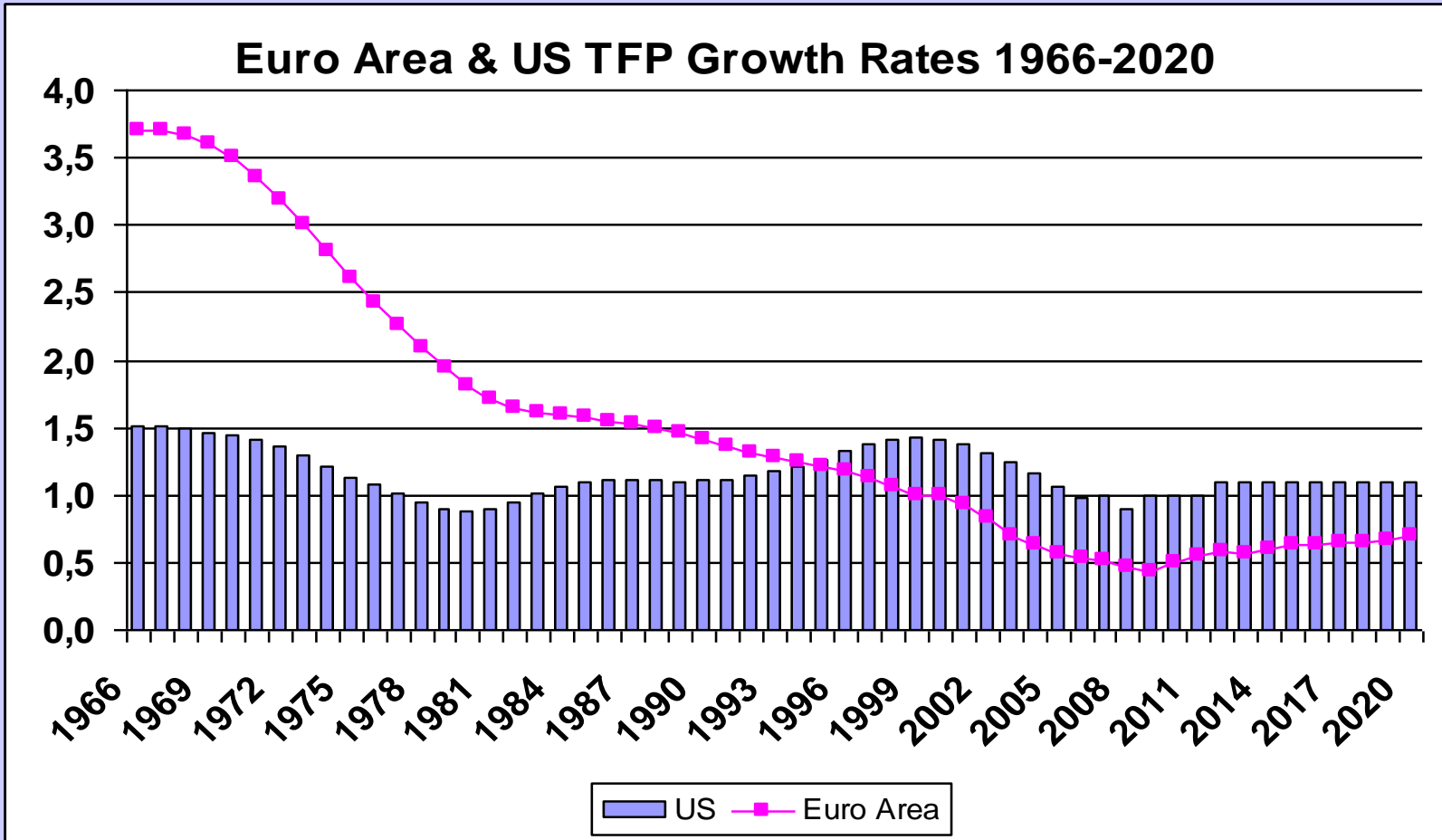
Will the shock to EU living standards be so severe ?

- **Yes, on the basis of current policies**
- **Effects can be lessened with appropriate policies (« Brussels Consensus » has a definite role to play)**
- **Other factors which need to be considered in assessing the likely shock to living standards**





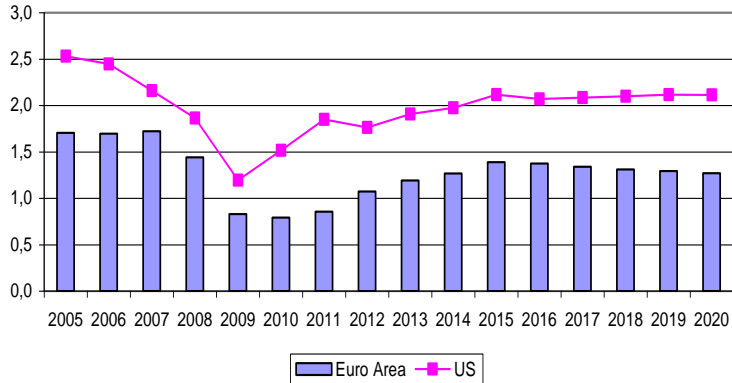
Shock to living standards will be severe if policies do not change



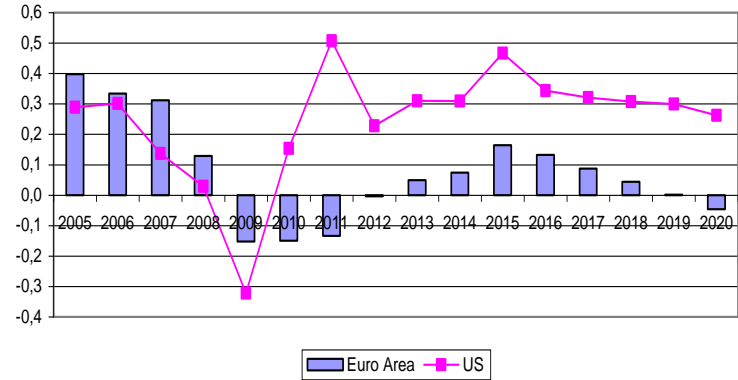


US vs Euro Area

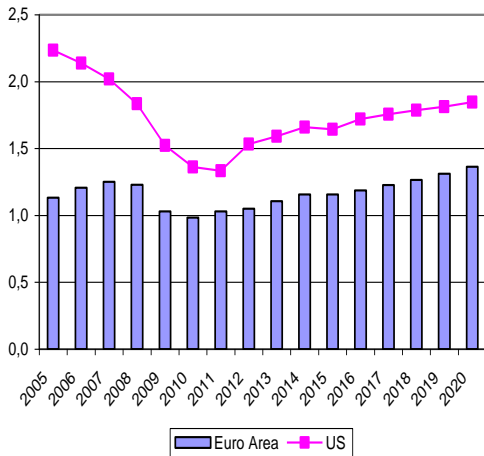
Potential Growth



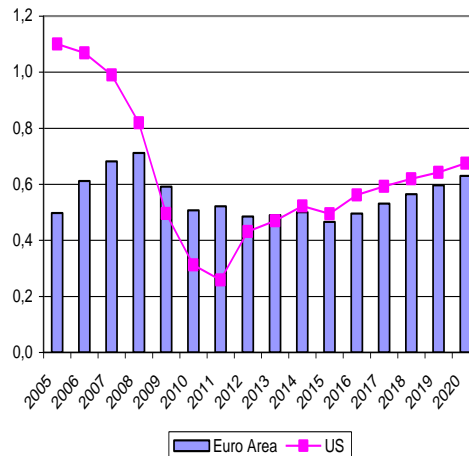
Labour Input



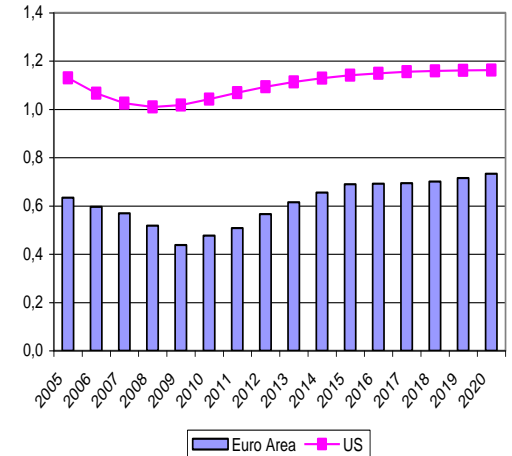
Labour Productivity



Capital Deepening



TFP





Shock to living standards can be reduced with appropriate policies

Shift in the conceptual framework for explaining TFP determinants

Limitations of earlier models in explaining TFP growth (especially post-1995)

1. Neoclassical model

2. AK Models

3. New Growth Theories based on « Schumpeterian » creative destruction mechanisms provide a better framework for understanding TFP

Institutions + Policies are key drivers of TFP growth

(Different focus for frontier vs. catching-up countries)





Need for a specific focus on TFP Enhancing Policies

(Boosting the 2 key drivers of TFP : Technology & Factor Efficiency)

Direct TFP Enhancing Policies

1. Action on innovation / intangible investments (Scientific+Non-Scientific R&D) +(Computerised Info Systems)+ (Economic Competencies)

2. Human Capital Development

3. Exploitation of ICT

4. Encouraging firm creation & entrepreneurship (Resource reallocation)

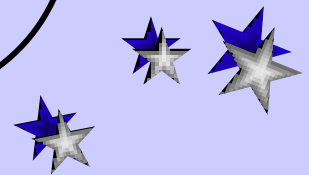
Indirect TFP Policies (Essential Framework Conditions / Flanking Policies)

1. Sufficient « demand » / « lead users » to reward successful innovators

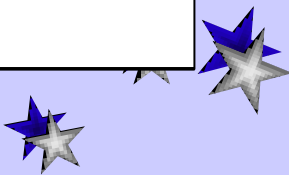
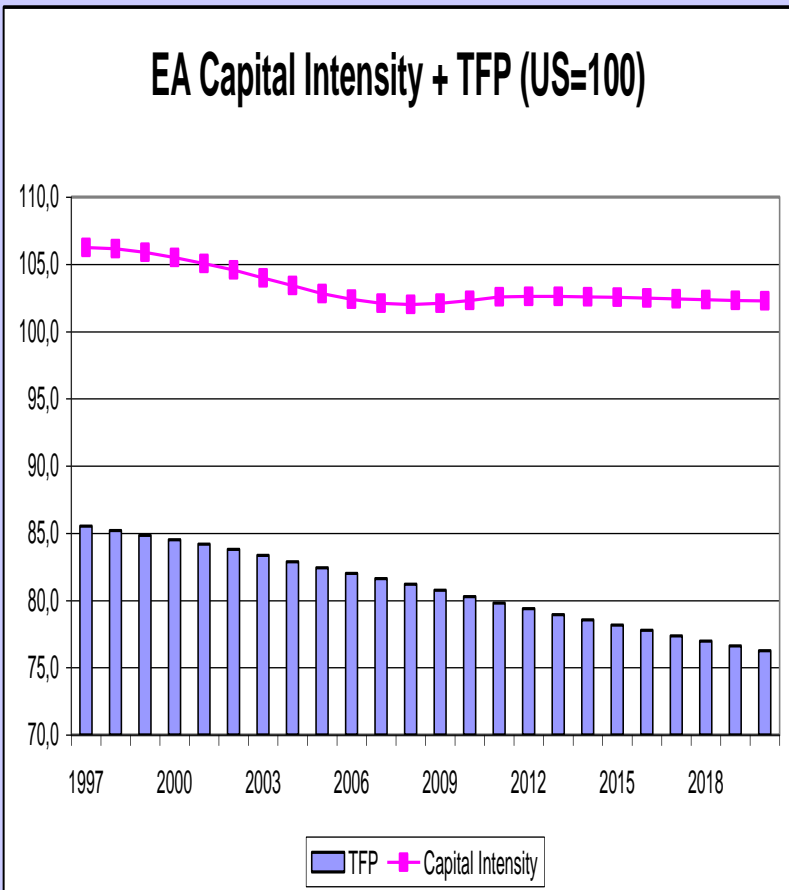
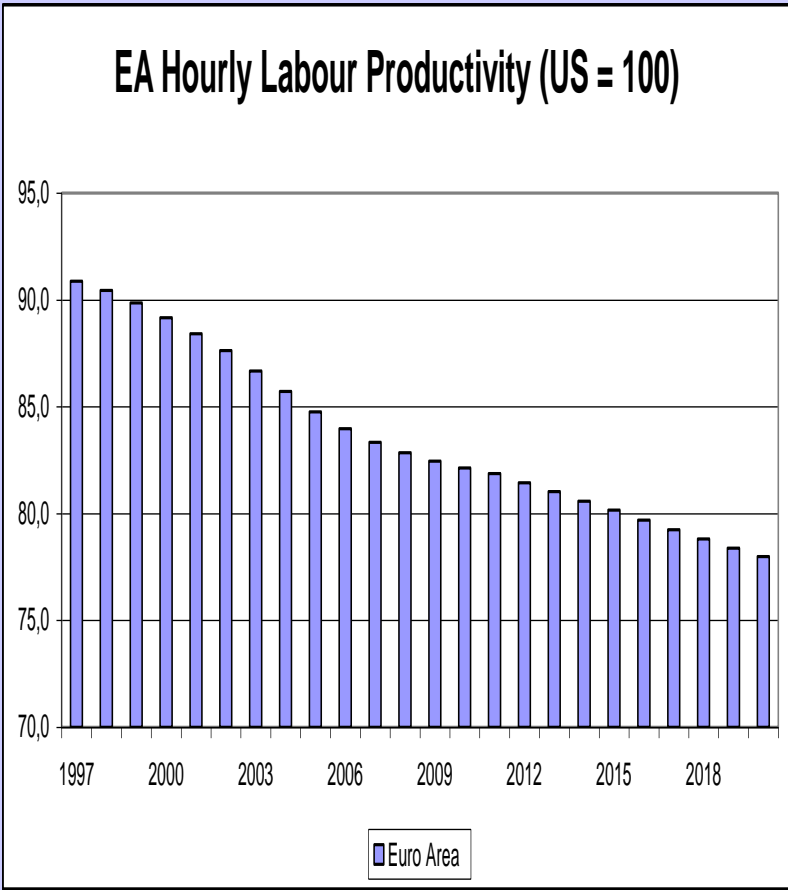
2. Effective Intellectual Property Rights (IPR) Schemes

3. Favourable macro-economic environment

4. Effective levels of competition



2. Euro Area TFP level differences (US=100)



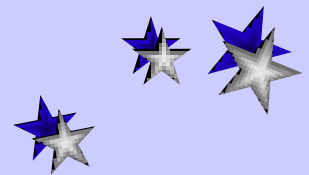


Large Euro Area – US TFP level differences in ICT production & Non-ICT Market Services

Euro Area TFP levels in 2005 (United States = 100)

| Total Industries | ICT Industry (Electrical & Optical Equipment – ICT Goods) (Telecommunications – ICT Services) | Non-ICT Goods Producing Industries | Non-ICT Market Services |
|------------------|--|---------------------------------------|----------------------------|
| 85 | 72 | 86 | 78 |

Source : EU KLEMS





Specific hypotheses for explaining the US's outperformance in market services

Technology / Knowledge Investment Drivers

1. Tangible ICT Investments

2. Human Capital Investments

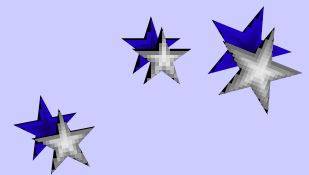
3. Intangible Investments

1+2+3
Total Knowledge Investments

Factor Efficiency Drivers

Inadequate Competition in EU Market Services

Economies of scale in US market services





Concluding Remarks

- **Risk to living standards, especially in the EU, is great over the coming decades**
- **However, the situation is not without hope**
- **Policy response is crucial**

