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To the point!

Cross-Asset- and Strategy-Research

Europe's productivity crisis revisited

Why the U.S. is pulling ahead

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Three weeks ago, I praised in this column Mario Draghi's diagnosis of Europe's weak productivity growth, albeit with a sprinkle of skepticism about his recommendation to finance upcoming investments through joint European bonds. But let's set that aspect aside and delve instead into the reasons for the growth weakness that makes the old continent look older every year compared to the U.S.

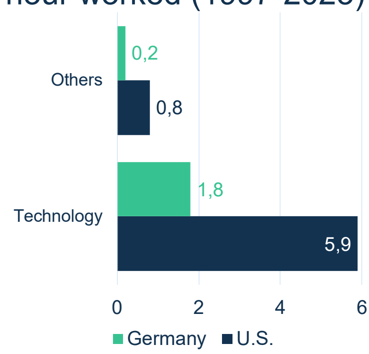
Since the times of Nikolaus Copernicus and Leonardo da Vinci, Europe has always been operating at the technological frontier well into the second half of the past century. Inventions and innovations were the hallmarks of the old continent. Since then, it has been lagging behind in technologies that are expected to shape the future. Companies like Apple or Nvidia alone have a higher market capitalization than all publicly listed corporations in Germany combined. And the trend points to a further widening of the transatlantic gap. Why?

Europe is lagging behind in future technologies

Reasons for Europe's productivity inferiority

First of all, Europe, and especially Germany, invests far too little in digital technologies. This also applies to companies. Since 1995, the capital stock related to IT in Germany and France has tripled. That sounds like a lot. And it is. But it's not enough. In the U.S., the high-tech capital stock has increased no less than ninefold over the same period!

Fig. 1: Annual change in gross value added per hour worked (1997-2023)



Source: Destatis, BEA, BLS, LBBW Research

Because productivity growth develops much more dynamically in information technology than in other sectors of the economy, Europe performs worse overall economically than the U.S. Figure 1 shows the enormous difference in sectoral productivity growth rates. But even outside of information technology in the narrow sense, the U.S. records higher productivity gains than

Europe. This is because established industries also become more productive when they use more IT.

Founders have a hard time in Germany

One reason is the different industrial structures on both sides of the Atlantic: large companies invest more in information technology than smaller ones. In the U.S., 60% of all employees work in companies with more than 250 employees. In Germany and France, it's less than 40%.

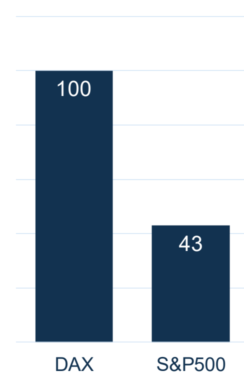
Smaller companies invest less in technology

Furthermore, innovative young companies have a harder time being successful in Europe because, on the one hand, there is a lack of venture capital investors, and on the other hand, bureaucratic hurdles often prevent inventions from becoming marketable innovations. As a result, promising start-ups move out, all too often to the U.S.

More courage breaking new ground!

Europe, and particularly Germany, has a strong propensity to try to preserve what has made it successful in the past. Every financial investor knows that past performance is no guarantee for future returns. And so it is in the economy overall. Just look at the largest companies on the stock exchange. None of the top 10 companies with the highest market capitalization in America's S&P 500 index were among the top ten back in 1997 (Microsoft joined this group in 1998). In contrast, half of the ten most valuable companies in the German DAX were already part of the illustrious group in 1997. The average age of the ten largest DAX companies is 100 years, more than twice as much as that of the ten largest U.S. companies (see Figure 2).

Fig. 2: Average age of the ten largest companies by market cap (years)



Source: LBBW Research

In an ever faster-changing world, those who only rely on preserving the tried and tested and do not dare to break new ground will lose out.