The European economy: Addressing New Challenges and Existing Weaknesses

A Perspective from the OECD

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BETTER POLICIES FOR BETTER LIVES

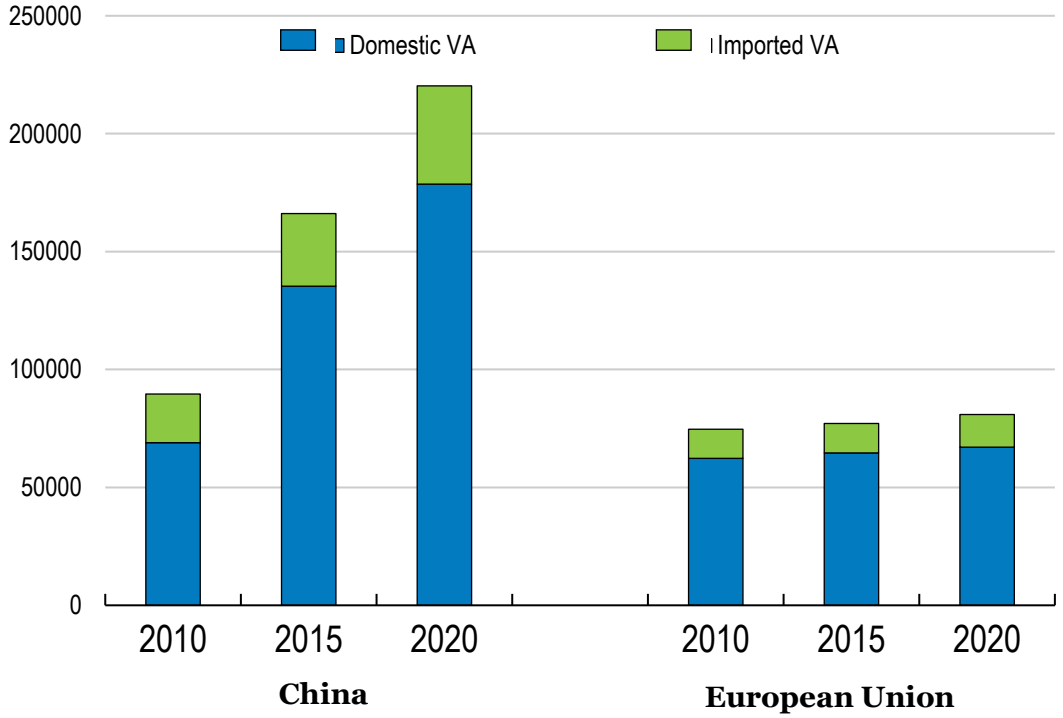
Key challenges

- Geo-economic disruptions – trade and defence
- Digital transition and AI
- Globalisation, growth of EMEs
- Energy and climate
- Ageing and health

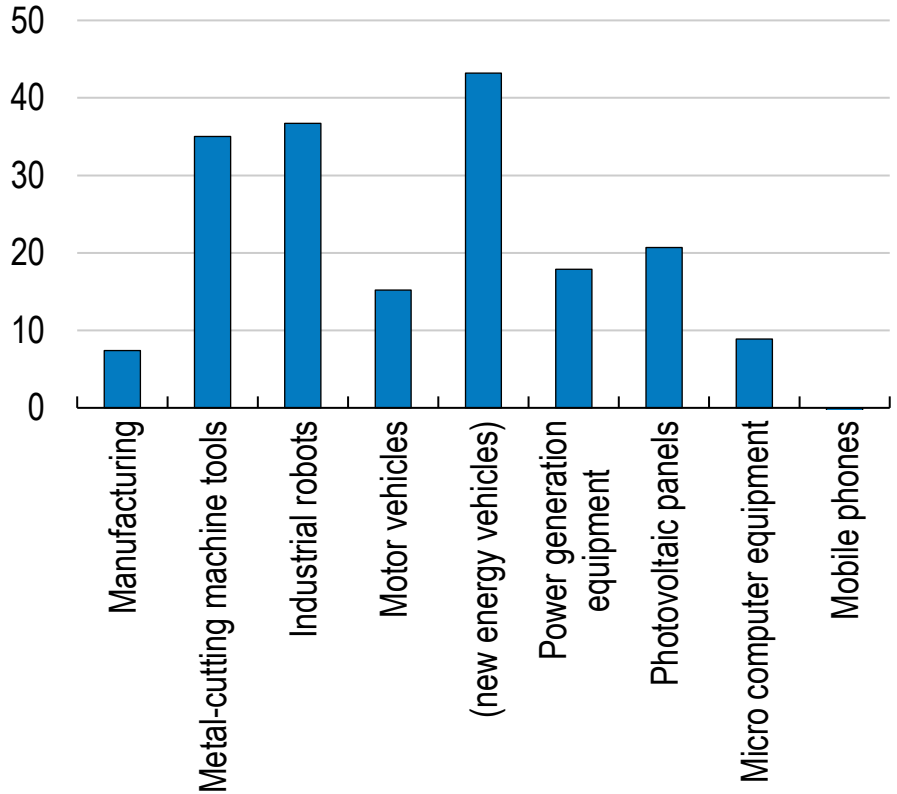
Image generated by Canva

China is upgrading its industry

China manufacturing exports
$ million

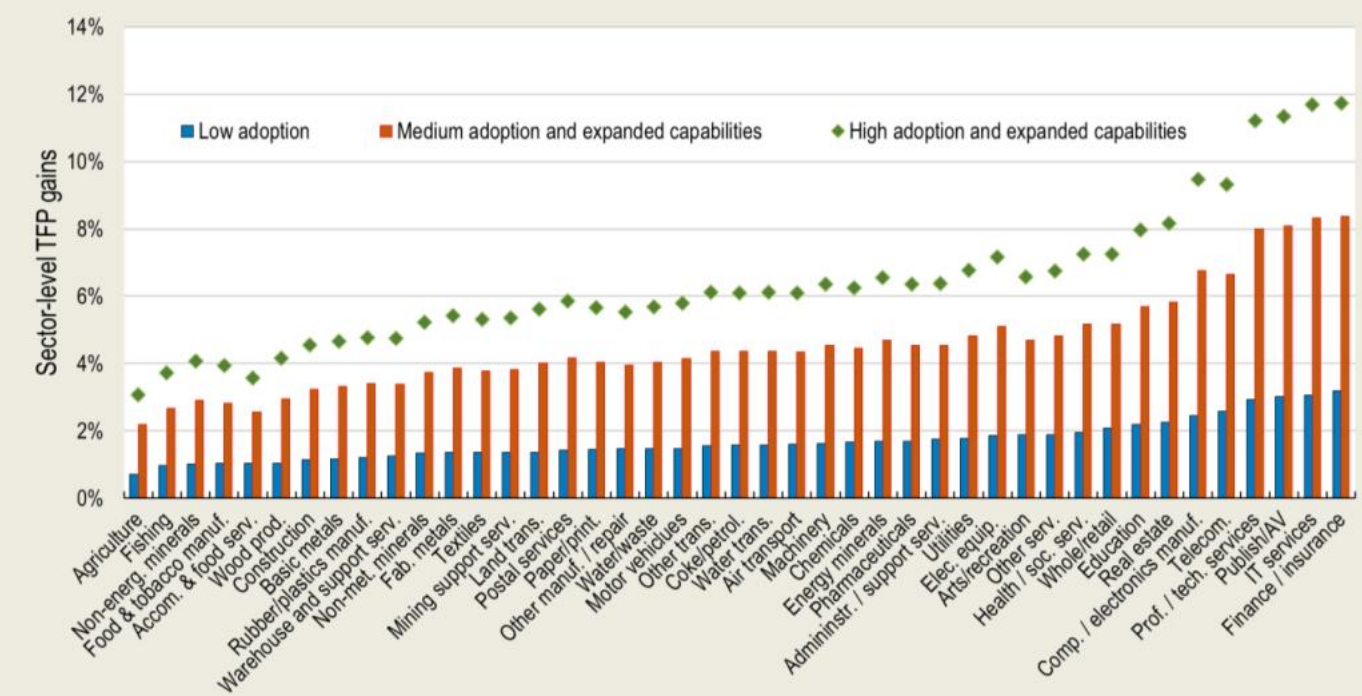


China: growth in industrial output in key sectors
YoY change to December 2024, %



AI will cause disruption, but creates opportunities

Projected AI-driven productivity gains
Cumulative % TFP gain over 10 years

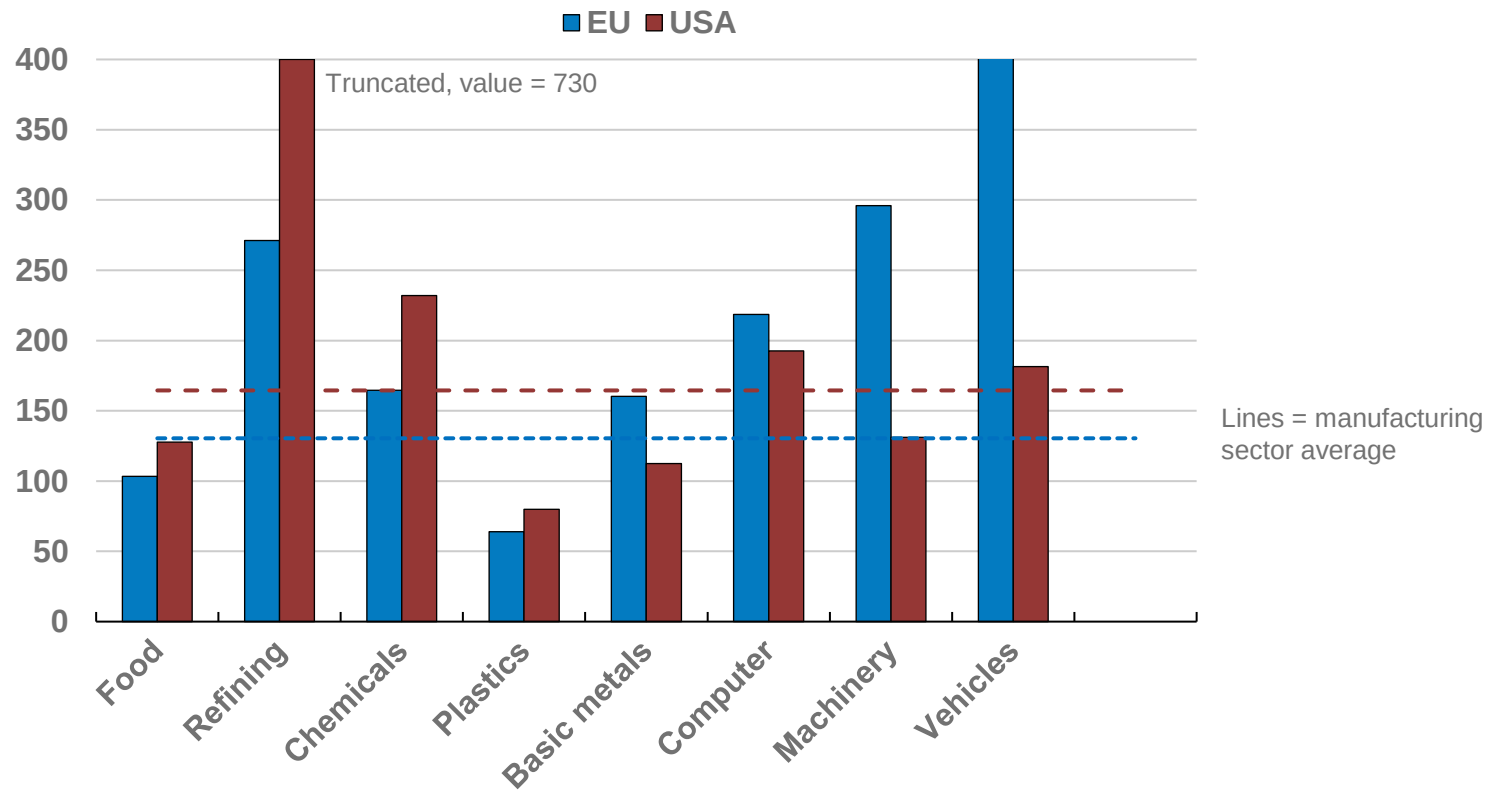


Filippucci, F et al., (2024), “Miracle or Myth? Assessing the macroeconomic productivity gains from Artificial Intelligence”, OECD Artificial Intelligence Papers No. 29

Existing challenges

Overall value-added per worker is lower in manufacturing in Europe, but higher in many sectors

Nominal value-added in selected manufacturing sectors
2022, euros

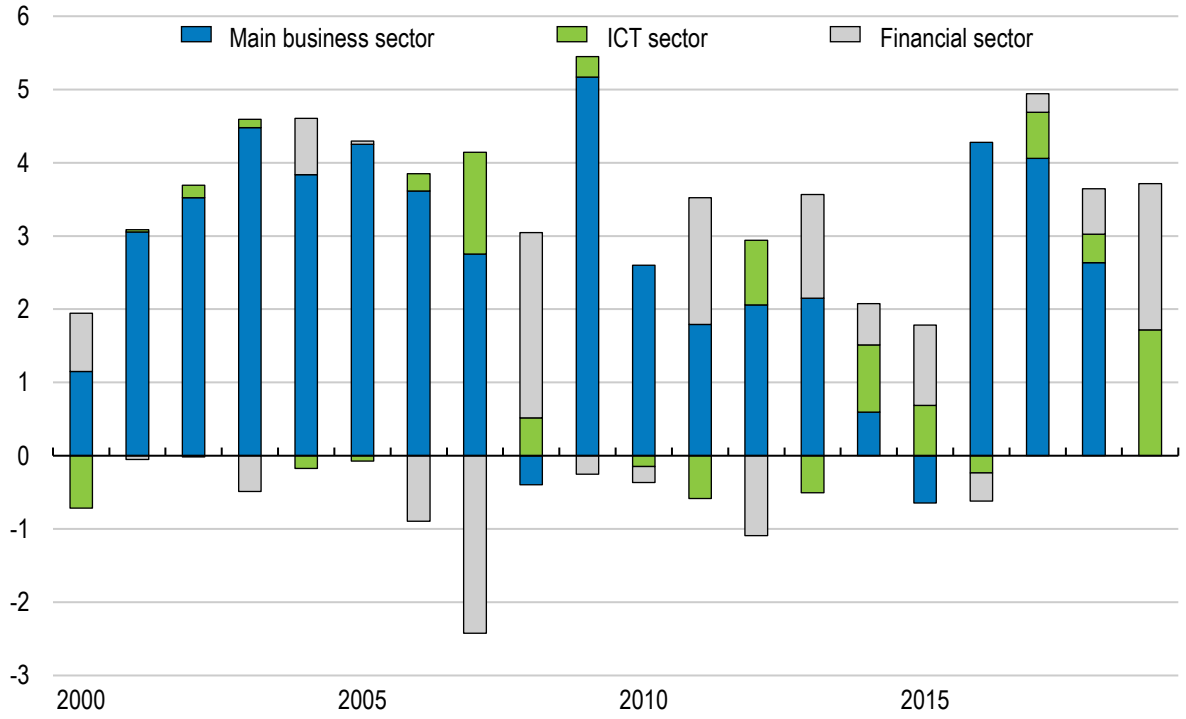


Source : OECD Structural Analysis (STAN) database and own calculations

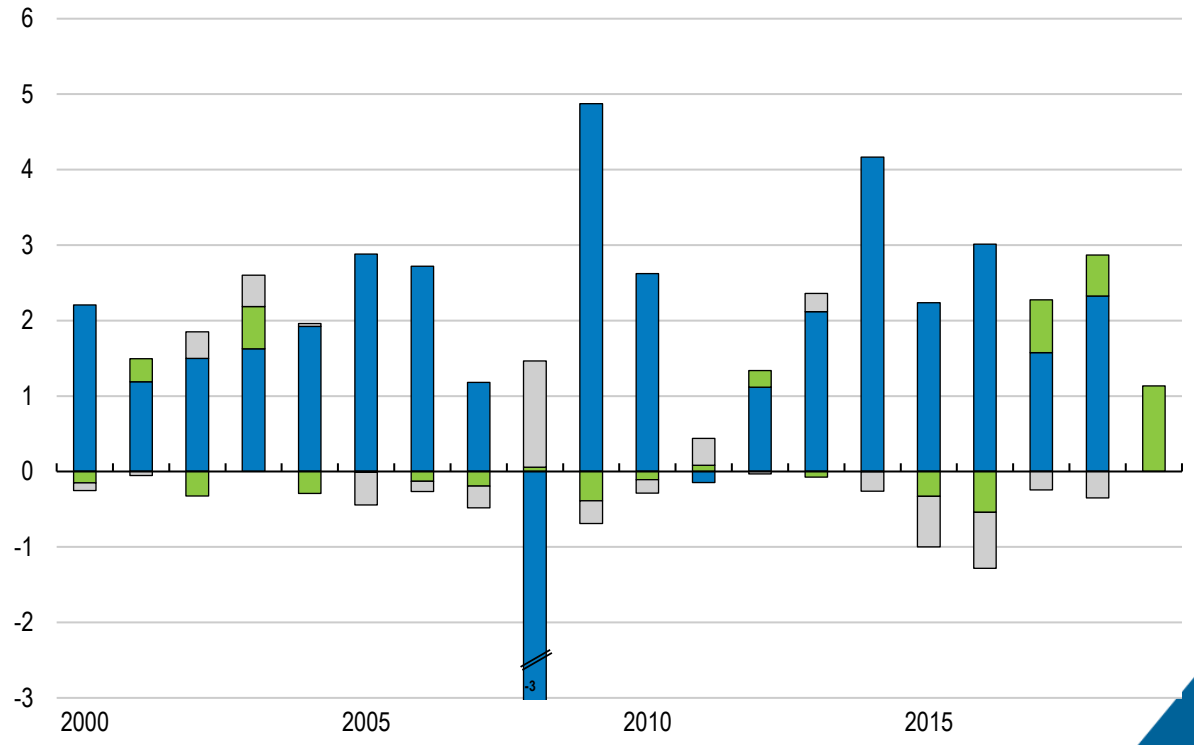
Productivity growth has slowed in both the US and Europe

Growth real value-added per worker

United States



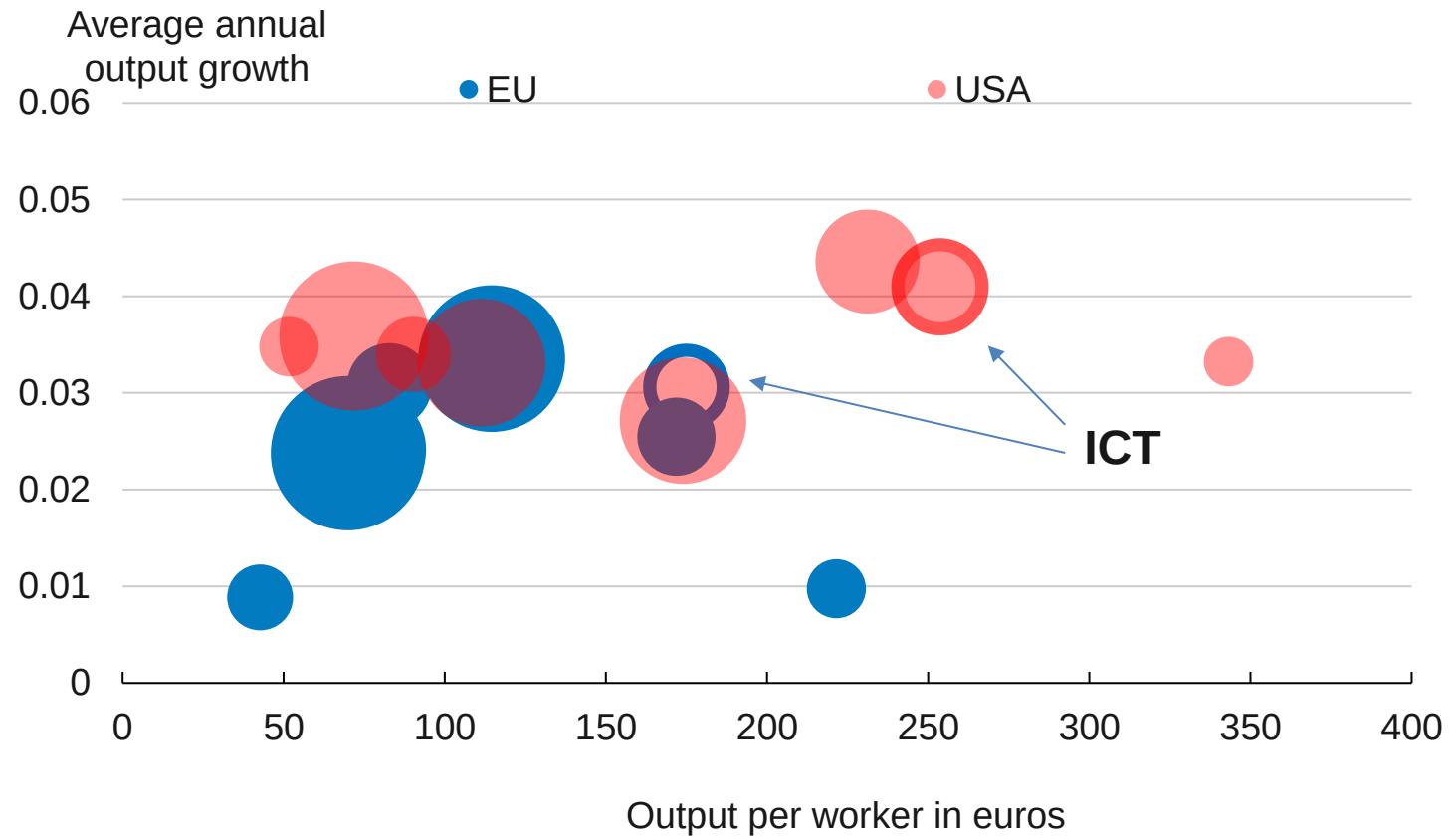
European Union



Source : OECD Structural Analysis (STAN) database and own calculations

Large, dynamic high-value added sectors are key

Growth, productivity and size of selected 2-digit sectors



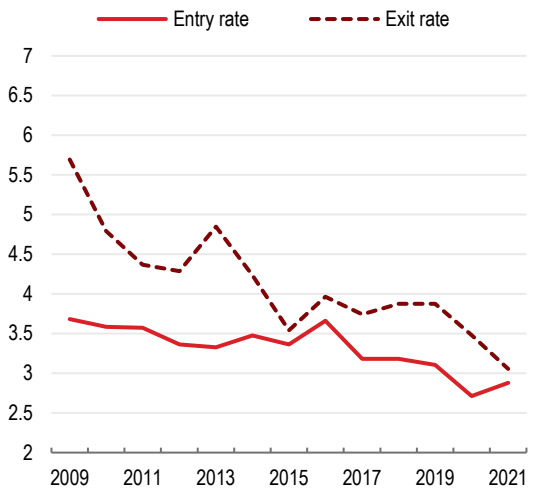
Bubbles represent share of value-added in euros

Source : OECD Structural Analysis (STAN) database and own calculations

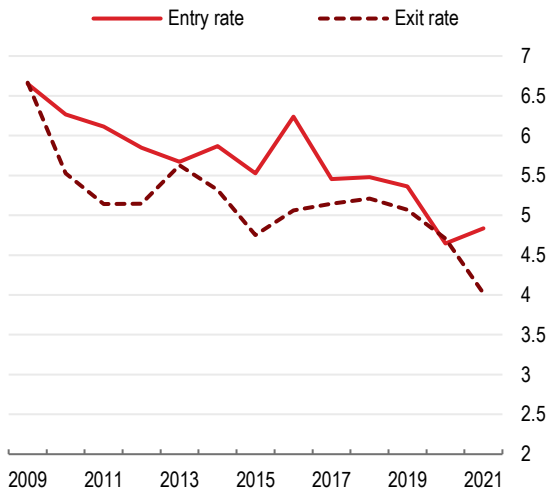
Business dynamism is weak and declining

Measures of business dynamism

Business dynamics
in the manufacturing sector
Large EU economies, %



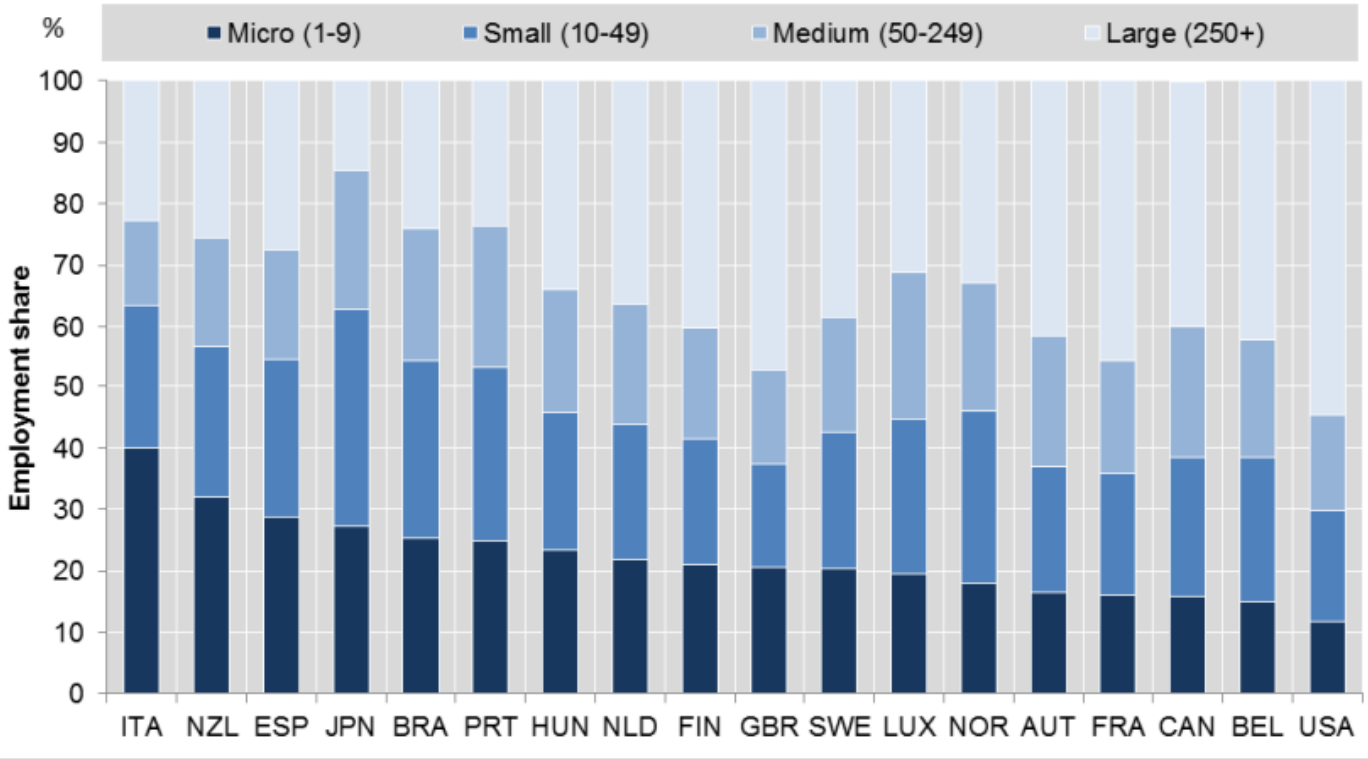
Business dynamics
in the services sector
Large EU economies, %



OECD (forthcoming), OECD Economics Surveys: European Union and Euro Area

Firms remain relatively small in EU countries

Share of employment by firm size

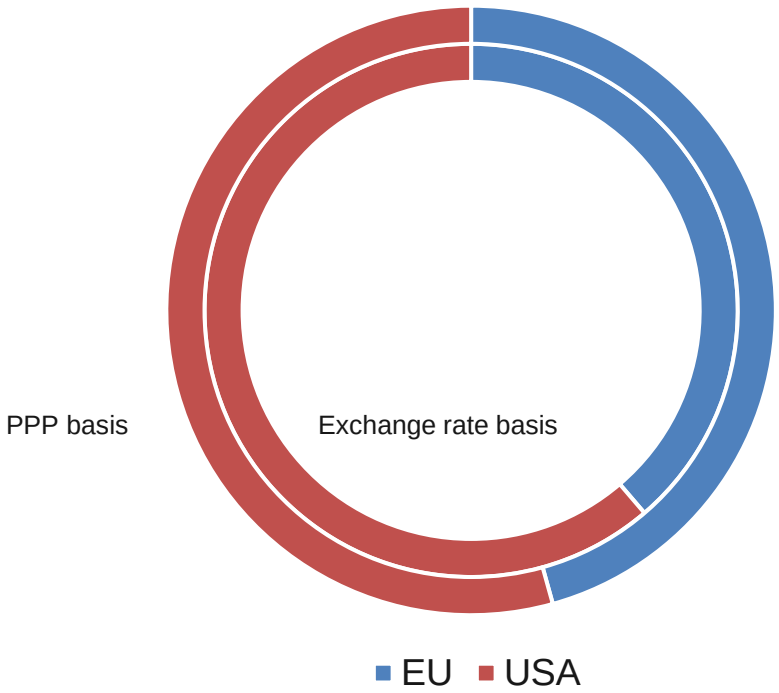


Criscuolo, C., P. Gal and C. Menon (2014-05-21), "The Dynamics of Employment Growth: New Evidence from 18 Countries", OECD Science, Technology and Industry Policy Papers, No. 14, OECD Publishing, Paris. http://dx.doi.org/10.1787/5jz417hj6hg6-en

Policy requirements

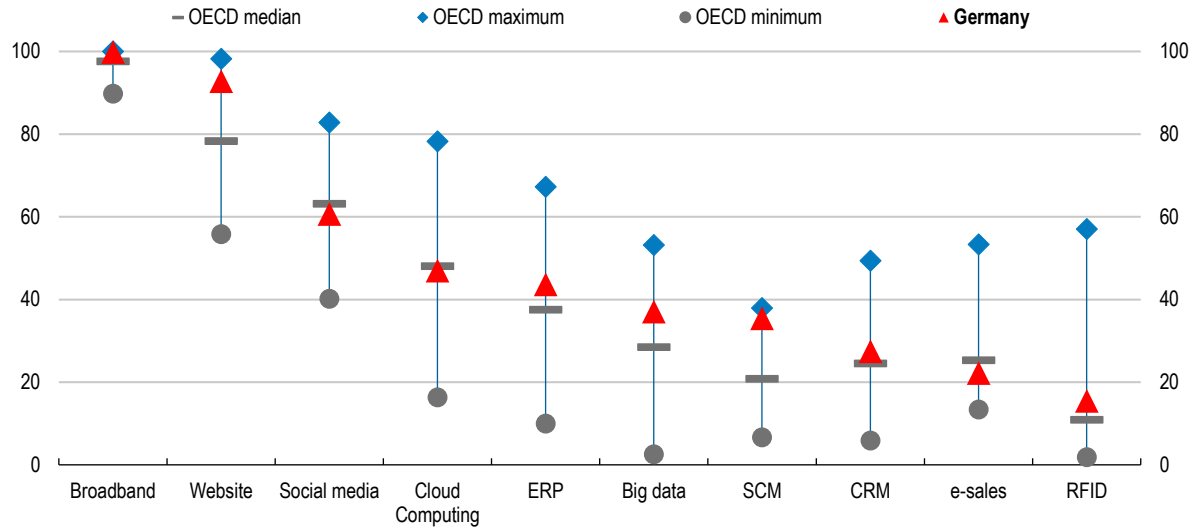
Innovation spending should be increased

Share of combined R&D spending



Enterprises using specific digital technologies

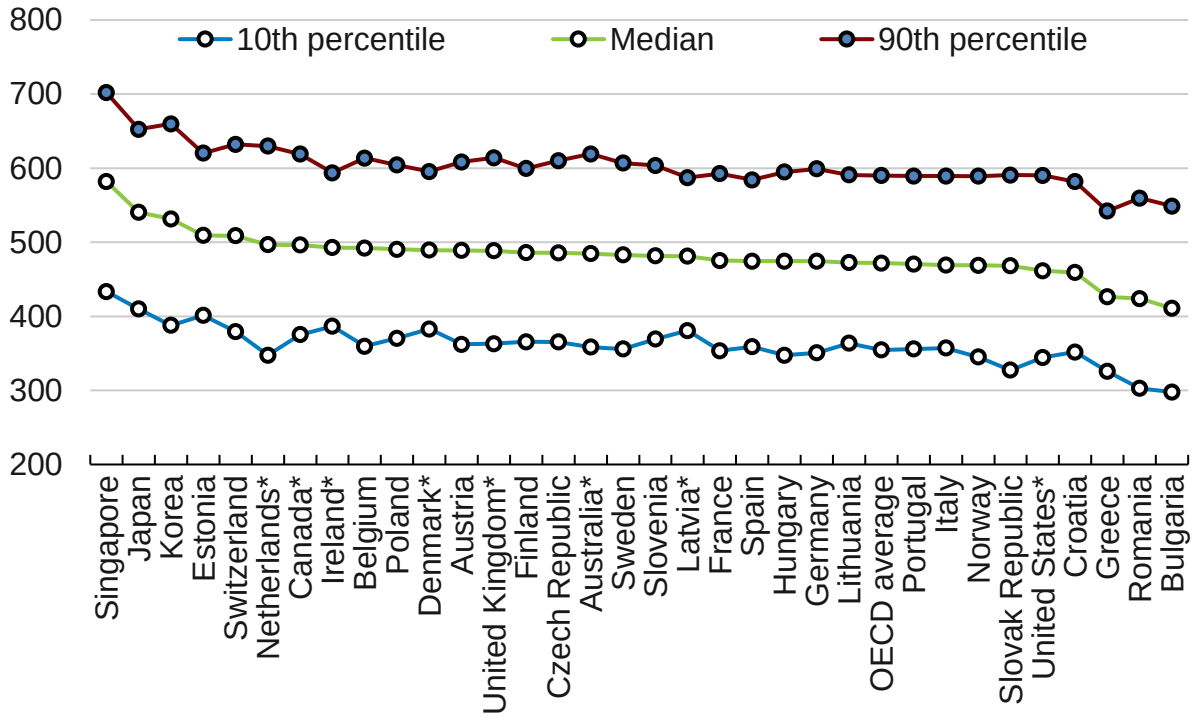
% of enterprises, 2023 or latest available year



OECD (2025), OECD Economics Surveys: Germany

Education and skills need to be improved

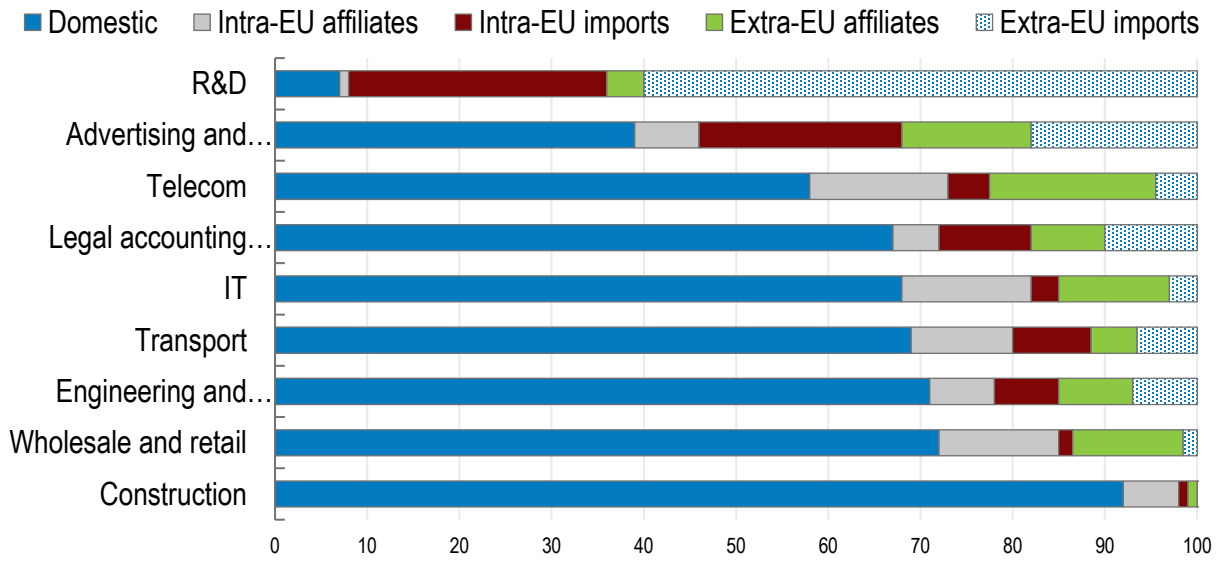
PISA mathematics scores (2022)



Completing the Single Market should be a major policy priority

Cross-border services trade and cross-border establishment

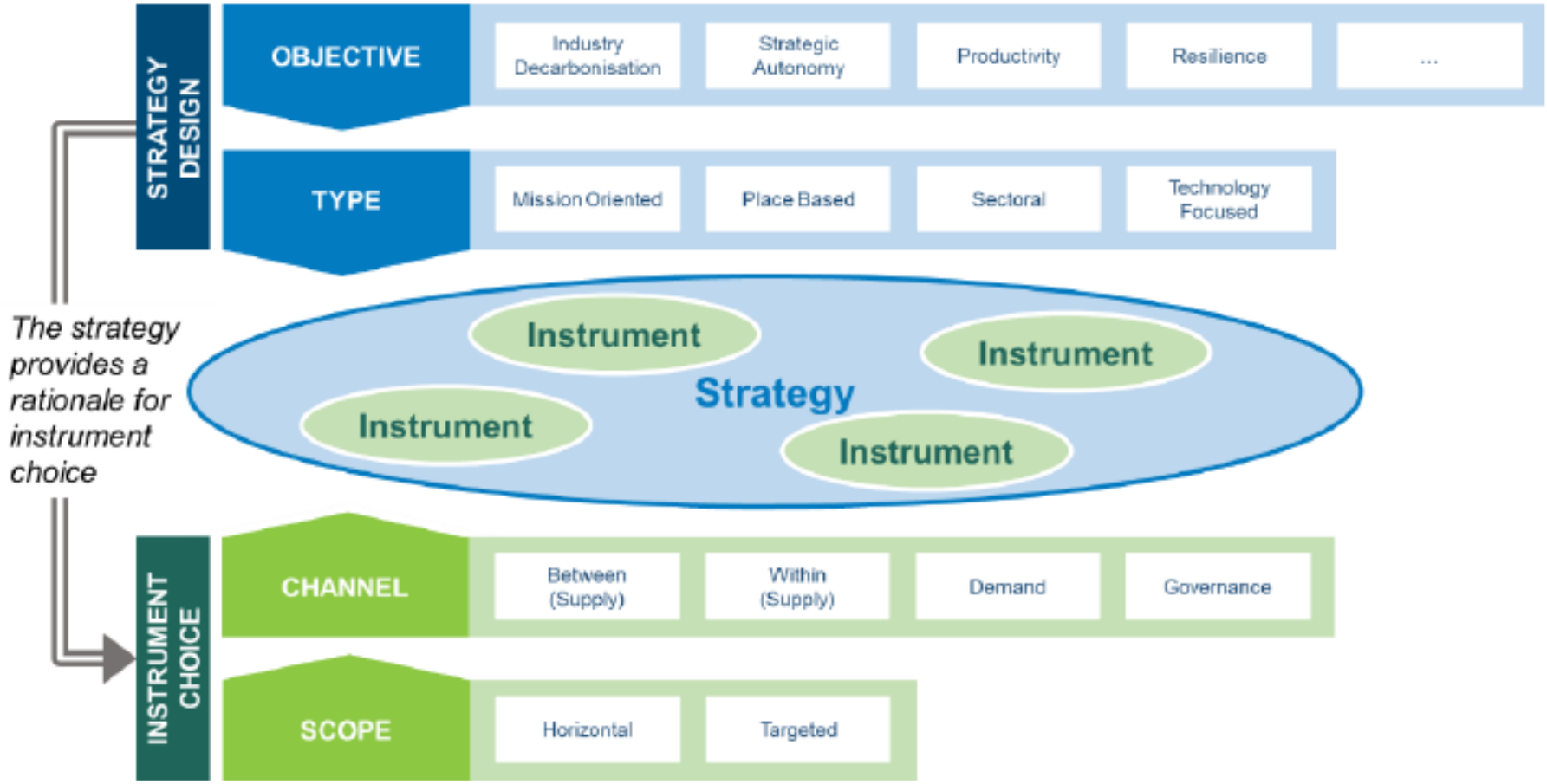
% of EU apparent consumption, 2018



European Commission (2022), "30 years of single market – taking stock and looking ahead"

Industrial policies

Industrial policy – a framework



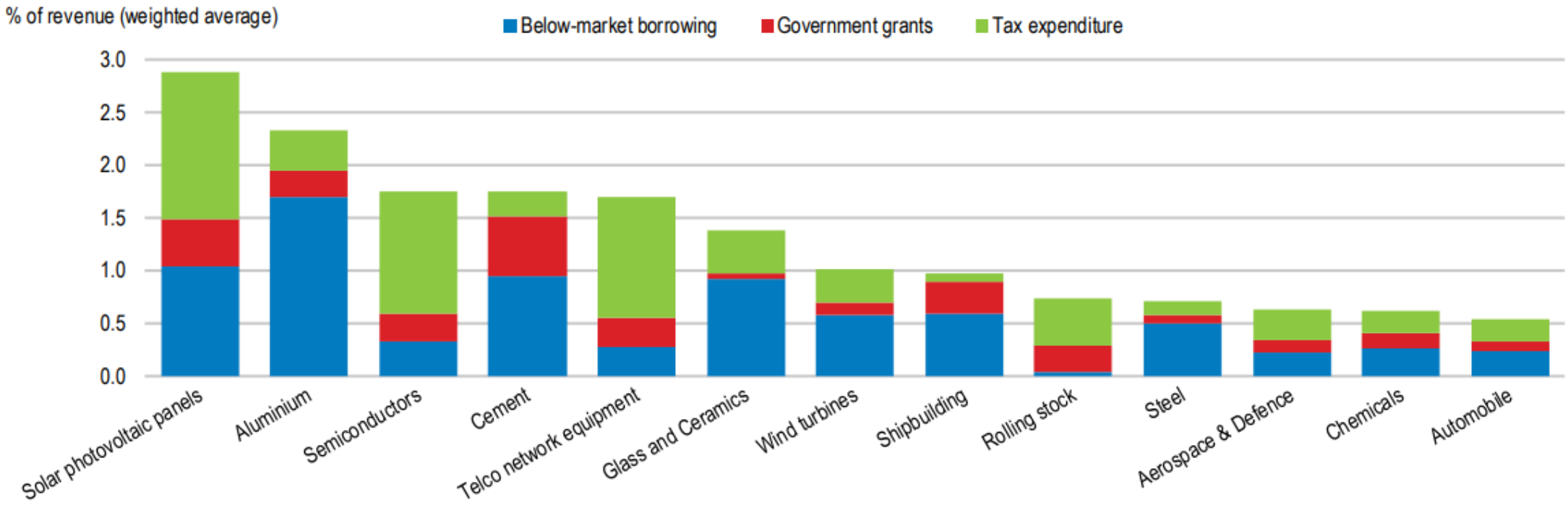
Criscuolo C. et al, (2002), "An Industrial Policy Framework for OECD Countries: Old Debates, New Perspective", OECD Science, Technology and Industry Policy Paper, May 2022 No. 127

Industrial policy – policy implications

- Well-designed R&D tax credits and subsidies are effective, while skill and knowledge transfer policies help
- **There is limited evidence on the effectiveness of targeted grants and subsidies**
- Framework conditions (eg competition) matter
- Demand-side policies can help
- Evaluation and regular re-assessment are needed for targeted industrial strategies

Industrial supports are widespread

Government support across selected industrial sectors at the global level 2005-2019 average, includes China

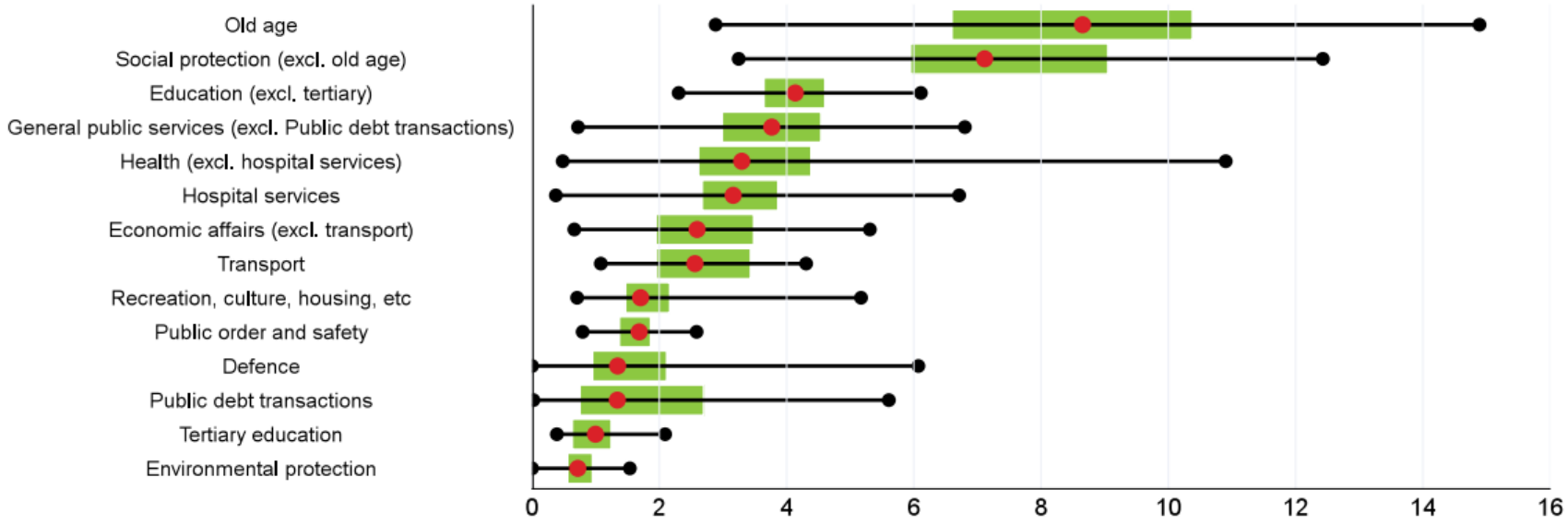


Millot, V. and Ł. Rawdanowicz (2024-05-31), "The return of industrial policies: Policy considerations in the current context", OECD Economic Policy Papers, No. 34

Addressing the challenges

Difficult choices will need to be need about the allocation of resources

Government spending across COFOG spending categories
2023 or latest year available, per cent of GDP



Barnes, S et al. (2025), "Searching for savings: what can be explained in government spending in OECD countries", OECD Economics Department Working Papers, forthcoming

Key references

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