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Extended Abstract

Prosperity in a changing world – Structural change and economic growth

In search for sustained economic growth

The recent crisis and the slow economic recovery have raised the awareness that creating sustained economic growth is a challenge. The current outlook for potential growth appears more dimmed than before mainly due to weak investment demand and supply-side problems. Thus, the question has become even more urgent which economic model EU countries should follow and how they are able to generate new growth potentials.

The answer to this question has changed over time. After a long period of focussing on industry as the main driver for economic success, information technology and other services became en vogue twenty years ago at the outset of the new economy boom. After the global financial crisis, the pendulum has swung again in the opposite direction: Industry is back. The question remains, however: Is there a superior economic model after all? And should national EU governments try to steer structural change in particular directions in order to evolve into this model?

Weak relation between economic structures and economic success

Against this outset, the study takes a closer look at the relation between economic structures and structural change on the one hand and indicators of prosperity on the other hand. Remarkably, it finds that there is no clear connection in the major advanced economies: For the years 2005 to 2014, the share of the service sector in total value added was lowest in Norway, with 57 per cent, and highest in Luxembourg, with 86 per cent. Yet both countries are positioned way ahead of the others in the rankings of per-capita income.

There is also no conclusive link between structural change and growth of per capita income. In Germany, for instance, the share of services in overall gross value increased by only 2.4 percentage points between 1995 and 2014 – much less than in most other advanced economies. However, Germany's per-capita income (adjusted to reflect differences in purchasing power) increased by a yearly average of 3.3 per cent during the same period, corresponding to the median of 21 advanced economies. The UK also displayed mid-range per capita growth – although its service sector share has increased by 11 percentage points since 1995, making it one of the fastest changing countries in this respect. Similarly, no clear connections can be found for the relationship between economic structure and structural change on the one hand and unemployment rates and their changes on the other hand.

Economic success derives from important drivers of structural change

Despite this, certain recipes for economic success do exist in terms of structural change: Econometric analysis shows that important drivers of structural change – such as globalisation, interconnectedness as well as innovation and knowledge – are significantly related to growth of per-capita income. Thus, the **key result** is:

No matter what economic model a country has developed over time, economic success hinges on effectively seizing the opportunities and on sufficiently tackling the challenges of structural change.

Recommendations: Different paths lead to prosperity

Policymakers must set the right framework conditions on the basis of historically shaped economic structures. The following represent just a selection of possible measures at EU level.

- Institutional framework

Economic policy should build on reliable institutions. The regulatory framework should allow flexibility, cost-efficiency and competition. This is a precondition for firms to cope effectively with structural change and to have sufficient incentives to be innovative and customer-oriented.

- Beware of conserving outdated economic structures

Striving for fixed targets of manufacturing's share in the EU economy is a double-edged sword. On the one hand, it assigns a clearer priority to industrial competitiveness for EU policy when aiming for the right balance with other policy fields such as energy or environmental policy. On the other hand, the danger arises that uncompetitive industrial structures are preserved and that the state pours out targeted subsidies to firms and sectors of uncertain economic future.

- Open markets

Open markets are a prerequisite for more competition, better consumer welfare as well as reliable access for EU companies to export destinations all over the globe. Companies therefore rely on a solid framework for trade and investment: The EU should try to bring forward the post-Doha agenda in the WTO and should strive to conclude an ambitious TTIP agreement with the United States.

- Cross-border infrastructure

Specialisation and labour sharing are essential for the efficiency of resource allocation on the level of the economy and for cost savings on the business level. EU companies need to be able to benefit from outsourcing and offshoring as well as from the integration in cross border value chains and innovation networks. Therefore, EU policy should particularly focus on enhancing cross border infrastructure and on further progress with the Single Market (including energy).

- Digital Single Market

Innovation is currently mainly driven by digitization. In order to be able to compete with the United States and Asia, the Digital Single Market is crucial and should be promoted further. This includes issues such as data protection legislation and the free flow of data and products across borders as well as a regulatory framework that supports the coexistence of traditional and new business models.

Full report in German via qr-code or via http://bit.ly/1p03ovB

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