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Navigating Europe's Demographic Challenges: The Burning Need for Increased Productivity

Europe faces a multitude of structural challenges that threaten its economic stability and future growth. In addition to the ongoing malaise in manufacturing, political uncertainty and a decline in competitiveness and investment, Europe faces the pressing problems of an ageing population and a shrinking workforce. With life expectancy rising and not enough babies being born to compensate for deaths, Europe risks soon having a workforce that will struggle to sustain current growth expectations.

To counter this, one solution could be to increase productivity to ensure that the economy continues to grow at a sustainable pace. New technologies, such as artificial intelligence (AI), will be key to supporting this productivity growth, but this is dependent on a rapid adoption and restructuring of companies to make the most of new technologies.

The number of babies being born in Europe is declining

According to the UN Population Fund, the number of children born per mother has declined steadily worldwide over the past 75 years, from 5 births per woman in 1950, to 2.3 in 2021, and is estimated to fall to 2.1 by 2050. 2.1 births per woman is the so-called 'replacement level', meaning that the children born will eventually replace their parents. In Europe today, fertility rates in many countries are already below the replacement level, leading the UN to predict that Europe's population will fall by 7% between 2022 and 2050. This, in turn, would have a significant impact on growth.

Zooming in on Luxembourg specifically, it was one of the few countries with a fertility rate below the replacement level when the UN started collecting data in 1950. Although the fertility rate rose slightly in the years that followed, it has remained below the replacement level since the late 1960s.

A threat to growth

But would it be so bad if Europe's population shrank? A major concern is that a declining workforce will struggle to sustain the quality of life that Europeans have become accustomed to, let alone meet government growth targets. Rising life expectancy and an ageing population will complicate the economy's ability to support current income and retirement patterns without significant changes.

Economic growth is directly linked to the size of the labor force. If the workforce diminishes, growth will be impacted as fewer individuals contribute to the production of goods and services. Furthermore, the income generated by a smaller workforce must be spread more thinly to support the increasing proportion of the population not in the labor force.

To maintain the current situation, one perhaps obvious solution would be to have more children. Economic and financial security, as well as the balance between work and family life, obviously play an important role in parents' decisions to have more children. Nevertheless, countries like Norway, that have invested heavily in family policies to make work/family life balance a reality, are still struggling to meaningfully increase their fertility rates. And even if European countries were able to persuade parents to have more children, these children would not enter the labour force for at least another 20 years.

Another natural solution is to make the workforce work longer. This is something that has already been set in motion in other parts of the world. In Japan, the employment rate of people aged 65 and over reached 25.2% in 2022, according to the World Economic Forum. This compares with 18.6% in the US and 10.9% in the UK. However, adopting this measure in European countries might not be as clearcut as it seems. In France, this has not been a popular proposal in the past. In 2022, the French took to the streets with the purpose of bringing France to a standstill to protest a plan to raise the pension age to 64.

Increasing productivity could help offset some of the lost output from a shrinking workforce

To address the threat to growth posed by a shrinking workforce, Europe needs to reverse the current trend of falling productivity. According to Eurostat, annual productivity growth in the European Union has slowed from 1.5% in 1999-2008 to -0.6% in 2023, due to a lack of investment and declining technology diffusion. GDP per capita is directly affected by how many hours people work and how productive that work is. Therefore, if the work done is more productive, the size of the labour force does not need to be as large.

AI could be one of the answers to boosting productivity. Just as we saw the internet boost productivity in the 1990s, AI has the potential to do the same now. According to the World Economic Forum, the average annual productivity growth in the US non-farm business sector rose to 2.5% between 1991 and 2007, up from 1.5% in the previous 15 years, as the benefits of the internet began to feed through to the economy. At the moment, however, the potential of AI to boost productivity has yet to be translated into anything tangible. For this productivity growth to materialise, companies will need to redesign their workforces to work alongside AI.

Productivity gains is, however, not a silver bullet, and would have to be substantial in order to offset the lost output from a shrinking workforce alone. Rather, it would have to be galvanised by longer working lives and higher fertility rates to offset the demographic time bomb. AI should therefore not be seen as a risk, but rather as a safety bell for European welfare model.

Unavoidable change

Europe is at a critical juncture, faced with the dual challenges of an ageing population and declining productivity. The urgency for innovation and adaptation is steadily increasing. As we look ahead, embracing new technologies like AI will be essential, but it will require a collective commitment from businesses, governments and individuals alike.

Moreover, lessons can be learned from countries like Japan, where increased labor force participation among older individuals has proven beneficial. Adopting these practices and actively addressing the factors contributing to declining productivity can ensure that Europe’s workforce continues to strengthen, even as it shrinks.

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