Demographic Obstacles to European Growth

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Abstract
Since the early 1990's there have been persistent slowdowns in the growth rates of the four largest European economies: France, Germany, Italy, and the United Kingdom. This persistence suggests a low-frequency structural change is at work. Ageing populations, both in terms of longer individual life expectancies and declining fertility have caused a shift in the age-cohort distribution. Growth accounting identifies the following five sources of economic growth: total factor productivity, capital accumulation, labor supply on the intensive and extensive margin, and population growth. Changing demographics affect all these five margins. The effects of ageing populations on economic growth are also exacerbated by the pension systems in place. In order to fund increasing liabilities with a shrinking tax base, tax rates must increase to balance budgets. This will impose distortions to individual factor-supply choices, providing further headwinds for economic growth. We quantify the additional growth effects resulting from these distortions.

JEL Classification Codes: F21, J21.

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