

Europe's business competitiveness gap: The role of capital formation and total factor productivity

Between 2000 and 2025, labour productivity in U.S. non-financial corporations rose by 56%, against 20% in the EU-27. Firms on both sides of the Atlantic allocate their inputs with the same cost-minimising logic, which places the origin of the gap in capital formation and total factor productivity growth.

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Abstract: Europe's productivity and investment gap with the U.S. ranks among the main challenges facing its economy and diagnosing it requires distinguishing how firms use the resources available to them from how they increase and improve those resources over time. Non-financial corporations account for approximately half of GDP in both blocs and offer a homogeneous basis for comparing performance between 2000 and 2025. U.S. firms faced faster growth in the cost of labour, yet productivity gains more than offset this, leaving their cumulative unit labour costs below those of their European counterparts. Responses to changes in relative factor prices are consistent with cost minimisation on both sides of the Atlantic, which points to comparable efficiency in the allocation of existing inputs. The divergence emerges in dynamic efficiency: by 2025, gross fixed capital formation stood 80% above its 2000 level in

U.S. firms and 40% above in EU-27 firms, with European investment barely growing since 2019. Sluggish capital formation slows the incorporation of new technology, including that tied to digitalisation and AI, and total factor productivity growth in Europe has stalled at 2019 levels. The evidence cannot determine whether the roots of the gap lie in the technological, institutional and market environment or in firms' internal governance and investment decisions, a question that remains open.

Foreword

The European economy's loss of competitiveness relative to the U.S. has risen to the top of the region's economic debate and policy agenda. The Draghi Report (2024) helped place productivity, investment and innovation at the heart of that debate. However, an accurate assessment of the competitiveness gap requires distinguishing between two different questions: how businesses use the productive resources available to them and how they add to and enhance those resources over time. The first question relates to the efficiency with which the factors of production are allocated; the second to investment, the accumulation of capital and technological progress. The distinction is important for both interpreting the differences observed and informing appropriate economic policy responses.

This paper examines these questions by comparing the performance of non-financial corporations (NFCs) in the European Union (EU-27) and the U.S. between 2000 and 2025. Unlike many other comparisons involving the economies as a whole, our analysis focuses on the non-financial corporate sector, whose value-added accounts for, on average, approximately 52% of GDP in both economic blocs. This focus allows us to compare more homogeneous subsets of the economy —firms driven by similar economic motives — and to more accurately analyse their productive outcomes, labour costs and investment decisions. [1]

The findings reveal significant differences between the two corporate sectors. The U.S. firms have sustained higher growth in costs per unit of labour but also much higher labour productivity gains. Between 2000 and 2025, the latter increased by 56% in the U.S., compared to 20% in the EU-27. As a result, the cumulative increase in unit labour costs was lower in the U.S. (47.5%) than in Europe (66.6%). The difference is also tangible in total factor productivity, whose annual growth is estimated at 1% in the U.S., compared to 0.4% in the EU-27. Moreover, there is a discernible difference, particularly visible since the pandemic, in investment dynamics, with capital formation rebounding far more intensely across the American cohort of businesses.

The interpretation of these results introduces an important nuance into the European competitiveness debate. The aggregate evidence is compatible with a similar response by European and American firms to the changes in the relative prices of their factors of production. Indeed, the results do not point to noteworthy differences in the behaviours associated with the minimisation of costs or efficiency of allocation. The most remarkable differences are observed in the trend in investment, capital accumulation and total factor productivity. In other words, the issue would appear to reside less in the use of available resources than in the ability to add to and upgrade productive capacity.

This distinction does not, by itself, allow us to identify the ultimate causes of the gap. The differences could be related to the technological, institutional or market conditions in which the businesses operate, as well as internal organisational, corporate

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governance or investment decision-making factors. Moreover, the differences between the European and American statistics and the use of aggregated data warrant caution in interpreting the results. This paper does not aim to resolve these matters of cause and effect but rather provide evidence to help pin them down.

To that end, the paper first compares the trend in unit labour costs and the key drivers in both economic areas. It then examines investment, capital formation and total factor productivity, distinguishing between static and dynamic efficiency. Lastly, it presents our key findings and the implications for the European business competitiveness debate.

Unit labour costs of NFCs in the EU-27 and U.S.

The cost of the labour needed to produce one unit of output is a common indicator of the competitiveness of individual firms which can nevertheless be extrapolated to economies as a whole. Using aggregated data for the universe of NFCs, if w denotes the cost per unit of labour (hour of work per person); L denotes the quantity of labour; and Q, the volume of output produced, the unit labour cost, ULC, is determined by dividing the cost per unit of labour by the units produced per unit of labour (partial labour productivity):

$$Unit\ labour\ cost, ULC = w\frac{L}{Q} = \frac{w}{\frac{Q}{L}} = \frac{Cost\ per\ unit\ of\ labour}{Partial\ labour\ productivity}$$

In the short term, capital is a given and, therefore, its cost can be regarded as fixed; similarly, product and process innovation takes time to materialise. For these reasons, a firm's competitiveness in the short term (maintaining or increasing its share of the market and/or profit margin) will depend primarily (and inversely) on its unit labour costs. To keep unit labour costs from rising, undermining competitiveness, the compensation paid for the labour used in production cannot increase faster than labour productivity. The unit labour cost calculated for the NFC sector on aggregate can be interpreted as an indicator of the competitiveness of a representative firm.

Expressing the unit labour cost relative to the market selling price denotes the distribution of the gross value added in production and sale in the market between labour and capital. Calling the selling price p, and assuming it is the same for all competitors if the product is homogeneous, the gross operating margin equals:

$$\frac{p - ULC}{p} = 1 - \frac{w}{p\frac{Q}{L}} = 1 - \frac{wL}{pQ}$$

The term $\frac{wL}{pQ}$ is the share of labour compensation in the value of output; its counterpart is the gross operating margin, which remunerates capital and entrepreneurship. If wages increase by more (less) than productivity, the share of labour in the value of output increases (decreases), while the exact opposite occurs with the gross operating margin. Note that any comparison of gross operating margins across economies should also consider possible differences in taxation and production subsidies.

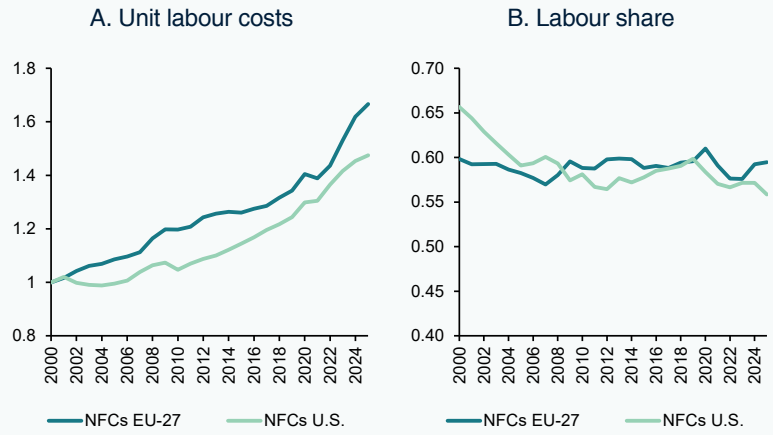
Findings

Exhibit 1 provides the trend in unit labour costs and the labour share for the NFCs in the EU-27 and U.S. The unit labour cost figures have been rebased to 2000 (such that what is really being compared is the trend over time in the variables in local currency, euros in the case of the EU and dollars in the case of the U.S.). The labour share is calculated directly by dividing worker compensation by gross value added.

As for the trend in unit labour costs, the EU NFCs exhibit a loss of competitiveness relative to their U.S. counterparts over the course of virtually the entire period. The comparison between 2025 and 2000 illustrates that over that time interval, the EU NFCs sustained a cumulative increase in unit labour costs of 66.6%, which is considerably above the 47.5% increase recorded by the U.S. business ecosystem. A substantial portion of the loss of competitiveness materialised between 2000 and 2007, when unit labour costs increased for NFCs in the EU while holding stable for their American counterparts.

Exhibit 1

Trend in unit labour costs (ULC) and the labour share for the NFC sectors in the EU-27 and U.S.



Sources: Author's own elaboration based on Eurostat and Bureau of Labor Statistics.

Elsewhere, the share of gross value added that remunerates labour held steady at 60% throughout the entire period for the EU-27 NFCs but fell on aggregate for the U.S. businesses, particularly between 2000 and 2007, the same years in which their unit labour costs held steady. The counterpart to the labour share is the gross operating margin, which means, based on the data above, on aggregate for the EU-27 NFCs, gross margins held steady at around 40% throughout the period, whereas for the U.S. NFC cohort, the gross operating margin trended upward from 35% at the start of the period to 43% by the end (without considering possible differences in taxation and production subsidies between the two economies).

It is interesting to analyse whether the differences in unit labour costs between the European and American firms are explained by differences in their costs per unit of labour or, rather, by differences in labour productivity, which is where Exhibit 2 comes into play.

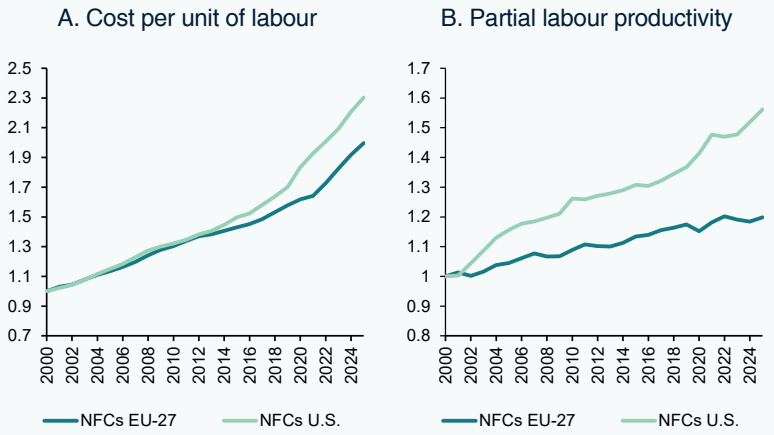
Until 2013, labour costs per unit of labour followed a virtually identical pattern in the EU-27 and the U.S. (Exhibit 2A). However, from 2014 on, nominal labour costs increased at a faster pace in the U.S. than in the EU-27. As a result, in 2025, the cost per unit of labour in the U.S. was 2.3 times that of 2000, growth of 130%, compared to an increase over the same timeline for the EU-27 businesses of 100%.

Meanwhile, the partial labour productivity increased faster at the American NFCs than for their European peers, creating a labour productivity gap that has widened over time (Exhibit 2B). Specifically, the labour productivity of the American NFCs was 56% higher in 2025 than in 2000, compared to a much smaller increase of 20% for the EU-27 NFCs on aggregate over the same timeframe. Therefore, the competitive advantage in terms of the evolution of unit labour costs of the U.S. NFCs relative to their EU-27 counterparts was driven by considerably higher labour

> "From 2014 on, nominal labour costs increased at a faster pace in the U.S. than in the EU-27."

Exhibit 2

Determinants of unit labour costs. Comparison between NFCs in the EU-27 and the U.S.



Sources: Author's own elaboration based on Eurostat and Bureau of Labor Statistics.

productivity gains over time on the other side of the Atlantic, which more than offset the disadvantage from higher growth in per unit of labour cost of U.S. corporations compared with EU-27 ones.

Capital formation and total factor productivity of the NFCs in the EU-27 and U.S.

Capital goods have a productive useful life spanning several years. The stock of capital businesses have at their disposal for production at a given moment in time is the result of the inflow of new capital from one period to the next — investment or gross fixed capital formation (GFCF) — less the consumption of units of capital services embodied in the existing stock due to wear and tear and/or technological obsolescence. In general, capital goods embody technological developments which in turn enhance the productivity of the stock. A portion of new capital goods typically replaces productive capacity lost through assets which are depreciated and/or withdrawn from service. Another portion of new investments may seek to substitute for labour as part of a rational response (cost minimisation) to an increase in the cost of labour relative to capital. The replacement of labour with more capital will increase apparent labour productivity and decrease that of capital, suggesting that the improvement in the labour productivity detected in the previous exhibit does not necessarily indicate greater efficiency in the use of inputs but rather the result of a substitution effect. Lastly, an investment in capital may be driven by the goal of increasing productive capacity and/or innovating in new products or services for sale.

In this section we compare GFCF and net investment for the NFCs in the EU-27 and the U.S. for the period under analysis. In addition, the growth in partial labour productivity shown in Exhibit 2B is broken down into the contribution explained by the substitution of more capital for less labour for the same volume of production and the part that is not explained by the substitution effect, which coincides with total factor productivity (aggregate productivity of capital and labour), plus a possible scale effect (refer to the annex).

Findings: Investment

Exhibit 3A provides the trend in the index (rebased: 1 = 2000) of annual gross fixed capital formation (GFCF) flows for the aggregate of U.S. NFCs, in constant 2000 dollars, and the index for the aggregate of EU-27 NFCs, in constant 2000 euros. Exhibit 3B provides a similar comparison using net

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fixed capital formation (NFCF), equal to GFCF less capital depreciation.

Between 2000 and 2008, prior to the financial crisis, fixed capital formation, both gross and net, increased by more across the EU-27 NFCs universe than the U.S. business cohort. The financial crisis triggered a sharp contraction in gross fixed capital formation back to the levels observed at the start of the period in both economies, coupled with an even sharper contraction in net investment.

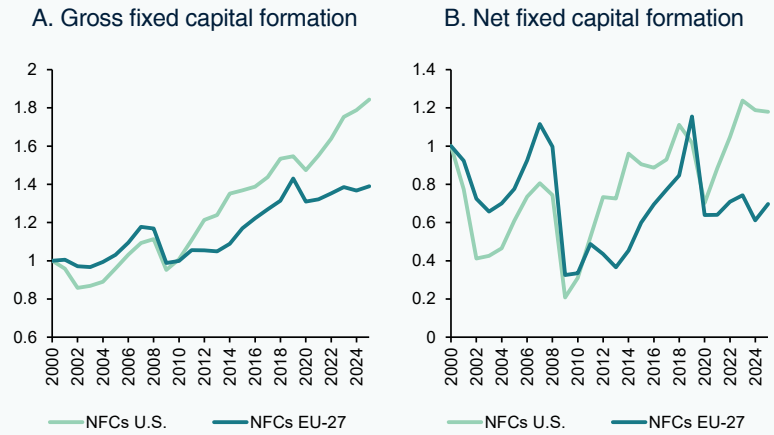
In the U.S. NFCs, on aggregate, gross fixed capital formation resumed growth immediately after the contraction, whereas investment did not begin to recover in the EU-27 business ecosystem until 2014. From then on, growth in gross investment was swift and by 2019, the capital formation index for the EU-27 NFCs matched that of the American NFCs. The Covid-19 pandemic triggered another severe contraction in capital formation from which the EU-27 NFCs have yet to recover, in contrast to the U.S., where corporate capital expenditure has etched out an accelerated recovery in the post-pandemic era.

The upshot is that by 2025, the GFCF index for the U.S. NFCs, in constant dollars, was 80% above 2000 levels, whereas the same index for the EU-27 NFCs, in constant euros, was only 40% above the starting point, exacerbated by the fact that investment has barely increased since 2019. As for net investment, for the U.S. NFC cohort, the 2025 figure was 20% above the 2000

Exhibit 3

Comparison between the time evolution of gross and net fixed capital formation flows for the NFC sectors in the EU-27 and U.S.

Values in constant euros and dollars, rebased to 1 = 2000



Sources: Author's own elaboration based on Eurostat and FRED.

> "In recent years, the substitution effect has slowed among the EU-27 firms, consistent with the stagnation in the stock of fixed capital observed from 2021 onwards, while continuing in the U.S. where investment growth has not stalled."

equivalent, whereas net investment across the EU-27 subset in 2025 was 30% below the 2000 level.

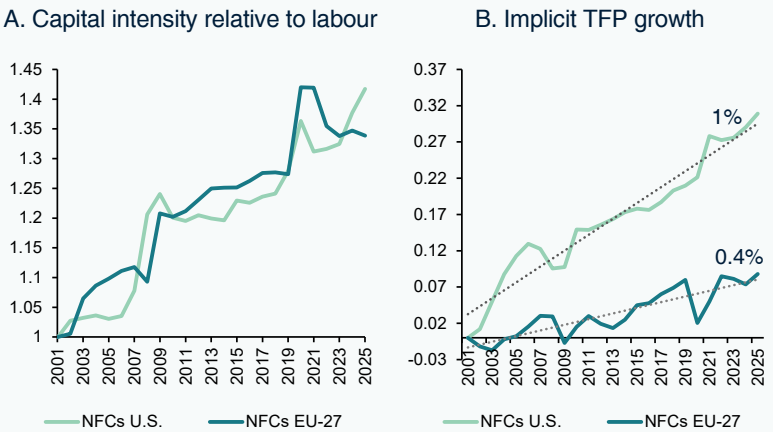
The contrast between the European businesses' ability to resume growth in investment between 2014 and 2019 and their inability to do so from 2019 on is noteworthy. Sluggish investment undermines the incorporation of the new technology embedded into new capital goods. In recent years, this phenomenon is of particular significance due to the heady investment cycle associated with digitalisation and AI in the U.S. However, the data used in this paper do not allow us to directly identify the impact of this channel on the composition and volume of capital investment.

Findings: Capital intensity and total factor productivity

The flows of new investment and consumption of the capital services embodied in the stock of capital accumulated in the past determine the trend in the stock of capital held by the NFCs along a path shaped by the goal of maximising the economic value of their investments, which is an extension of that of maximising profits from one year to the next. The perpetual inventory method allows us to estimate the stock of fixed capital for the NFC sectors in the EU-27 and U.S. between 2000 and 2025. As noted earlier, some of the growth in the capital stock could be attributable to a desire to reduce labour inputs and increase capital to achieve the same level of production in response to a

Exhibit 4

Comparison of the trend over time in capital intensity per unit of labour (logarithm of the rebased values, 1 = 2000) for the NFC sectors in the EU-27 and U.S. (Exhibit 4A) and comparison of the cumulative annual average growth in TFP for both business cohorts



Source: Author's own elaboration; refer to the Annex for further explanation.

change in the relative prices of the inputs (labour relatively more expensive). Exhibit 4 provides the trend in the capital-labour ratio for the NFC aggregates in the EU-27 and U.S. (numerator and denominator values rebased to 1 = 2000) (Exhibit 4A) and the trend in total factor productivity (TFP), similarly in logarithms, as implied by the difference between the trend in labour productivity and capital intensity per unit of labour (refer to the Annex for an explanation of the calculations made).

The general tendency to replace units of labour with more units of capital in production affects the NFCs in the EU-27 and U.S. in a similar fashion. That phenomenon is consistent with an increase in the cost of labour relative to capital (observed in the data, albeit not reported) when businesses frame their choice of inputs for production based on the profit maximisation rationale (cost minimisation). The substitution process does not etch out an even time pattern (see the significant jump in the years immediately following the financial crisis) and there are differences between the two cohorts at specific moments in time; for example, in recent years, the substitution effect has slowed among the EU-27 firms (consistent with the stagnation in the stock of fixed capital observed from 2021 onwards) while continuing in the U.S. (where investment growth has not stalled).

Exhibit 4B provides the TFP estimates gleaned from the difference between observed production and that estimated given the quantities of inputs — capital and labour — used in production. The total productivity measure increases at an annual rate of 1% among the U.S. NFCs, compared to annual growth of 0.4% among the EU-27 firms. Note that the TFP estimated for the EU-27 NFC aggregate has been virtually stuck at 2019 levels in recent years.

Here TFP is interpreted as a residual measure of the combined efficiency with which the measurable labour and capital factors are transformed in production. Changes in TFP may reflect technological progress, as well as changes in intangible assets not measured, the quality of the factors, organisational factors, capacity utilisation and other elements not considered. When calculated as a "residual", this measure cannot be used to delve into the differences observed in the growth in TFP between the two sets of businesses.

Summing up

Table 1 summarises the comparison between the EU-27 and U.S. NFCs based on the values estimated for a set of variables used to prepare the previous figures. The first two columns compare the cumulative annual rate of growth in the selected variables between 2000 and 2025; the other two columns compare the trend in those same variables between the start of 2019 and end of 2025. Note that not all the values featured in the table are measured with the same level of accuracy, as the variability around the trend line of the logarithm of the corresponding variable is not the same for all of them. The estimates of the changes in the values of the variables between 2019 and 2025 do not allow for identification of differences within the sub-period, affecting the interpretation of certain results. For example, growth in working capital for the EU-27 NFCs was virtually nil between 2021 and 2025, which makes sense in light of the trend in investment.

Table 1 shows that input and output prices have followed broadly similar trends in the EU-27 and the U.S. In both cases, firms' production decisions appear consistent with profit-maximising behaviour: Rising real labour costs have encouraged increases in labour productivity.

By the same token, a decrease in the real cost of using capital is expected to lead to a drop in partial capital productivity. Lastly, an increase in the cost of labour relative to capital can be expected to unleash a process of substitution between the factors of production (more capital and less labour). The movements in the quantities featured in Table 1 are consistent with these expectations for both sets of NFCs. Therefore, through the lens of the allocation efficiency derived from using inputs in order to minimise costs, there are no noteworthy differences between the EU-27 and U.S. NFCs during the period under analysis.

Table 1

A comparison of selected indicators (used in the indices above) covering prices, production, productivity and competitiveness between the NFCs in the EU-27 and U.S.

Primary data for the U.S. in 2000 dollars and primary data for the EU-27 in 2000 euros

	Annual rate of growth, 2000-2025 (%)		Growth between 2019 and 2025 (%)	
	EU-27	U.S.	EU-27	U.S.
Output price deflator	1.75	2.04	24	23
Nominal cost per unit of labour	2.53	3.20	26	35
Real cost per unit of labour	0.78	1.16	2	7
Real user cost of capital	-0.9	-0.62	0	0
Labour	0.87	0.47	6.6	3
Operational capital stock	2.2	2.5	11.5	14
Output	1.64	2	8.6	18
Labour productivity	0.76	1.58	2	14
Total factor productivity	0.4	1.0	0.8	10
Unit labour costs	1.78	1.60	24	19
Share of labour	0.00	-0.43	0	-4
GFCF	1.55	3.00	-3	19

Sources: Author's own elaboration based on Eurostat, BLS and FRED.

The key differences in the outcomes for the NFCs in the EU-27 relative to their American counterparts are concentrated in the variables related to the efficiency we term as "dynamic" and which materialise in the trend in TFP. Capital formation influences TFP via the technological developments embodied in new capital goods and via the internal generation of assets, mainly intangible, which are not even recognised on the companies' balance sheets (organisational capital, commercial capital and certain forms of knowledge capital). It would be interesting to ascertain what portion of the gap opened up in NFC capital formation on either side of the Atlantic in recent years is attributable to uneven dynamism in the two economies around investments to develop AI-adjacent technologies.

Conclusions

The NFCs are driven by behavioural motivations and face technical and competition constraints in the market that differ from those affecting the other institutional sectors of the economy. This

> "European corporations achieve similar levels of allocation efficiency in terms of cost minimisation as the American NFCs, however, in terms of dynamic efficiency measured using capital formation and growth in total factor productivity, the European firms are lagging the Americans, and the gap has only been widening in recent years."

distinguishing, qualitative consideration, coupled with the sector's quantitative significance (its value added represents more than half of GDP), more than justifies the separate assessment of the NFC sector's performance and competitiveness in the short and long term.

The evidence presented, underpinned in turn by that collected as part of an earlier study of the NFC sector's performance in the EU-27 (Salas Fumás, 2026), yields the conclusion that the European firms achieve similar levels of allocation efficiency in terms of cost minimisation as the American NFCs; in terms of dynamic efficiency, however, measured using capital formation and growth in total factor productivity, the European firms are lagging the Americans and the gap has only been widening in recent years. The different interpretation yielded by comparing the firms' efficiency in allocating available inputs relative to the efficiency gleaned from investment dynamics and the trend in TFP over time provides new insight *vis-a-vis* the results of the studies focused on comparing the European and U.S. economies as a whole and not just their NFCs.

The policies articulated around the *Competitiveness Compass* applied by the European Commission — encouraging investment in R&D, extending a truly single market to services in addition to goods, implementing new industrial and competition policies, etc. — will ultimately improve the conditions for doing business in the EU and broaden technological opportunities. The *Compass*, broadly in line with the assessment set down in the Draghi Report, places particular emphasis on improving the external forces shaping how European firms invest and innovate. Mazzucato et al. (2026), in contrast, underline the importance of internal factors, particularly the governance model of the EU's large enterprises which, the authors argue, prioritises the extraction of value over the creation of value, in their assessment of the causes of the competitiveness gap facing European businesses. The results presented in this study and in the broader analysis which it draws from are consistent with those expected of price-taker firms which frame the allocation of their resources with the criteria of maximising profits or minimising costs, and this is so for both the European and American corporations on aggregate. However, they do not explain the underperformance by the EU-27 NFCs in dynamic efficiency terms (investment in capital and innovation).

The crux of the matter remains why the private investment and innovation decisions of the European firms, taken as a whole, have translated into weaker capital formation and productivity growth than in the U.S. The evidence presented is not conducive to determining whether the source of that difference lies mainly with the technological, institutional and market environment in which the European firms operate or more with internal factors at the firms themselves, a question left on the table for future analyses.

Annex: TFP estimation

To estimate the total factor productivity (TFP) figures provided in Exhibit 4B, we start from the assumption that the observed values for output, Q, and the labour, L, and capital, K, inputs are related productively according to the production function:

$$Q = AL^{\alpha}K^{\beta}$$

In which, A,α,β are non-negative parameters and α,β are less than or equal to one. The equation can be expressed as:

$$Ln\left(\frac{Q}{L}\right) = LnA + aLn\left(\frac{K}{L}\right) + (\gamma - 1)LnL$$

For $\gamma=\alpha+\beta$, using year-on-year data for labour productivity (Exhibit 2), capital-labour intensity (Exhibit 4), the quantity of labour, and the values of the production function parameters, $\alpha,\beta,$ it is possible to calculate the TFP index using the following expression:

$$LnA(t) = Ln\left(\frac{Q(t)}{L(t)}\right) - aLn\left(\frac{K(t)}{L(t)}\right) + (1-\gamma)LnL(t), \quad t = 2000...2025$$

Assuming that the observed values for the quantities of output and inputs result from business decisions taken with a view to

maximising profit for a given technology and at given prices, the values of the parameters α,β correspond to the share of labour remuneration and the share of the user cost of capital, respectively, in the value of output.

Exhibit 1B reveals a share of labour remuneration in the overall EU-27 NFC sector's Gross Value Added (GVA) of 60%, where it has been stable over time. For those same firms, the share of the user cost of capital is estimated at 33% (Salas Fumás, 2026). Therefore, the NFCs on aggregate, $\hat{\alpha} = 0.6$, $\hat{\beta} = 0.33$. For the U.S. NFC sector, Exhibit 1B reveals a downward trend in the share of labour, with an average reading over the 25-year period of very close to 60%. The share of the user cost of capital was estimated for the purposes of this paper using the same calculation methodology as for the European firms, yielding an average also of 33%. In estimating the TFP trendline, $\widehat{LnA(t)}$, in Exhibit 4B, the same values of $\hat{\alpha} = 0.6$, $\hat{\beta} = 0.33$ were used for both sets of firms. We also verified that the estimated cumulative annual growth of 1% in TFP for the American NFC universe does not change when modelling the year-on-year changes in the labour share provided in Exhibit 1B.

Notes

[1] For a more complete version of this paper, including details about the data sources and methodology used, refer to Salas Fumás (2026). Several recent papers analyse European business performance using individual business data, including Adilbish et al. (2025); Archanskaia et al. (2026); Mazzucato et al. (2026) and van Ark (2026). Veiga-Duarte et al. (2026) analyse the sources of economic growth across the main European economies using disaggregated sector data. Becker et al. (2026) compare and explain the market values of the listed companies in Europe and the U.S.

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