Establishing a genuine single market for services could generate significant growth across the EU.

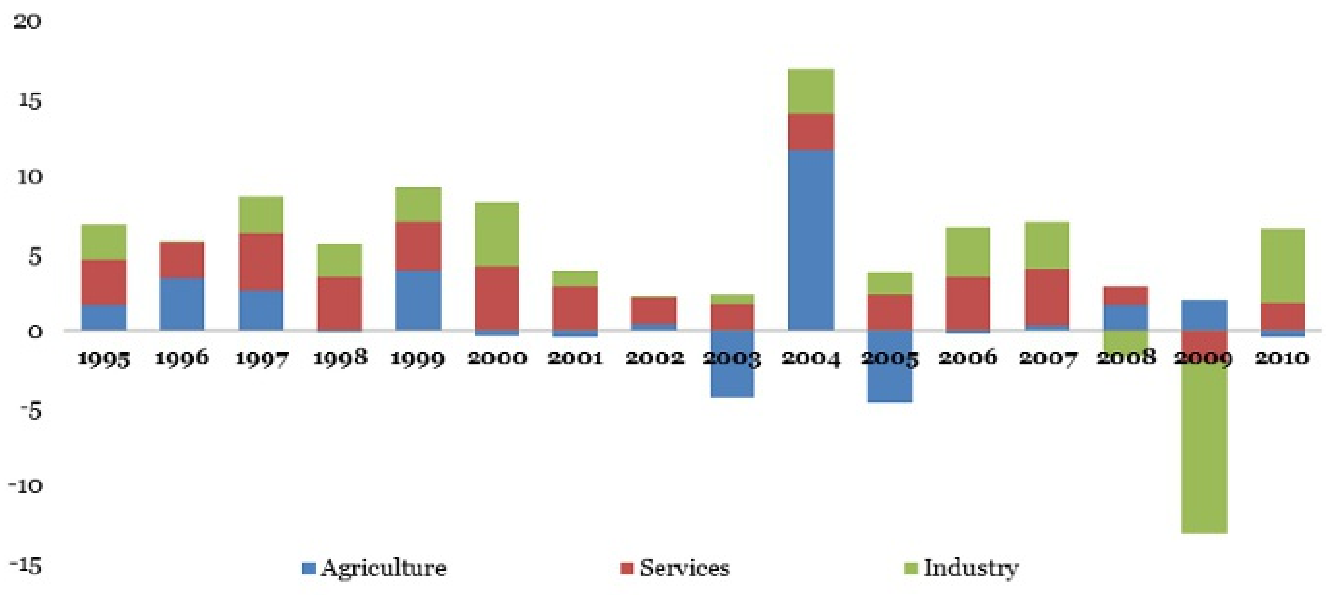
Blog Admin

Austerity has hit both public and private sector spending across Europe, and new sources of economic growth are now being sought. Using the latest empirical economic analysis **Federica Mustilli** *and* **Jacques Pelkmans** *argue that reforms to the single services market in the EU may provide ample scope for further economic growth. Further reforms to both domestic services markets and the deepening of the 'single services market' may lead to substantial increases in productivity across Europe. This intertwining of domestic and EU-level service reform means that such reform may lead to a "double-dividend" for the EU.*

The European Union, particularly the eurozone, is currently preoccupied with finding sources of economic growth. With extra public spending ruled out, private spending at best stagnant, almost no increase expected in labour and capital, and little scope for a significant increase in research and development, the call for the better functioning of services markets in Europe grows louder. However, the suggestion of '*securing growth from services*' remains exceedingly general. It begs the question whether and how better functioning of services markets could lead to higher growth in the EU. Indeed, when referring to services, many EU leaders and observers blend 'assertion' with 'hope' in their attempts to send out a positive message in the crisis. Recent empirical economic research has produced new evidence on how better functioning service markets can boost growth in the EU. Hence, research to bridge the gap between the economic literature on services productivity and the EU policy debate on services markets should be useful for policy makers and opinion leaders.

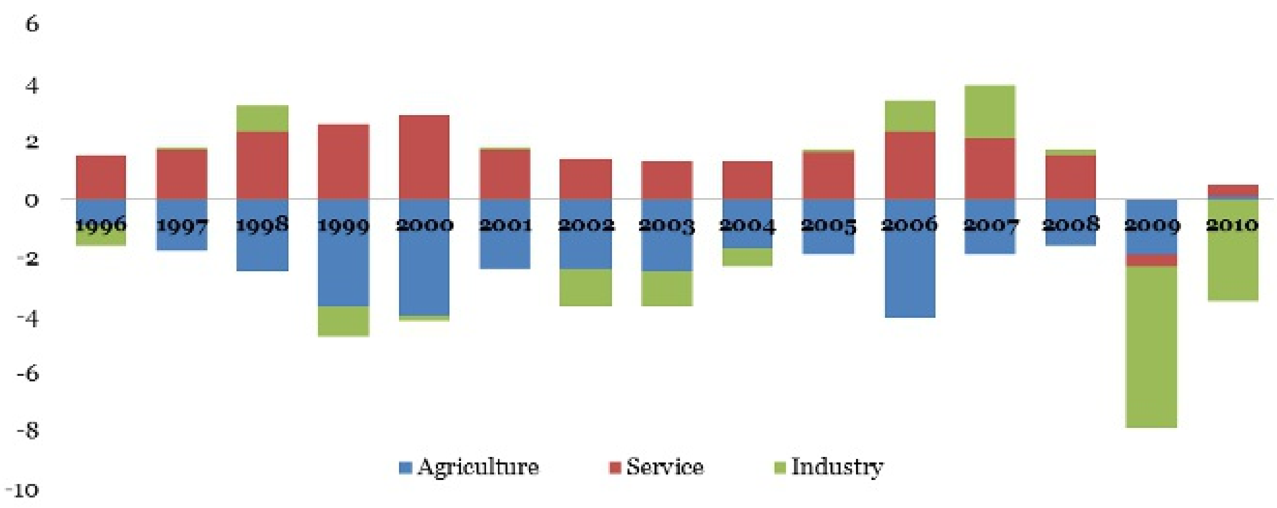
Service activities have been important for EU growth for many years. As shown in Figure 1, during 13 of the 16 years depicted, the contribution of services to annual EU growth in terms of value added is greater than that of industry. Services have also consistently generated job growth in the EU (see Figure 2).

Figure 1- Sectoral value-added contribution in the EU (% annual growth)



Source: Eurostat (2012).

Figure 2 – Sectoral employment growth (% annual growth)



Source: Eurostat (2012).

At the same time, EU member states have realised that services markets in Europe were underperforming, to the detriment of medium and long-term economic growth. From this, the economic understanding of the services sector and knowledge about regulation and anti-competitive structures in the EU internal service market has improved markedly in recent years. The grand experiment of the horizontal Services Directive, which aimed to remove legal and administrative barriers in the service sector from 2006, has turned out to be a blessing in disguise due to the intense domestic screening of services laws by member states, the 2010 mutual-evaluation exercise between member states, and the active follow-up by the European Commission ever since. The potential for further reforms in domestic services markets is nonetheless considerable and indications are that such reforms would yield substantial productivity increases. However, there is not yet a single services market in the EU. It is worth pursuing this since the economic literature suggests that it is likely to generate additional economic growth.

Our main conclusions are, first, that domestic and EU-level services reforms tend to be economically intertwined. This is true not only from looking at national implementation simply as a way to comply with liberalisation under the Services Directive, but also from the perspective of the overarching common objective of fostering EU growth. This implies deep domestic reforms resulting in more competitive and a better-functioning services market everywhere, which is far more important for EU growth than simply increasing cross-border exchange in services.

Second, more competitive services markets matter for the competitiveness of European industry, especially in the global value chains. Indeed, the cost increasing 'knock-on' effects from services (as inputs to industry) can be effectively mitigated by allowing market selection induced by greater competitive pressures in business services. Simulations of domestic reforms that bring EU countries' regulatory restrictiveness to best-practice levels (without affecting the solution to market failures) show very substantial productivity improvements for many countries. Third, EU and domestic services reforms (and to some extent, labour reforms as well) are one among several factors needed to better exploit ICT in EU user industries and user services sectors. This is especially linked to the swift introduction of new ICT-driven business models, flexible, yet effective intra-firm organisation and radically new patterns of ICT related innovation.

The gains from realising a fully-fledged EU internal market for services are still not fully understood. In financial services, network industries and professional services, there is no such thing as a genuine single market, which is suggestive of considerable potential gains. The manifold economic benefits from the Services Directive are beginning to be understood only now and the medium as well as longer-run gains almost certainly add up to several percentage points of EU GDP.

Reaping the gains from better functioning services markets is not always just a matter of greater competition, engendered by pro-competitive reforms, possibly helped by selective harmonisation at the EU level. In several network industries, it requires considerable infrastructural investments over longer periods throughout the EU. A unique case is the digital single market, coupled with a much broader Digital Agenda where various supply and demand issues, research and development in ICT, harmonisation questions, interoperability standards, benchmarking of performance and e-government are brought together to leverage digital services in Europe.

Altogether, one can speak of a *'double-dividend'* strategy: what member states are expected to do in terms of reforms also serves the broader goal of EU economic growth, whereas the EU pursuit of the single market in services not only serves this goal but, in turn, helps directly the national reform efforts as well. The eurozone may even enjoy a '*triple dividend*', because promoting domestic services reform helps the proper functioning of monetary union by taking advantage of a smooth and swiftly working adjustment mechanism reducing the cumulative growth loss in case of an adverse shock (given that the exchange rate flexibility is no longer available).

This article is based on the CEPS Special Report, Securing EU Growth from Services.

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Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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About the authors

Federica Mustilli – *Centre for European Policy Studies*
Federica Mustilli is Research Assistant at the Centre for European Policy Studies.

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Jacques Pelkmans – *Centre for European Policy Studies*
Jacques Pelkmans is a Senior Research Fellow at the Centre for European Policy Studies (CEPS) in Brussels (www.ceps.eu). He is also a Professor at the College of Europe, Bruges, where he is the Jan Tinbergen Chair of European Economic Integration and was Director of the Economic Studies department at the College (www.coleurop.be).

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