Summary for non-specialists
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Economic performance and competition in services in the euro area: Policy lessons in times of crisis

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Services have become the largest sector in euro area economies, providing the bulk of employment and income. Over the past decade rising demand has led to net job creation in most euro area services sectors. Nevertheless, the economic performance of these sectors in the euro area has been somewhat disappointing. This may have been caused by various factors including inappropriate regulation and lack of competition, which tend to slow down the diffusion of new technologies and the pace of innovation.

The services sector is also a key element in the adjustment mechanism within the euro area: in the absence of nominal exchange rate movements, appropriate responses to shocks need smooth internal prices adjustments. However price rigidities in services markets may hinder the necessary adjustment. Over the past couple of years, significant external competitiveness imbalances have built up, leading to diverging current account positions which have increased the exposure of some Member States to the financial turmoil.

Against the background of the weak growth triggered by the financial crisis and the recorded strong contraction in the manufacturing sector, a more dynamic and labour intensive service sector could help sustain growth. However, services in the euro area seem to have been hit harder by the crisis than in the European Union as a whole. Moreover, some of the services sectors most affected by the crisis, such as logistics and telecommunications, are particularly important for adjustment in the euro area, as they have large interactions with other sectors of the economy. A poor performance of these sectors can therefore create negative spill-overs to the euro area economy as a whole.

The analysis in this paper identifies a number of explanatory factors for the disappointing performance of services sectors in the euro area:

- The Single Market in services is still incomplete and therefore, many of the services sectors continue to be fragmented.
- There are many regulatory obstacles at national level in many services markets that act as barriers to entry, limiting the pressures of competition and reducing the possibilities for firms to achieve economies of scale.
- Start-up conditions in the euro area are more restrictive and there are many licensing provisions.

To address these problems, the EU has developed an ambitious reform agenda under the Lisbon strategy combining measures at EU and national level. Implementation of this agenda has, however, been uneven and more progress is needed. A key challenge is to ensure the timely and full transposition of the Services Directive by Member States. Moreover, further reforms aimed at improving business conditions, in particular in sectors such as professional services and retail trade, are needed.

Improving the economic performance of services is not only important for long-term term growth, but this is also essential in a period of economic crisis:

- First, lower prices of services can contribute to preserve the purchasing power of consumers and to cushion the impact of the crisis on the most vulnerable segment of the population.
- Second, as many services are labour intensive, well functioning services can more easily absorb workers affected by restructuring.
- Finally, such reforms can help demonstrate a credible commitment of authorities to the achievement of the growth potential.

The European Economic Recovery Plan (EERP), endorsed by the European Council, recognised that measures to fight the crisis should support household incomes, stimulate aggregate demand, reduce regulatory costs and be consistent with long run policy objectives. Most countries are supporting business and sectors through easing their financing constraints and by accelerating the implementation of non-financial measures such as reduction of administrative burdens. Compared to the manufacturing sector, there are not many services-specific measures undertaken by Member States in response to the crisis.