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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL,
THE EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

**The competitiveness of business-related services
and their contribution to the performance of European enterprises**

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EXECUTIVE SUMMARY

This Communication, which contains an economic analysis of the role of services in the European economy and examines their competitiveness, seeks to reflect their importance in the overall EU economy and to signal the Commission's commitment to improve their framework conditions, in line with the 2002 Communication on "Industrial Policy in an Enlarged Europe".

The role of services in the economy and their potential for growth and employment creation was highlighted at the Lisbon European Council in March 2000. A key part of the economic reform program adopted by the Council is to make the Internal Market work for services. The Commission Communication on an Internal Market Strategy for Services of December 2000 set out a strategy in response to the European Council's request. The Communication included an action to launch "flanking" measures (better statistics, reporting on intangibles, training and ICT skills, innovation and R&D etc.) in support of the competitiveness of the EU service industry. This action was specified in the Council Conclusions of November 2002, calling on the Commission to "*complement measures to remove barriers to cross-border trade in services with other measures, aimed at improving the competitiveness of services and their contribution to the performance of enterprises in all economic sectors*".

This Communication is the response to that request from the Council, closely linking and complementing the legislative and non-legislative measures in the Directive on Services in the Internal Market to other measures improving the competitiveness of European enterprises.

This Communication deals with the wide range of market services directly affecting the competitiveness of enterprises, both manufacturers and other services providers. These are collectively referred to as "business-related services", and consist of 4 major groups of activities, namely business services, distributive trades, network services and financial services. As these services are very heterogeneous and performing at different market conditions, the Communication has a special focus on the knowledge intensive part of business services, such as computer and professional services, due to their role as drivers of the knowledge based economy.

The economic analysis is based on existing official statistics, even though these do not fully reflect the scale of the sector and its economic importance. This economic analysis then forms the basis for policy conclusions to be implemented through a number of specific actions within a coherent EU policy framework in close co-operation with all stakeholders. The main findings of the economic analysis are:

Business-related services constitute the largest sector of the economy employing around 55 million persons in 2001 – or nearly 55 % of total employment in the EU market economy.

Business-related services have been, by far, the main source of job creation in the EU. Growth in employment in business-related services in several Member States exceeds the growth in the US. Further growth can be expected from the Candidate Countries, which are characterised by economies with relatively smaller shares of employment in business-related services and especially within knowledge-intensive business services.

The business-related services sector is also the most dynamic sector in the EU in terms of establishment of new enterprises, as entry barriers in many business-related services markets are low. More than two-thirds of all new enterprises start up within business-related services.

Since business-related services are the dominant part of the European market economy, the sector is important in its own right for the European economy. However, of even greater importance is the fact that business-related services are an indispensable contributor to the performance of the rest of the economy. They are inextricably linked to manufacturing industry. All goods contain elements of services and their contribution to the value added of any manufactured product often determines its attractiveness to the market. Furthermore, the public sector and the services sector itself are becoming more and more dependent on providers of business-related services.

Services can be produced either internally by the enterprise itself – independent of its activity – or they can be purchased. Many enterprises have outsourced some of their services activities previously produced in-house in order to procure these services in a competitive market or to obtain greater flexibility. Growth of business-related services is usually explained by the migration of employment from manufacturing industry to services due to the outsourcing of the services functions previously produced in-house. But the reasons for the growth are much more complex.

Changes in production systems, more flexibility, stronger competition on international markets, the increasing role of ICT and knowledge and the emergence of new types of services are other important factors. To fully understand the role of business-related services in the European economy, their penetration into the value chain of all enterprises, including other service enterprises, must be kept in mind. The analysis shows that the services sector consumes more than half of the output going to intermediate demand from business-related services, compared to a share of less than one-third consumed by manufacturing.

The recent development in overall productivity growth in the EU has caused concern and threatens the possibility of achieving the goals of the Lisbon strategy. Without competitive business-related services, it will not be possible to fulfil the Lisbon objective of the EU becoming the most competitive knowledge based economy in the world.

In the first half of the 1990s, the EU experienced an annual average growth in labour productivity (1.9 %) considerably exceeding the US (1.2 %), but the pattern changed dramatically in the following period 1995-2001. The annual growth rate declined to 1.2 %, while the growth in the US expanded to 1.9 %. The development was mainly caused by the very strong growth performance of the US distributive trades sector – both compared to the corresponding sector in the EU and to other sectors of the economy.

ICT is enabling rapid productivity growth in sectors having invested heavily in ICT, as the use of ICT can help companies increase their overall efficiency in combining labour and capital. This is assumed to be the explanatory factor behind the recent productivity growth achieved by distributive trades in the USA.

Some of Europe's most innovative companies are to be found in business-related services, but the overall level of R&D in these sectors is generally low and lags substantially behind the US. Whilst the EU economy has developed into a services economy in the last decades, market services still account for a relatively small amount of total business expenditure on R&D (13 %).

Without the growth generated by business-related services in the second half of the 1990's, unemployment in the EU would have been even higher than at present. Although there is a plentiful labour supply, a breakdown by educational attainment of the jobs created shows a

mismatch between supply and demand. The observed skills shortages is a problem especially for the knowledge-intensive business services, but also for the other sectors of the economy.

A skilled labour force contributes to productivity growth by enabling the companies to utilise and take advantage of their investments in ICT and other innovative features. The labour-intensive nature of many business-related services, the high degree of interaction with customers, the knowledge intensity of many services and the importance of tacit knowledge are all factors implying the importance of sufficient supply of skilled human capital for future productivity gains.

Based on the above-mentioned findings of the economic analysis, a number of policy conclusions are drawn and an integrated policy framework is established. The main political issues identified are:

- 1. Market integration and competition in business-related services markets is not vigorous enough to ensure and strengthen their competitiveness;*
- 2. The inputs necessary for the production (labour qualifications, integration of ICT and capital) are lacking in quality and quantity;*
- 3. The outputs from the business-related services enterprises are not sufficiently transparent (standards), valued (reporting on intangible assets) or documented (quality);*
- 4. The provision and use of business-related services is limited in less developed regions and candidate countries, mainly affecting SMEs and convergence processes;*
- 5. Knowledge about the sector and the markets is scarce, hampering the decision making of enterprises and policy makers.*

The policy challenges derived from this Communication not only concern the Commission, but equally the other Community institutions, the national governments as well as other enterprise-related stakeholders with vested interests in a well functioning business-related services sector. The proposed Directive on Services in the Internal Market brings to a close a long process of consultation on barriers, but implementation of the accompanying measures will necessitate an ongoing consultation of all involved parties concerned, based on more detailed policy proposals which the Commission will draft on the basis of the key policy issues identified in this Communication.

This consultation will be organised through a European Forum on business-related services which the Commission will establish in the forthcoming months: it will be composed of the Community institutions, Member State representatives, professional organisations, workers representations, research institutions and other enterprise-related stakeholders. The work foreseen to be carried out by this Forum, will complement in a more focussed and expert way that of other bodies, such as the Enterprise Policy Group(s).

This discussion will lead to an Action Plan to be proposed by the Commission in the first half of 2005. This Action Plan will be complementary to and reinforce the measures undertaken in the Directive on Services in the Internal Market and due account and synergy will be sought with progress in the implementation of the Directive¹.

¹ It should be noted that whereas the present Communication covers business-related services, the Directive also covers business-to-consumers aspects of trade in services.

I. INTRODUCTION

I.1. Background and objective

The role of services in the economy and their potential for growth and employment creation was highlighted at the Lisbon European Council in March 2000. The importance of the services sector is justified by its sheer weight in the economy (around 70% of EU GDP) and the increasing consumption of services by manufacturing industry, affecting the cost, price and quality of manufactured goods.

A key part of the economic reform program adopted by the Council is to make the Internal Market work for services. Consequently, the Lisbon Council invited the Commission to propose a comprehensive Internal Market Strategy to remove barriers to services with the objective of allowing services to move across national borders as easy as within a Member State.

The Commission Communication on an Internal Market Strategy for Services of December 2000² set out a two-stage strategy in response to the European Council's request: the first stage involved the identification and analysis of existing barriers³, the second stage, based on that analysis, was to bring forward appropriate solutions to the problems identified⁴.

The Communication included an action to launch "flanking" measures (better statistics, reporting on intangibles, training and ICT skills, innovation and R&D etc.) in support of the competitiveness of the EU service industry. This action was specified in the Council Conclusions of November 2002⁵, endorsing the Report from July 2002, by the Council calling on the Commission to "*complement measures to remove barriers to cross-border trade in services with other measures, aimed at improving the competitiveness of services and their contribution to the performance of enterprises in all economic sectors*".

This Communication is the response to that request from the Council, closely linking and complementing the legislative and non-legislative measures in the Directive on Services in the Internal Market *to other measures improving the competitiveness of European enterprises*. Thus, the Communication supports and accompanies the Directive on Services in the Internal Market, for the aspects covering business-related services. The two initiatives mutually reinforce the competitiveness of European services providers and their business clients in accordance with the Commission Communication on an Internal Market Strategy for Services and the Council Conclusions from November 2002.

Consequently, the objective of this Communication is to deal with the enterprise perspective, i.e. treating the market services having a direct impact on the performance of all enterprises. The measures proposed in this Communication are directed towards the improvement of the input to the production of services (for instance, skills, ICT, R&D and innovation) and their output to their clients (for instance, quality and standardisation of services products), together with measures generally improving the market conditions for services enterprises. Under this last aspect, the Directive on Services in the Internal Market is a necessary, but not sufficient condition to improve the competitiveness of European enterprises.

² Doc COM (2000) 888 of 29.12.2000.

³ Report on the State of the Internal Market for services. Doc. COM (2002) 441 of 31.07.2002.

⁴ Directive on Services in the Internal Market. Doc. COM (2003)...

⁵ 14.11.2002, 13839/02 (Presse 344).

I.2. Scope

Due to the magnitude and heterogeneity of the services sector, a horizontal approach covering all services is neither feasible, nor constructive. The proposed measures need to take sectoral market conditions into consideration. Consequently, the scope of this Communication is limited to the range of market services directly affecting the competitiveness of enterprises, both manufacturers and other services providers. These are collectively referred to as “business-related services”, and consist of 4 major groups of activities, namely business services⁶, distributive trades, network services⁷ and financial services, see box 1.

The term “business-related services” is used to illustrate that the Communication focuses on those services having a direct impact on the competitiveness of enterprises. Some of these services have dual functions, also covering business-to-consumers relations. Thus their competitiveness also depends on their availability to consumers, consumer confidence in the market and its operation as well as consumer satisfaction. However, due to the focus on the impact of business-related services on enterprises, the Communication does not address the situation in the business to consumer market nor does it cover in great detail the role consumer policy and protection rules have to play in a competitive functioning of the market. Furthermore, the Communication does not address the wider issues relating to services of general interest, which are treated in the recent Green Paper on this subject⁸.

The Communication has a special focus on the knowledge intensive part of business services, such as computer and professional services, due to their role as drivers of the knowledge based economy.

Box 1. Definition of Business-related services in accordance with the EU statistical activity nomenclature, NACE.

Business Services (NACE 70–74) This group can be divided into two groups: 1) *Knowledge-Intensive Business Services*, which are professional services, such as IT-consulting, management consulting, R&D services, advertising and professional training. 2) *Operational services* consisting of services such as industrial cleaning, security services and secretarial services.

Distributive Trade (NACE 50–52) This group consists of enterprises facilitating the distribution of goods and services to other sectors of the economy and to final consumers.

Network Services (NACE 40–41, 60–64) This composite group consists of electricity, gas and water supply, transport and communication services.

Financial Services (NACE 65–67) This group consists of enterprises offering intermediation of financial services such as banks and insurance companies.

Business-related services constitute the largest part of the market economy (around 55% of total employment) and are as such important in their own right for the European economy. *However, of even greater importance is the fact that business-related services are an indispensable contributor to the performance of the rest of the economy.* They are inextricably linked to manufacturing industry. All goods contain elements of services and their

⁶ Commission Communication on Business Services. COM (1998) 534.

⁷ This Communication deals with network services as provided to businesses, and does not cover their consumer aspects.

⁸ COM (2003) 270 of 20.05.2003.

contribution to the value added of any manufactured product often determines its attractiveness to the market. For example, the automobile industry uses pre-production services such as design services and Research and Development, production-related services (such as engineering and IT services), after-production services (transport and distribution services) and financial services and finally other business services such as accounting or legal services.

I.3. Context and rationale

Without competitive business-related services, it will be difficult to fulfil the Lisbon objective of making Europe by 2010 the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth and more and better jobs and greater social cohesion. This is evident from the fact that the business-related services sector is the largest creator of employment. It produces more value added to the economy than any other macro economic sector. It has the highest growth potential, more new enterprises are created than in any other sector and business-related services provide the foundation for the knowledge-based economy.

The Commission Communication on an Industrial Policy in an Enlarged Europe⁹ demonstrated the need for specific sectoral applications of the horizontal enterprise policy. This also applies to the services segment of the EU economy, which was not addressed in detail in that Communication. The policy actions proposed in this Communication address specific issues of business-related services and are a response to the need for an additional sectoral layer of measures for services, without detracting from the importance of the current policy framework applicable to manufacturing industry.

The Commission finds that the time has come to make a serious effort to put the economic importance and potential of services on the EU policy agenda as a key component of its revisited competitiveness strategy. There is a need for the Commission to enter into a dialogue with business operators, professional organisations, unions, policy makers, economists, researchers and the media. They are, in the opinion of the Commission, not sufficiently aware of the role of, the functioning and the potential impact that services possess for the development of the EU economy.

There are several reasons for this lack of awareness. *Firstly*, the services sector comprises a large number of different activities, which are difficult to classify and to treat under one heading. *Secondly*, official statistics at national and EU level do not properly reflect the importance of services and their interaction with the rest of the economy. *Thirdly*, and as a consequence of the lack of data, economic research on services is weak compared to the primary and secondary sectors. *Fourthly*, services are not well organised on the business market, mainly because of their diversity and a perceived lack of common interests of business operators.

As mentioned above, the services sector has been the main generator of new jobs, but – as the economic analysis in this Communication shows – it can not be taken for granted to continue. If Europe does not improve its track record on development of high skilled human resources in a knowledge-based economy, the business-related services sector will become less competitive. This could lead to a de-localisation of services jobs, similar to what has been experienced within manufacturing, loosing markets to US and Asian providers.

⁹ Communication from the Commission. Industrial Policy in an Enlarged Europe. COM (2002) 714 final.

It is against this background that the present Communication examines the crucial role of services for the competitiveness of European enterprises. This economic analysis then forms the basis for policy actions to be implemented through a wide range of specific actions inside a coherent EU policy framework in close co-operation with all the stakeholders, and taking into account the specific framework conditions in the various services sectors making up the business-related services sector.

I.4. Structure of the Communication

As mentioned above, there is a need to create better awareness of the role, potential and competitiveness of business-related services through a comprehensive economic analysis. Chapter II describes, on the basis of available data, the economic importance of these services, and Chapter III analyses their competitiveness. Chapter IV draws the policy conclusions based on these analyses. Annex I includes a box illustrating the use of services in the value chain and additional figures providing statistical information. Annex II presents a graphic illustration of the scope of the Communication. Annex III outlines the user needs in a long term strategy on services statistics to be implemented by the Commission, led by Eurostat and the Member States as a prerequisite for further progress in analysis, monitoring and policy formulation regarding the market for business-related services.

II. THE IMPORTANCE OF BUSINESS-RELATED SERVICES IN EUROPE

II.1. What are business-related services?

Services have traditionally been defined in negative terms, not by what they are, but what they are not (tangible, durable, storable, transportable, etc.). The services sector has been considered the residual activities of the economy – what is left after classifying agriculture and manufacturing. This approach, combined with the fact that the services sector comprises a large number of very heterogeneous activities, has made a commonly accepted definition difficult. This, amplified by a low level of organised representation of services providers at EU policy shaping level, has made it difficult to define a coherent strategy for addressing the problems and needs of the service sector. But with the ever-growing importance of services for a knowledge-based economy, work has intensified on defining and qualifying the notion of services. The main characteristics of the services sector can be summarised as follows:

- The output is generally characterised as being intangible by nature. However, the output of some services activities, for instance research, software development etc. can be codified and traded in much the same way as physical goods. In addition, through information technology, many services can nowadays be embedded in physical products and thus stored, transported and delivered via physical means.
- The production of services, knowledge intensive services especially, requires interaction between the producer and the client. This interaction focuses attention on the so-called “soft technology” (e.g. qualifications, skills and expertise) to be present on both the supply and demand side.
- Knowledge-intensive services provide the intangible assets (know-how, software, organisational skills, R&D capabilities etc.) which have often become key drivers of value creation, whereas physical and financial assets tend to become commodities of relatively lesser importance.

The scope of this Communication is the wide range of market services directly affecting the competitiveness of enterprises, both manufacturers and other services providers. As mentioned in the introduction, these services activities are collectively referred to as “business-related services” consisting of 4 major groups of activities, namely business services¹⁰, distributive trades, network services and financial services (see box 1 page 8). The Communication has a special focus on the knowledge intensive part of business services, such as computer and professional services, due to their role as drivers of the knowledge based economy.

The economic analysis in this and the following chapter is based on the existing official statistics. The gaps in the coverage of the services sector should be taken into consideration and thus results interpreted with caution. It is an explicit priority of this Communication to initiate the development of the official statistics at national and EU level to facilitate further analysis, monitoring and policy formulation in this area (see Annex III).

II.2. The importance of business-related services in the market economy

Business-related services constitute the largest sector of the economy employing around 55 million persons in 2001 – or nearly 55 % of total employment in the EU market economy.

According to Structural Business Statistics, the business-related services sector (*excluding financial services*)¹¹ constitutes 53 % of total employment in the EU market economy in 2001, while manufacturing has a share of 29 % (or around 29 million persons employed), see figure 1. Business-related services are especially prevalent in the Netherlands (65 %) and the United Kingdom (61 %). The least dominant role of business-related services – in terms of employment - is found in Portugal (45 %), Germany (46 %) and Italy (48 %).

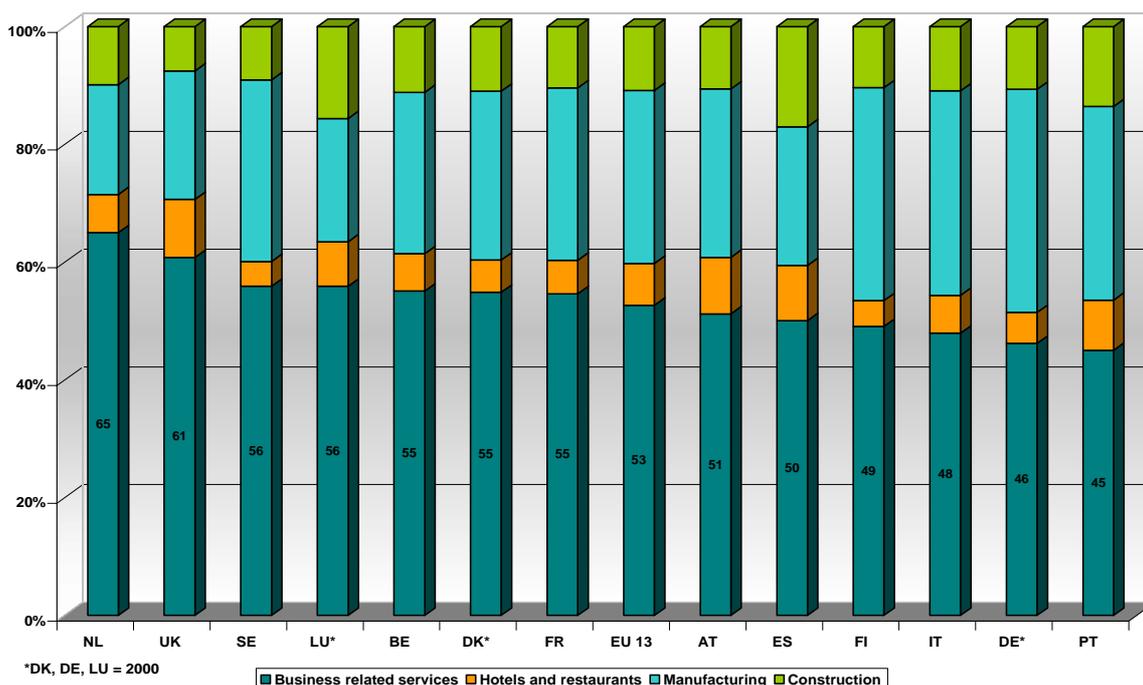
On average, total value added created by business-related services constitute 54 %¹² in 2001 compared to 34 % for manufacturing (see figure A in annex I). The share of value added differs substantially across Member States, as business-related services in the Netherlands account for 61 % and the United Kingdom for 60 %, compared to 44 % in Finland and 48 % in Germany.

¹⁰ Communication from the Commission. The contribution of business services to industrial performance - A common policy framework COM(98)534 final.

¹¹ As the term “business-related services” is not an aggregation used in official statistics proxies frequently has to be used, in cases where the statistics do not allow aggregation of data to the level of business-related services. The employment in business-related services as defined in box 1 has been estimated by using two sources, Structural Business Statistics and National Accounts. In the SBS data used for this section, no harmonised data for financial services are available. The employment in business-related services including financial services can be estimated at around 55 per cent of total employment in the EU market economy.

¹² Excluding financial services, cf. footnote 11.

Figure 1. Employment in the market economy 2001. Broken down by sector.



Source: Eurostat: SBS data.

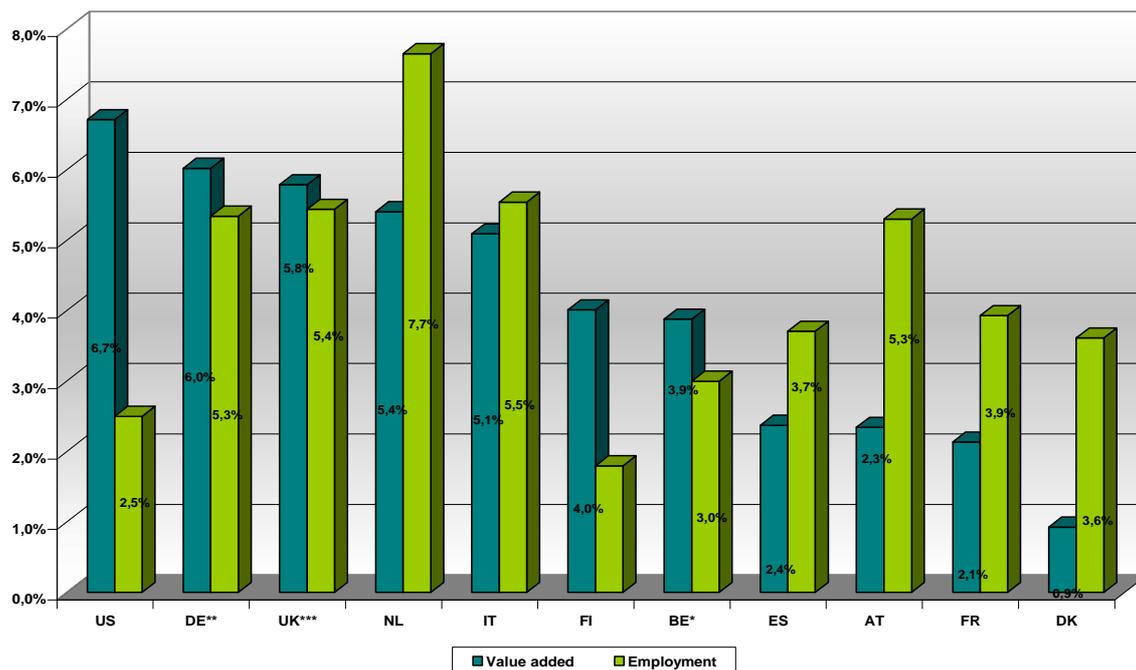
The services sector is characterised by a very large number of micro enterprises (less than 10 employees). They constitute 33 % of total employment within the services sector in the EU compared to 18 % in manufacturing. In business-related services, micro enterprises are most dominant in distributive trades (38 %). On the other hand, a similar proportion of employment is found in large enterprises in business-related services (33 %, compared to 30 % in manufacturing). Transport and communication is characterised by a large share of employment in large enterprises (57 %).

Micro enterprises in the services sector are particularly dominant in Italy, Spain, Portugal and Ireland, whereas the United Kingdom, France and the Netherlands show a relatively large percentage of employment in large services enterprises.

II.3. The growth of the business-related services sector

At the beginning of the third millennium, the European economy can be characterised as a services economy. A closer look at the last decade shows considerable growth for business-related services in a number of Member States and interestingly, the pattern is not uniform, see figure 2. On the one hand, Germany, starting from a services share less than the EU average, shows high growth rates in both employment and value added. However, countries such as the Netherlands and the United Kingdom, with very developed services sectors, also show high growth rates. This indicates that there is still a strong potential for growth, with the right framework conditions in place.

Figure 2. Change in share of business-related services between 1990 and 2001. Value added and employment.



* Estimates for 2001; ** Estimates for 1990; *** Estimates for the employment

Sources: Based on Eurostat (New Cronos) and OECD in Figures 2002.

Business-related services have been, by far, the main source of job creation in the EU. It should be noted that the growth in employment in business-related services in several Member States exceeds the growth in the US. On the other hand, the US shows a very high growth in value added compared to the EU. This also supports the higher growth rates in labour productivity observed for the US compared to the Member States, see chapter III.2.

Furthermore, a future growth can be expected from the Candidate Countries which are characterised by economies with relatively smaller shares of employment in business-related services and especially within knowledge-intensive business services, see figure B in annex I. The economic structure in the Candidate Countries differs from the existing Member States, as business-related services constitute only around 40 % of total employment compared to more than 50 % in the Member States.

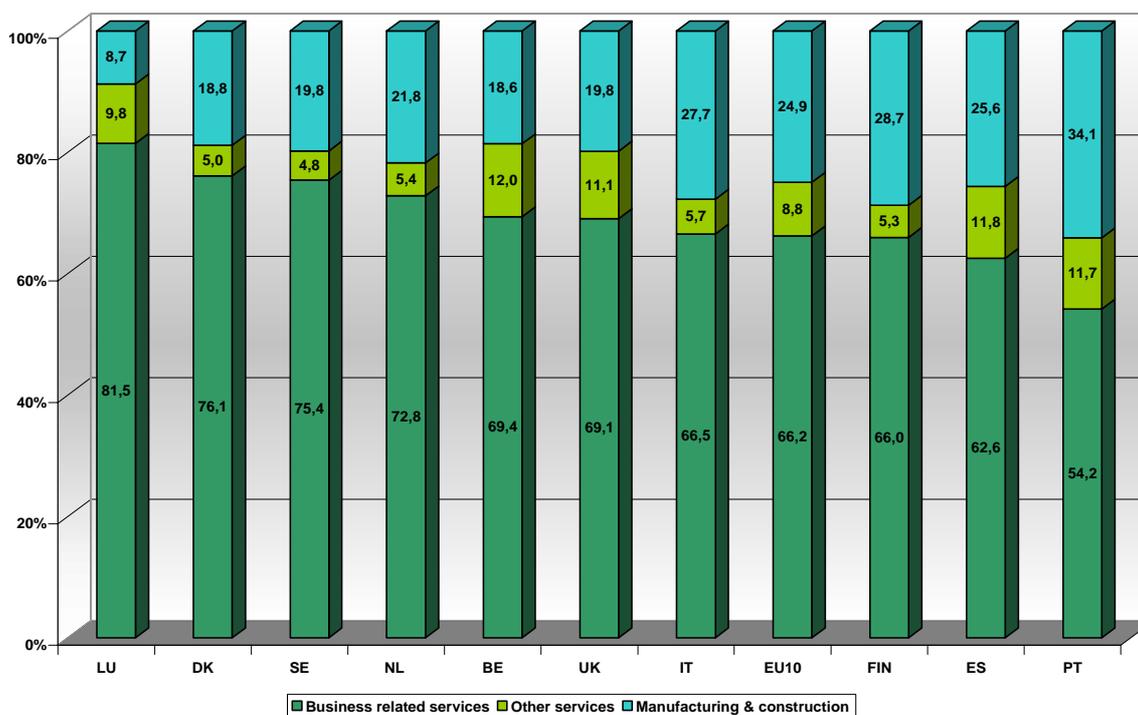
Challenge

The development of business-related services in regional and local markets, also in the less developed regions of an enlarged EU, is crucial for the competitiveness and catching-up of the economies in these regions.

II.4. Enterprise dynamics in business-related services

More than 1 million new enterprises were established in 2000 in the 10 Member States for which data are available. 66 % of all new enterprises were started in business-related services, with business services¹³ (28 %) being the most outstanding sector, see figure 3. The distribution of new enterprises by economic activity clearly reflects the general development towards a service and knowledge-based economy within the EU.

Figure 3. New enterprises broken down by activity – 2000.



Source: Eurostat: Business Demography 2000.

To get a better idea of the dynamics of the different sectors, the number of new enterprises can be compared to the existing stock of enterprises (enterprise birth rate). The highest share of new enterprises is found in business services (10.9 %). By contrast, new enterprises in the manufacturing industry only account for 6.0 % of the existing stock. Business-related services are the most dynamic segment of the economy, with the largest share of start-ups in the EU.

More important than the mere creation of new enterprises is their survival; not every new activity is sustainable. Nearly 75 % of the new enterprises established in 1998 survived their two first years of activity. In all Member States covered, new enterprises within manufacturing industry had a higher survival rate than in services, except for the United Kingdom.

In many business-related services markets entry barriers are low and one or a few persons can start an enterprise and compete on the market with only a small amount of capital and few resources available. Thus, business-related services are contributing to a dynamic business environment through economic growth and opening up of new job opportunities. Of even

¹³ Financial services is included in business-related services.

greater importance than the direct effects is the indirect contribution from new enterprises to increased competitive pressure, forcing existing companies to react by improving efficiency, introducing innovative processes and products, which again boosts productivity.

Challenges

Business-related services are the most dynamic sector of the economy implying high rates of births and deaths of enterprises. To establish a solid basis for policy formulation related to entrepreneurship, more knowledge concerning the factors behind success and failures of entrepreneurship within business-related services is needed.

Insufficient management experience can be a reason for business failure. Training programmes, tailored to the specific needs of SMEs in business-related services, are needed to improve conditions for survival.

II.5. The interaction between business-related services and other sectors of the economy

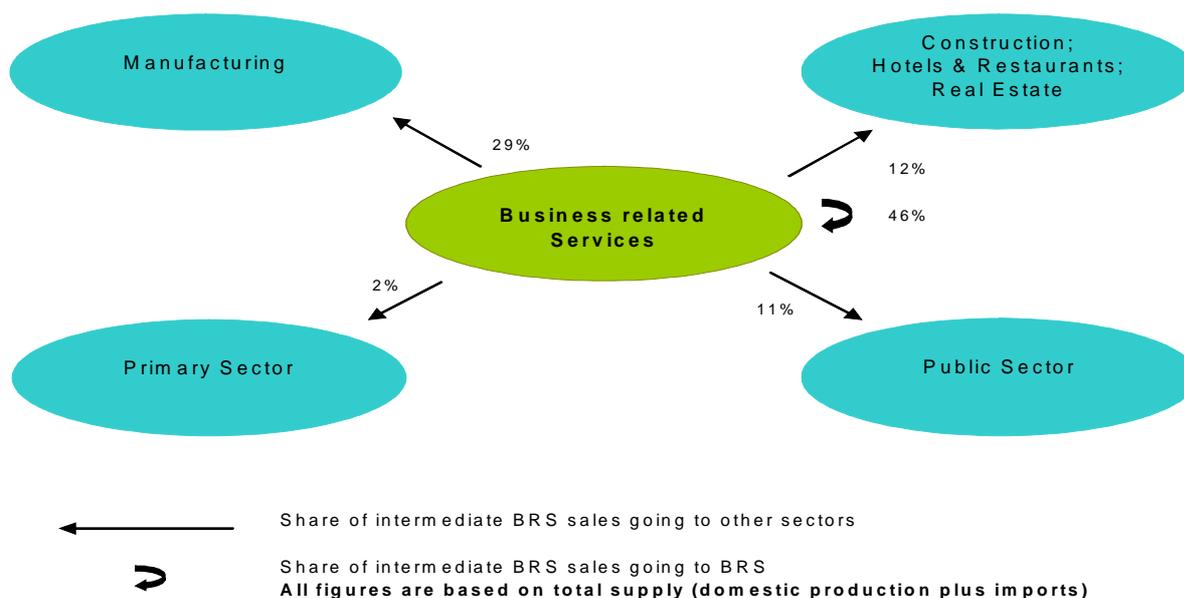
Since business-related services are the dominant part of the European market economy, the sector is important in its own right for the European economy. However, the most important feature of business-related services is that they are present in - and integrated into - every stage of the value added chain. They are a fundamental necessity for the existence of all enterprises, whether in manufacturing or services, micro or large enterprise. All enterprises need services to produce and to be competitive, see main services grouped by productive function in box 1 in Annex 1.

Services can be produced either internally by the enterprise itself – independent of its activity – or they can be purchased. Many enterprises have outsourced some of their services activities previously produced in-house in order to procure these services in a competitive market or to obtain greater flexibility, see point II.6 below. As a consequence, business-related services have become more specialised and thus capable of delivering products of higher quality and differentiation, increasing the competitiveness of the users of these services.

Growth of business-related services is usually explained by the migration of employment from manufacturing industry to services due to the outsourcing of the services functions previously produced in-house. But the reasons for the growth are multiple. Changes in production systems, more flexibility, stronger competition on international markets, the increasing role of ICT and knowledge and the emergence of new types of services are other important factors. Due to a lack of statistical information on the demand for services by the different sectors of the economy, the interrelationship between the sectors is currently not well documented. However, according to new economic analysis using input-output tables from National Accounts it is possible to indicate the magnitude of the interrelationship between the different sectors of the economy, see figure 4¹⁴.

¹⁴ The estimated intermediate consumption of business-related services at aggregated EU-15 level is calculated by using available harmonised input-output tables for 9 Member States for the latest year available.

Figure 4. The relations between business-related services and the other sectors of the economy in the EU.



Source: Calculations based on OECD input/output database.

The figure shows that manufacturing industry is an important user of business-related services, as nearly 30 % of the intermediate output from the sector is consumed by manufacturing companies. Nevertheless, crucial for understanding the growth of business-related services in the last decades is the demand for business-related services created by the sector itself as a consequence of the penetration of these services into the value chain of all enterprises. The role of the public sector, as a market consuming around 11 % of business-related services, is noteworthy. The public sector is an important market for business-related services, with a considerable growth potential.

A more detailed breakdown of the consumption of services shows that business services (such as IT-consultancy services, advertising or accounting) is the most important group of services consumed both by the manufacturing and public sector in Europe, as business services constitute more than one third of total input of business-related services. Furthermore, the close linkage between distributive trades and manufacturing can be observed as well as the relative importance of financial services for the public sector.

Challenges

There is a need for new knowledge. The process of interaction between business-related services and their clients requires much more in-depth analysis and availability of input-output tables with sufficient country and sectoral coverage.

The public sector has been identified as an important user of business-related services, which suggests that public-private co-operation could be an important means to further enhance the business-related services market.

II.6. The importance and impact of outsourcing of services

The process of externalisation of services functions has been an important driver of the growth in the services sector. Outsourcing decisions are not solely driven by labour costs aspects, but frequently by the need to gain access to specialised skills (quality aspects) in order to increase flexibility. An enterprise has to make strategic and often long-term decisions: whether to produce the necessary services by itself or to contract these services out to specialised companies. Part of the economic performance of manufacturing and services enterprises related to price, quality or market positioning can be linked to “make or buy” decisions.

In addition to the advantages related to quality and cost, outsourcing allows concentration on core business. To fully benefit from the advantages related to outsourcing, the services purchaser needs to implement the necessary organisational and managerial changes. Especially for SMEs, the lack of appropriate skills amongst the employees can hamper reaping the benefits of outsourcing.

Outsourcing of more strategic services such as IT, professional training, sales and marketing and product innovation is becoming a major issue in improving competitiveness. Sometimes the services provider might take control of an entire business process such as human resources or IT, leading to the so-called BPO (business process outsourcing). Outsourcing is, however, not without risk. The financial viability of the partner must be taken into account, as well as loss of control and leakage of crucial know-how.

Parallel to the outsourcing of services by manufacturing firms, there is also a phenomenon of manufacturing firms increasingly becoming service providers, as some production activities are being de-localized to countries where labour is less expensive than in the EU. Nowadays some services such as call services, ticketing, software programming, technical support etc. seem to follow a similar pattern. The types of services remaining within the companies in the EU are “headquarter activities” (e.g. coordination, management, quality control, design). These activities are so knowledge intensive that they can only be provided by face to face transactions (e.g. to pass tacit knowledge that cannot be codified). At the same time, however, there is a distinct trend towards cooperation between firms in R&D activities, the necessary outsourcing of R&D by many SMEs, and the existence of a specific R&D service activity.

Challenges

Competition in the services market is impaired by the lack of possibilities for measuring the prices for comparable services from alternative services providers. Agreed standards need to be developed to improve transparency. Standards would furthermore benefit the services providers by enabling them to focus on the internal process of services production.

In contrast to the supply of goods, the delivery of a service usually involves a close interaction between the services provider and the client, making it difficult to distinguish between the delivery process and its outcome. An objective, a priori definition of all the elements of quality of a service provided is in general not possible at this stage. A comprehensive European quality policy for services does not exist, but needs to be developed.

Access of SME's to business-related services must be facilitated by providing the training necessary to obtain the required skills of the employees.

III. THE COMPETITIVENESS OF EUROPEAN BUSINESS-RELATED SERVICES

III.1. Key factors contributing to competitiveness

As mentioned in chapter I, business-related services play a key role in fulfilling the ambitious objective of the Lisbon strategy. The Lisbon strategy for sustainable development combines the goals of competitiveness, full employment, social cohesion and environmental sustainability. It is recalled that the business-related services constitute the main segment of the European economy and that they are at the same time the major contributor to the performance of the other sectors of the economy. Consequently, business-related services should benefit from the simultaneous pursuit of the objectives – enhanced competitiveness, full employment, social cohesion and environmental sustainability – which lie at the core of the Lisbon strategy.

Economic growth is a precondition for obtaining a sustainable increase in real income and standards of living. Historically, growth in productivity has been the principal source of economic growth. Productivity growth depends on the quality of physical capital, improvements in the skills of the labour force, technological advances and new ways of organising these inputs. This chapter will focus on analysing aspects of the last three elements by looking at ICT usage, R&D and innovation in services, human capital and, finally, international trade and foreign direct investment in services as indicators for the competitiveness of European business-related services.

III.2. Labour productivity growth in business related services

The recent development in overall productivity growth in the EU has caused concern and threatens the possibility of achieving the goals of the Lisbon strategy. In the first half of the 1990s, the EU experienced an annual average growth in labour productivity (1.9 %) considerably exceeding the US (1.2 %), but the pattern changed dramatically in the following period 1995-2001. The annual growth rate declined to 1.2 %, while the growth in the US expanded to 1.9 %. The development was mainly caused by the relatively poor productivity performance of the European business-related services compared to the US, see figure C Annex I.

This reinforces the need for effectiveness, at both the European and the national level, in pursuing productivity gains and higher employment rates as the pre-requisite for competitiveness.

The underlying trends are important when analysing the reasons for the different performance of European and US business-related services, since sector specific patterns can be observed. The main reason for the difference in growth is the very strong growth performance of the US distributive trades sector – both compared to the corresponding sector in the EU and to other sectors of the economy. The only sector generally experiencing higher growth rates is the telecommunication sector in the EU – exceeding also the corresponding US sector. In the second half of the 1990s, the European telecommunications sector experienced increased competition due to market liberalisation. For the other business-related services sectors, which have not been exposed to the same extent of competitive pressure, productivity growth differs considerably both between Member States and between the EU and the US. In general, the development of business-related services sectors in the US indicates a larger growth in productivity compared to the corresponding sectors in the EU.

III.3. Measurement problems

The reported figures on the continuing labour productivity gap with the US give cause for concern, but before analysing and explaining the reasons for the slow growth of productivity, the problems related to measurement of services productivity should be emphasised. The concepts of labour productivity work well for manufacturing enterprises, but are subject to considerable uncertainty when it comes to measuring productivity in the services sectors.

Productivity improvement in business-related services depends heavily on investment in intangibles, such as training, customer relationship management, brand image and creation of an efficient organisation, as well as investment in software and information and communication technologies. There is an urgent need for defining “intangible investment”, both in statistical terms and in company reports, to enable intangible assets to be identified, measured and reported.

An illustration of the deficiencies in existing services statistics and thus in the measurement of economy-wide productivity is shown in box 2 in annex III.

Challenges

In general, the statistical coverage of the services sector is lagging behind the coverage of manufacturing, but the statistical gaps are particularly serious in relation to measurement of productivity.

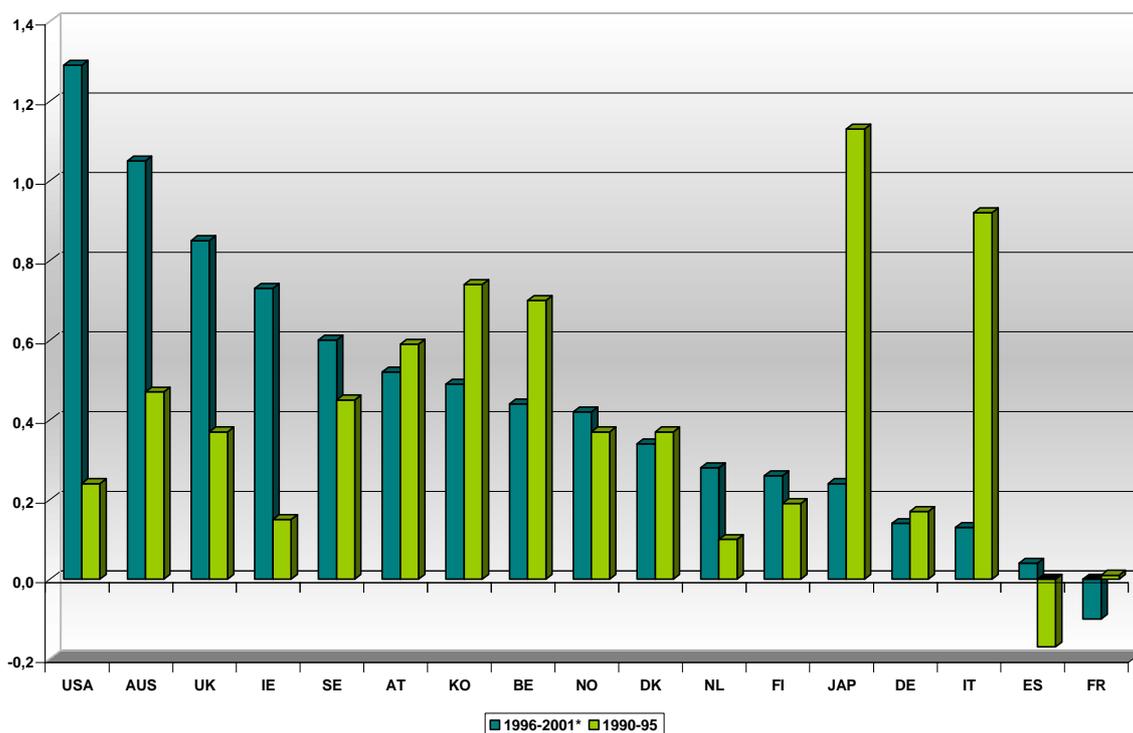
Lack of reliable information about the intangible assets of a company results in uncertainty and speculation on its real value. Measurement and reporting of intangible assets have become a major concern for governments, enterprises, investors and other stakeholders. Services enterprises are particularly exposed to this problem since they are almost entirely based on intangible assets.

III.4. Use of ICT by the enterprises in business related services

Evidence from recent studies on productivity growth and use of ICT suggests that ICT is enabling rapid productivity growth in sectors having invested heavily in ICT, see figure 5¹⁵. The use of ICT can help companies increase their overall efficiency in combining labour and capital, the so-called multi-factor productivity. This is assumed to be the main explanatory factor behind the recent productivity growth achieved by distributive trades in the USA and Australia.

¹⁵ European Competitiveness Report 2002 (SEC (2002) 528).

Figure 5. Contribution of ICT-using services to annual average labour productivity growth, percentage points.



Note: ICT –using services include distributive trades, financial services and business services

Source: OECD.

Unfortunately, no sectoral data are available, but overall IT expenditures in the EU amounted to 4.2 % of GDP in 2001 compared to 5.3% in the US and 4.0% in Japan. To narrow the productivity gap, the EU has to increase investments in ICT, especially in business-related services. It is particularly important to reap the benefits related to improvement and innovation of the business processes by better integration, expanding or customising the services offered.

Given the lack of official statistics on ICT use at the sectoral level, the Commission launched in late 2001 a separate activity to monitor and assess the maturity and impact of e-business across different sectors of the European economy¹⁶.

Challenge

There is a need to further stimulate the integration of ICT into business processes. Of special importance for business-related services is improvement of framework conditions for digital delivery in terms of sufficient network infrastructure, establishment of messaging standards, quality certification and accreditation.

¹⁶ The e-business W@tch. The results, including the specific sectoral reports, are regularly published and available at www.ebusiness-watch.org, or via the Commission's Europa web-server at www.europa.eu.int/comm/enterprise/ict/policy/watch/index.htm.

III.5. R&D and innovation by enterprises in business-related services

Some of Europe's most innovative companies are to be found in the business-related services, but the overall level of R&D in these sectors is generally low and lags substantially behind the US. Whilst the EU economy has developed into a services economy in the last decades (see chapter II), market services¹⁷ still account for a relatively small amount of total business expenditure on R&D. The EU average in 2001 is 13 % - with large differences across Member States, see figure D in Annex I. The corresponding US figure is 34 %, so even if the R&D expenditures of services enterprises have grown substantially since 1991, the gap to the US has widened in the same period.

Challenge

A greater direct involvement in collaborative R&D projects, together with the high tech industries, could result in more rapid development of technologies as well as a faster deployment of the new technologies. The involvement of services companies in the Research Framework Programme could also be increased by inclusion of appropriate topics in the WP. The EU target of devoting 3 % of GDP to research and development¹⁸ will be less difficult to achieve if the services sector plays a larger role, reflecting its overall economic weight.

III.6. Human skills

Without the growth generated by business-related services in the second half of the 1990's, unemployment in the EU would have been even higher than at present. Although there is a plentiful labour supply, a breakdown by educational attainment of the jobs created shows a mismatch between supply and demand. In all sectors of the economy, and not only in the knowledge-intensive business services, there has been a growing demand for highly educated employees (first and second stage of tertiary education), see figure E in Annex I. This development confirms the need for a larger supply of employees with further training.

The problems of skills shortages are addressed in the European Employment Strategy and have led to considerable investment in a general upgrading of the European labour force. Existing data suggest, however, that the growth of medium- and high-skill employment, especially in the knowledge-intensive business services, has outstripped the growth of the supply of employees with the corresponding attainment levels. As the level of educational attainment is higher in the US and Japan, skills shortages in these countries are not expected to hamper the productivity of knowledge-intensive business services in the same magnitude as in the EU¹⁹.

A skilled labour force contributes to productivity growth by enabling the companies to utilise and take advantage of their investments in ICT and other innovative features. The labour-intensive nature of many business-related services, the high degree of interaction with customers, the knowledge intensity of many services and the importance of tacit knowledge are all factors implying the importance of sufficient supply of skilled human capital for future productivity gains.

¹⁷ It is important to note that sectoral breakdown of R&D expenditures is subject to serious problems of methodology and international comparability. For instance, different levels of outsourcing of R&D activities hamper the comparability of sectoral data across countries.

¹⁸ Communication from the Commission. More research for Europe – Towards 3% of GDP. COM(2002) 499 final, and investing in Research, an action plan for Europe. COM(2003)226 final.

¹⁹ OECD : Science, technology and industry scoreboard 2003.

Challenge

Continuous learning and updating of skills is of special importance for the competitiveness of business-related services' enterprises due partly to their labour intensity, partly to the fact that the quality of the input of the individual employee is of vital importance for the services offered. The supply of training for employees of SMEs must be specifically addressed in the policy framework. Business-related services are highly sensitive to changes in labour market conditions. Business-related services encounter continuously emerging needs with regard to employment flexibility, which should be accounted for in labour market regulations (for instance part-time employment, mobility)²⁰.

III.7. International trade and foreign direct investment

International trade and foreign direct investment reveal a key dimension of the competitiveness of European business-related services. For the sector to be seen as competitive, European business-related services should show leadership in foreign trading and investments.

One of the characteristics of the services sector is the importance of presence in the local market. This is the reason for the relatively large share of business-related services in foreign direct investment (66 % of total inward and outward investments); with business services (34 % of foreign direct investments in business-related services) and financial and insurance services (30 %) as the dominant sectors.

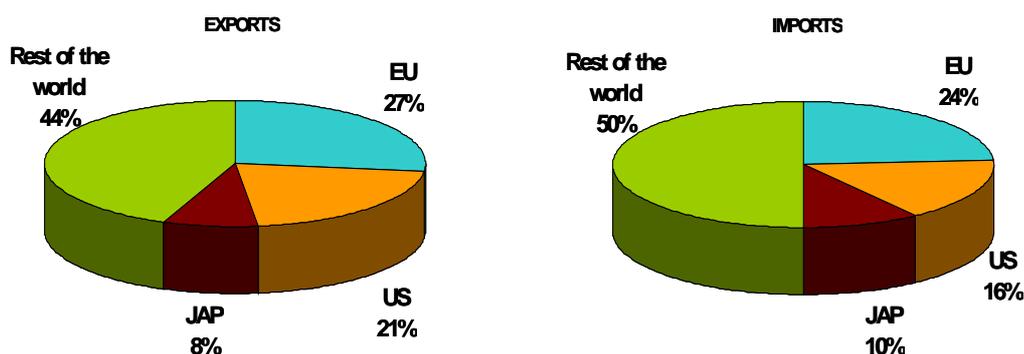
The preference of business-related services for foreign direct investment is also reflected in the limited share of business-related services in total international trade in goods and services at around 18% in the EU, somewhat higher than in the US (16%) and Japan (13%). However, international trade in business-related services accounts for around two-thirds of total international trade in services of the EU.

European business-related services hold a major market share (26 %) of international trade (exports + imports) in business-related services compared to the US (18 %), see figure 6. This can be interpreted as a strong indicator of competitiveness of European business-related services. However, the differences in market shares are larger in imports than exports (see figure 6). The EU is a major importer of business-related services, implying only a small net surplus. The positive net balance is created by relatively large surpluses for financial and insurance services, transportation and IT services, whereas some knowledge intensive business-services (legal, accounting and management services, advertising and market research) and royalties show a large deficit. The overall net US balance is the double of the EU one, in absolute terms (35 billion € versus 17 billion €) and clearly better using the exports/imports cover rates: 124% of surplus versus 108%.

An improved trade balance with the rest of the world presupposes that business-related services are confronted with increased competitive pressure, raising their productivity. In the present situation, this is in general the case for network and financial services following a still on-going liberalisation, but not for some business services and distributive trades that in many cases are operating in fragmented and closed markets.

²⁰ The Commission Proposal for a Directive on the Recognition of Professional Qualifications (COM(2002)119) can make a key contribution to increase skills mobility through improved conditions for free movement of qualified professionals throughout the EU.

Figure 6. Exports and imports of business related services. 2001.



Source: Eurostat: Foreign trade. Note that intra-EU trade is excluded from the totals.

European services providers continue to face a wide range of restrictions in dealing with third countries. The inclusion of services activities into the WTO agreement constituted one of the major steps of the Uruguay Round. However, barriers to trade in services have proven to be more varied and complex than the barriers to trade in goods. In order to continue to open the global trade in services, negotiations are taking place within a multilateral framework on the basis of the "General agreement on Trade in Services" (GATS) which entered into force on 1 January 1995. In addition, and without detriment to the negotiations held in this multilateral framework, the EU pursues negotiations on services at bilateral and plurilateral level, such as the free trade agreements concluded with Mexico and Chile, and the negotiations underway with Mercosur and the Gulf Co-operation Council.

Challenges

Multilateral and bilateral negotiations must open up global trade in business-related services. The direct advantages for enterprises in the sector are obvious, but the indirect effects are equally important: liberalisation of international trade in business-related services, together with the abolition of Internal Market obstacles to cross-border trade and investment in the EU following on from the Directive on Services in the Internal Market, will put EU enterprises under stronger competitive pressure, giving them a competitive advantage compared to enterprises from third countries.

To the extent that a number of business-related services are also sold to consumers, their treatment in terms of liberalisation and market access must take into account consumer concerns.

IV. THE WAY FORWARD

IV.1. Key policy issues

The economic analysis shows that business-related services constitute the largest sector of the EU economy employing around 55 million persons in 2001 – or nearly 55 % of total employment in the EU market economy. Business-related services have been, by far, the main source of job creation in the EU. The business-related services is also the most dynamic sector in terms of establishment of new enterprises. More than two-thirds of all new enterprises start up within business-related services. But the analysis also points out that the sector's recent

development in productivity is lagging considerably behind the development in the US. At the same time, the future employment in the sector is threatened by a de-localisation of services jobs – from call centers to IT services – to the US and Asia.

These challenges identified in the analysis must be dealt with urgently. If not, the European business-related services sector is at the risk of losing markets. If we are not able to provide better framework conditions tackling the problems, there will be a risk of rapid migration of employment – already experienced in certain segments of business-related services – to other regions, as has been the case in many manufacturing sectors. *This would in particular be to the detriment of the industrial sectors, which are all dependent on the availability of a top class service infrastructure.*

Based on the range of challenges for business-related services in the EU listed in the economic analysis, the following key policy issues have been identified:

1. Market integration and competition in business-related services markets is not vigorous enough to ensure and strengthen their competitiveness;
2. The inputs necessary for the production (labour qualifications, integration of ICT and capital) are lacking in quality and quantity;
3. The outputs from the business-related services enterprises are not sufficiently transparent (standards), valued (reporting on intangible assets) or documented (quality);
4. The provision and use of business-related services is limited in less developed regions and candidate countries, mainly affecting SMEs and convergence processes;
5. Knowledge about the sector and the markets is scarce, hampering the decision making of enterprises and policy makers.

1. *Market integration and competition in business-related services markets is not vigorous enough to ensure and strengthen their competitiveness*²¹

1.1. Elimination of obstacles to trade in services in the Internal Market and international trade. The abolition of obstacles to cross-border trade and investment in the EU following on from the Directive on Services in the Internal Market and the possible extension of the Notification Directive (98/34), together with liberalisation of international trade in business-related services, will put EU enterprises under stronger competitive pressure and will provide the EU regulatory framework necessary for the opening of those markets which are still too fragmented and protected. This will give European enterprises a competitive advantage compared to enterprises from third countries in the present situation where outsourcing to these countries poses a growing risk to the EU services enterprises and employment.

The elimination of legal and administrative obstacles inside Europe is a necessary but not sufficient condition to obtain a real single market for services. There are other barriers

²¹ The Services Directive will be a key tool in solving this problem of failing integration of the services markets in Europe. For business-related services the situation is not identical for all services, since some markets have already high degree of competition and integration at European level. However, the proposed actions apply to a majority of business-related services, especially with respect to the need of better market integration.

hampering the full integration of service markets: economic, social, cultural, etc. Many of the economic barriers can be reduced with the promotion of complementary measures such as the reinforcement of entrepreneurship, networks, skills, common quality standards or innovation. The wide set of barriers is another element justifying the complementarity of legislative and non-legislative measures derived respectively from the Directive on Services in the Internal Market and from this Communication in order to achieve a competitive internal market for services.

1.2. Boost competition in the business-related services markets. The competitiveness of business-related services can only be obtained through competitive markets. The introduction of competition in some service sectors like telecommunications and air transport has increased the number of enterprises operating under market conditions, reducing prices, improving quality and boosting employment and the range of services offered. Those previously protected enterprises have become more competitive and motivated to adapt themselves to pro-competitive strategies. Competition is important for innovation, entrepreneurship, productivity and growth, especially in those services sectors traditionally operating in more fragmented and closed markets.

Similarly, in other sectors, like certain business services, their markets have been operating to some extent under competitive conditions and the administrative environment has been less regulated. Nevertheless, competition policy has an important role to play in encouraging competition in particular in professional services and distributive trades.

1.3. Modernisation of public administrations. The competitiveness of many business-related services is closely linked to the performance of public administrations. A wide range of services, traditionally provided by public authorities, can also be delivered by businesses. In particular, the development of e-government and the good management of services of general economic interest with enhanced private financing can result in better co-operation between public and private operators in the interest of users and providers of these services. Public Private Partnerships (PPPs) should thus be encouraged, leading to gains in efficiency and also lower costs to the user as a result of competitive pressure.

Complementary actions to improve service innovation and modernisation in public administrations should also be promoted through benchmarking of best practices among Member States. Finally, new modernised public procurement rules as proposed by the Commission will further strengthen competition between services providers.

2. *The inputs necessary for the production (labour qualifications, integration of ICT and capital) are lacking in quality and quantity*

2.1. Ensure continuous learning and updating of skills. The shift towards a knowledge-based economy, in which business-related services play a determinant role, depends on a labour force with skills adapted to this change, ensuring its employability and thus leading to a better balance between employment protection and flexibility of work organisation (e.g., part/time, teleworking). Furthermore, it will facilitate the mobility of workers helping to overcome skills imbalances, in particular in sectors such as computer and other knowledge intensive services.

If Europe does not improve its track record on development of high skilled human resources in a knowledge-based economy, the business-related services sector will become less competitive. Policy measures related to the qualifications of the labour force in the EU

particularly for SMEs must be implemented in order to avoid a de-localisation of services jobs, similar to what has been experienced within manufacturing.

2.2. Support integration of ICT in the business processes. All enterprises in the field of business-related services especially SMEs, must fully exploit the potential of ICTs to increase their productivity. This has already happened in the US, where productivity growth acceleration occurred in ICT using as well as ICT producing sectors. However, ICT-using services in Europe have shown weak productivity growth in the last years. ICT should be more and better integrated in ICT-using business-related services to ensure that the ambitious goals of the Lisbon strategy will not be put at risk. Moreover, the role of certain ICT-producing services should be promoted to increase the performance of ICT in any service or manufacturing sector. New technology does not lead to productivity gains in itself. It requires the relevant input from services to support its implementation, application and integration into the business processes.

2.3. Encourage R&D and innovation in business-related services. Services companies show a high level of innovation, and are often the leading edge users of advanced technological developments. Furthermore, knowledge service activities (e.g., management consultancy, computer services, R&D services) act as catalysers of innovation processes in the entire economy. Some of Europe's most innovative companies are to be found in the services sector, but the overall level of R&D in this sector is generally low. The level of R&D in services lags substantially behind the US.

Policy innovation initiatives should promote both specific actions oriented towards services activities (e.g., role of organisational service innovation), and more active participation of services companies in R&D programmes. The involvement of services companies in the national and European R&D Programmes should be improved to address their specific problems and needs. The EU target of devoting 3 % of GDP to research and development will be less difficult to achieve, if the business-related services sector plays a larger role, reflecting their overall economic weight.

3. *The output from the business-related services enterprises are not sufficiently transparent (standards), valued (reporting on intangible assets) or documented (quality)*

3.1. Standardisation. Voluntary standards provide solutions to interface problems that occur when the provision of services crosses national borders. They permit the user to compare products and prices, which enforces competition and efficiency. In the absence of previously agreed and balanced standards²², market transparency remains low and the effect of switching to an alternative supplier can be both costly and risky. Standards would benefit the services providers by enabling them to focus on the internal process of services production and obtain some economies of scale. They would also be able to increase the market presence and negotiating position of services providers by compliance with standards. The Commission will promote the setting up of such voluntary standards led by the services providers, in the same way as for manufactured products.

²² An "over-standardisation" process or the emergence of many different non-compatible standards across the different EU countries would lead to negative effects.

3.2. Reporting on Intangible assets. Reliable information about the intangible assets of companies is needed, both at the level of the enterprise, and in government policy development in order to avoid inefficient resource allocation. It also results in uncertainty and speculation on its real value. Measurement and reporting of intangible assets has become a major concern for governments, regulators, enterprises, the accounting profession, investors and other stakeholders. Services enterprises are particularly exposed to this problem since they are almost entirely based on intangible assets. Productivity improvement in business-related services depends heavily on investment in intangibles, such as training, customer relationship management, brand image, internal organisation, investment in software and ICT.

Businesses have now gained considerable experience in the use of various voluntary guidelines for reporting on intellectual capital and other forms of intangible assets. These efforts will only have long-term value if there is convergence of the taxonomies, rather than a proliferation of reporting methods. The Commission intends to address improved identification, measuring and reporting in order to overcome the present lack of reliable information about the intangible assets of a company. This would be complementary to, but separate from ongoing developments in the fields of accounting rules and corporate governance.

3.3. Quality. Quality is besides prices the most important factor in the attractiveness of a product to its market and is thus fundamental in ensuring competitiveness. Quality plays a significant role in defining the differentiation factor for companies, reputation and producing competitive advantages and specialised services. A knowledge-based society cannot be competitive without high quality services. In addition, European services should be ready to compete in quality since low-wages countries (e.g., those in Asia) will often have a better position to compete in costs.

However, in contrast to the supply of goods, the delivery of a service usually involves a close interaction between the services provider and the client, making it difficult to distinguish between the delivery process and its outcome. An objective, a priori definition of all the elements of the quality of a service is in general not yet possible, and there is no comprehensive European quality policy for services. Similar to what is being done for manufactured products, the Commission will encourage and support the drawing up of quality indicators and promote best services practices.

4. *The provision and use of business-related services is limited in less developed regions and candidate countries, mainly affecting SME and convergence processes*

In the context of globalization of the economy, business services operate as the "brains of industry" which may provide competitive advantage to those firms and regions which have easy access to advanced business services. By their own nature these services tend to cluster in core metropolitan areas which are well connected internationally.

The development of regional markets for business-related services, in particular those related to advanced services facilitating innovation in SMEs, is a necessary element for the catching-up process of the less favoured European regions, including the accession countries. These services can also contribute to a more competitive regional environment and thus attract inward investment. Moreover, it is in the services sector where most of the new quality jobs that regional policy is trying to create will take place. Both public and private services competing on an equal footing and exploiting synergies among them can contribute to this desirable development path. Modern regional development policy tends to be a more service-inclusive policy which does not only focus on the manufacturing sector as a matter of priority.

5. *Knowledge about the sector and the markets is scarce, hampering the decision making of enterprises and policy makers*

There is an urgent need for improving the level of economic information and analysis, in particular through improved services statistics. The essential role of business-related services for the growth and sustainable development of the EU economy is not fully recognised by business operators, professional organisations, economists, policy makers and the media. The main reason is that existing research and statistics do not properly reflect the role of services in the economy. Improvement of the knowledge and statistical coverage of the business-related services is an important action in order to better understand the real forces behind competitiveness. This is an essential instrument for giving guidance to decision making by business operators, policymakers and other stakeholders and for monitoring of progress in the implementation of policy areas of action described in this Communication.

The fact that the duration from the time of presentation of a proposal for new statistical data to the time of availability of data is long, explains the approach of presenting a relatively detailed strategy in annex III “Statistics on the services sector – outline of user needs in a long-term strategy” simultaneously with this Communication and the proposed policy actions. The improvement of services sector statistics has to be seen in the full context of collecting statistical information on enterprises. In order to manage the level of the respondent burden on enterprises, priorities for statistical requirements related to enterprise statistics have to be established.

IV.2. Establishment of a coherent policy framework

The analytical part of this Communication demonstrates that it is necessary to address the framework conditions affecting costs and quality of business-related services, which depend on a number of issues, related to current EU policies. These issues have two main dimensions:

Firstly, it is necessary to further investigate together with all stakeholders where current EU policies affecting the framework conditions of enterprises do not take sufficient account of the specific nature of services. When this is the case, these policies must be moulded into a shape that corresponds to the new economic realities.

Secondly, a coherent framework must be sought in order to create better synergies and mutual reinforcement between the various policy areas affecting services. One or several isolated policy actions will only lead to limited progress in European competitiveness due to the complexity of this concept. Conditions must be created for both strong productivity and employment growth, contributing to sustainable increase in real incomes and standards of living. The means lie in adaptation to structural changes and implementation of measures subjecting business-related services to competitive pressure resulting from the appropriate application of all relevant Community policies.

The Commission is convinced that the implementation of policy actions mentioned above under points 1-5, taking into account sector specific conditions will result in lower prices and higher quality in these services that in turn will raise the demand. At an aggregate level, it will result in more economic activity, leading to higher real income and demand and improve the competitiveness of all European enterprises. The rise in aggregate demand will subsequently encourage new investment in the economy as a whole and create new employment opportunities. Such a virtuous cycle is only sustainable if all policies contribute. The notion of sustainable development is in itself a clear example of the necessity to create synergies between economic, social and environmental policies.

It is emphasised that the proposed policy actions do not apply to the same extent to the various activities that make up business-related services. *The challenge lies in finding the most appropriate combination of actions and to establish which policy actions should be applied within a catalogue of policy actions to be implemented in the specific services sectors, according to their specific framework conditions.*

IV.3. Implementation

The policy challenges derived from this Communication do not only concern the Commission, but equally the other Community institutions, the national governments as well as other enterprise-related stakeholders with vested interests in a well functioning business-related services sector. The proposed Directive on Services in the Internal Market brings to a close a long process of consultation on barriers, but implementation of the accompanying measures will necessitate an ongoing consultation of all involved parties concerned, based on more detailed policy proposals which the Commission will draft on the basis of the key policy issues identified in this Communication.

These discussions should lead to more targeted actions, meeting the requirements of business-related services and taking into account the specific framework conditions applying to the individual activities. A balance between their different priorities will be determined and the main actors and timetables for the implementation will be identified.

This consultation will be organised through a European Forum on business-related services which the Commission will establish in the forthcoming months: it will be composed of the Community institutions, Member State representatives, professional organisations, workers representations, research institutions and other enterprise-related stakeholders. The work foreseen to be carried out by this Forum, will complement in a more focussed and expert way that of other bodies, such as the Enterprise Policy Group(s).

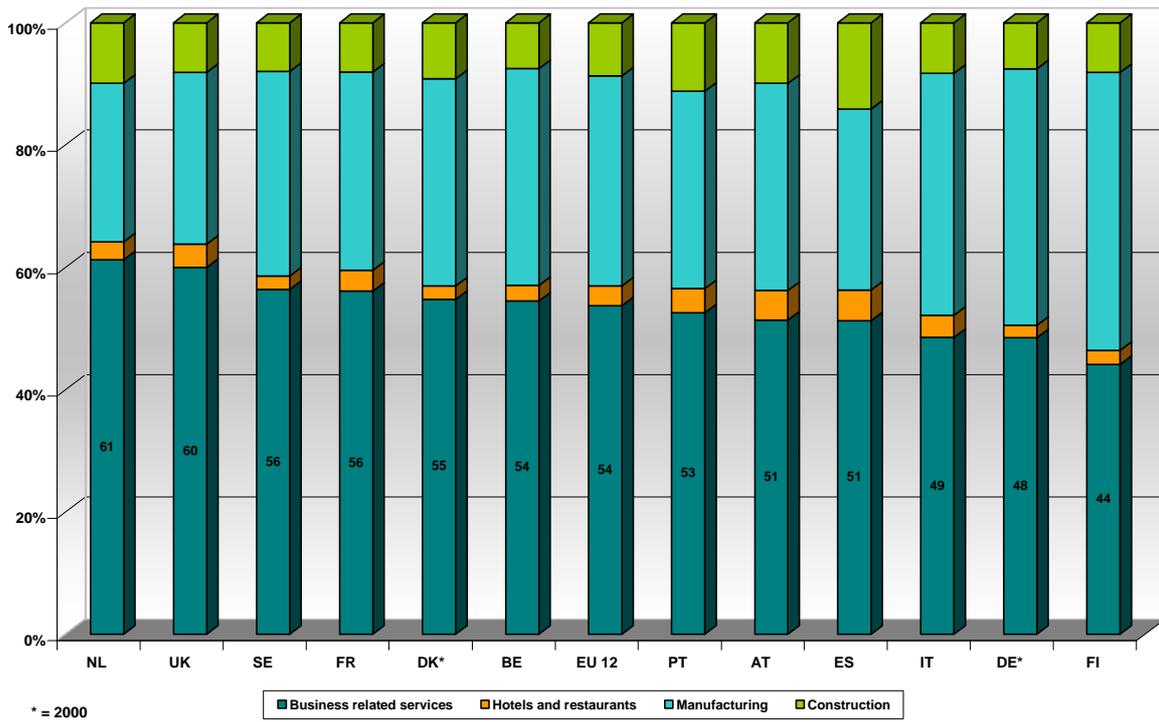
This discussion will lead to an Action Plan to be proposed by the Commission in the first half of 2005. This Action Plan will be complementary to and reinforce the measures undertaken in the Directive on Services in the Internal Market and due account and synergy will be sought with progress in the implementation of the Directive.

ANNEX I
Classifications of services and additional figures.

Box 1. Major services required for the performance of enterprises (functional approach)

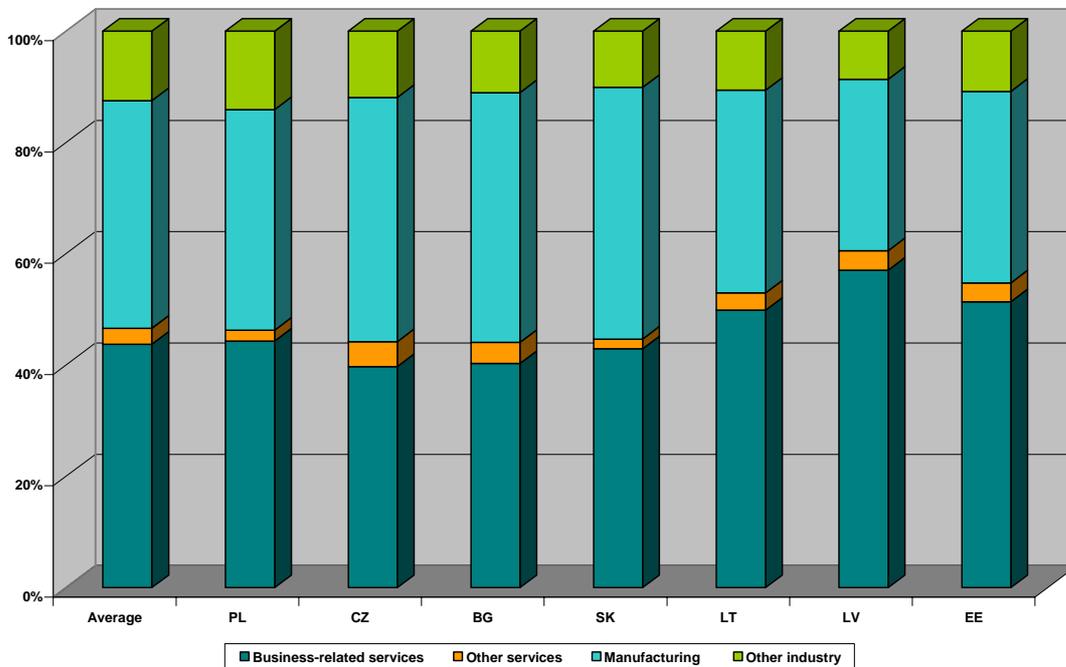
FUNCTIONS IN ENTERPRISES	MAIN BUSINESS- RELATED SERVICES	FUNCTIONS IN ENTERPRISES	MAIN BUSINESS- RELATED SERVICES
Administration	Management consultancy Legal services Auditing and accounting	Information management	Computer and IT services Telecommunications
Human resources	Temporary work Recruitment of personnel Professional training	Marketing and sales	Advertising Distributive trades Public relations Fairs and exhibitions After-sales services
Financial intermediation	Banking Insurance Renting and leasing	Transport and logistics	Logistics Transport services Express courier
Production and technical function	Engineering and technical services Tests and quality control – R & D services Industrial design Maintenance and repair of equipment	Facility management	Security services Cleaning services Catering Environmental services / waste disposal Energy and water services Real Estate (warehouses)

Figure A. Value added in the market economy 2001. Broken down by sector.



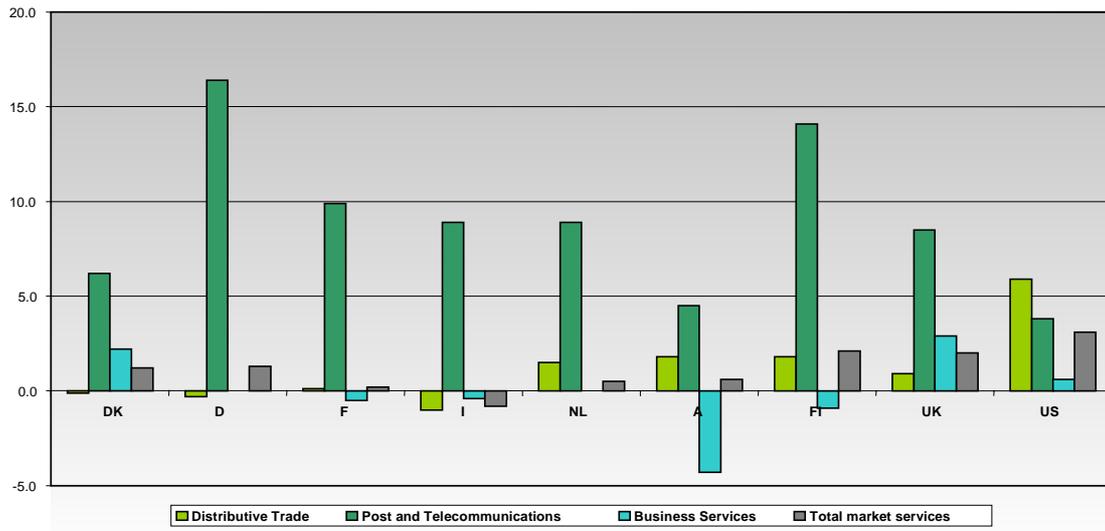
Source: Eurostat. SBS data.

Figure B. Employment in Candidate Countries 2000. Broken down by sector.



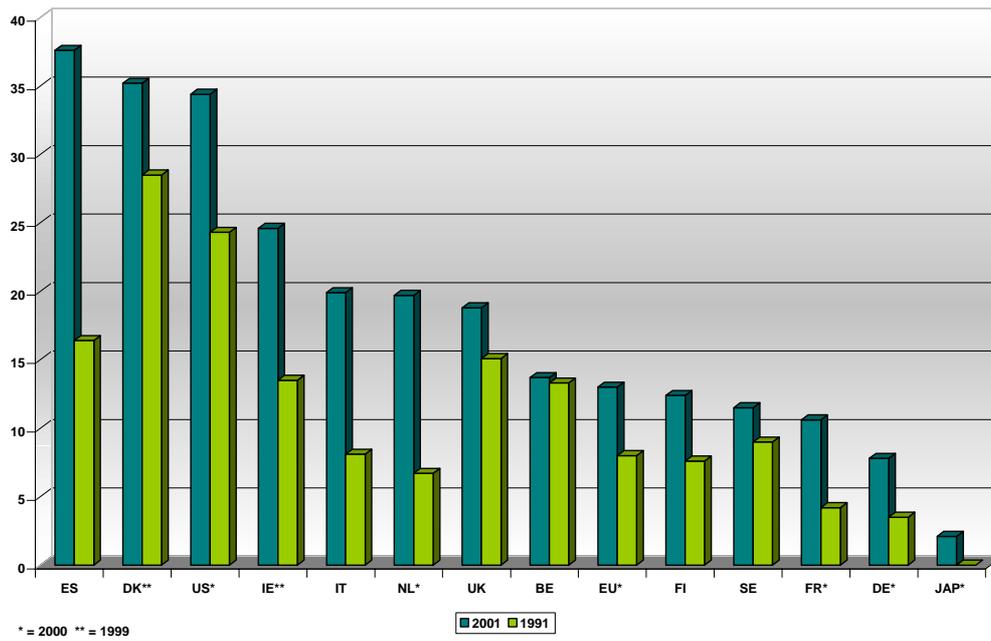
Source: Eurostat. SBS data.

Figure C. Labour productivity growth in business-related services, 1995-2000.



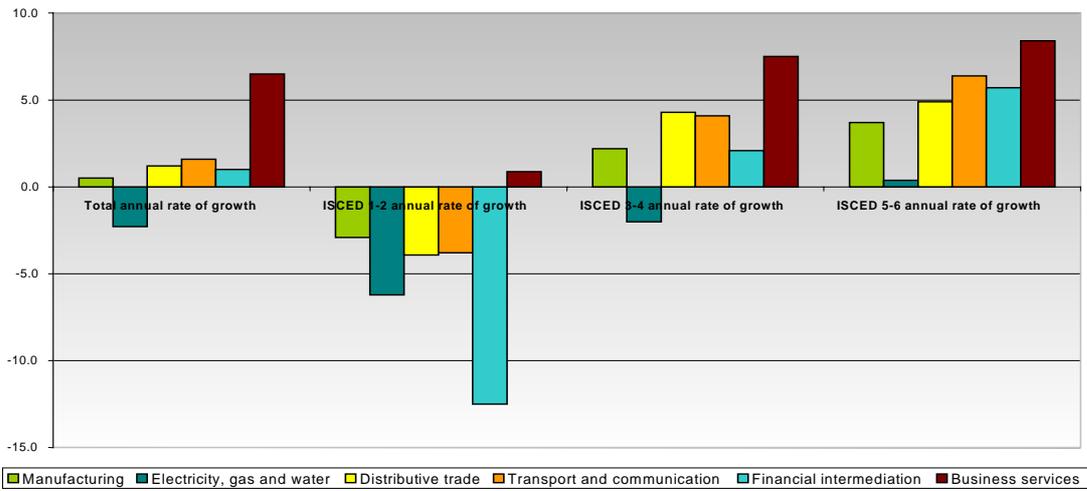
Source: Calculations based on OECD STAN database 2001.

Figure D. Share of services in business R&D.



Source: OECD, ANBERD database 2003.

Figure E. Employment growth by sector and level of education, 1995-2000.



Note: ISCED 1-2: Primary and lower secondary level of education, ISCED 3-4: Upper secondary and post secondary non tertiary level, ISCED 5-6: First and second stage of tertiary education.

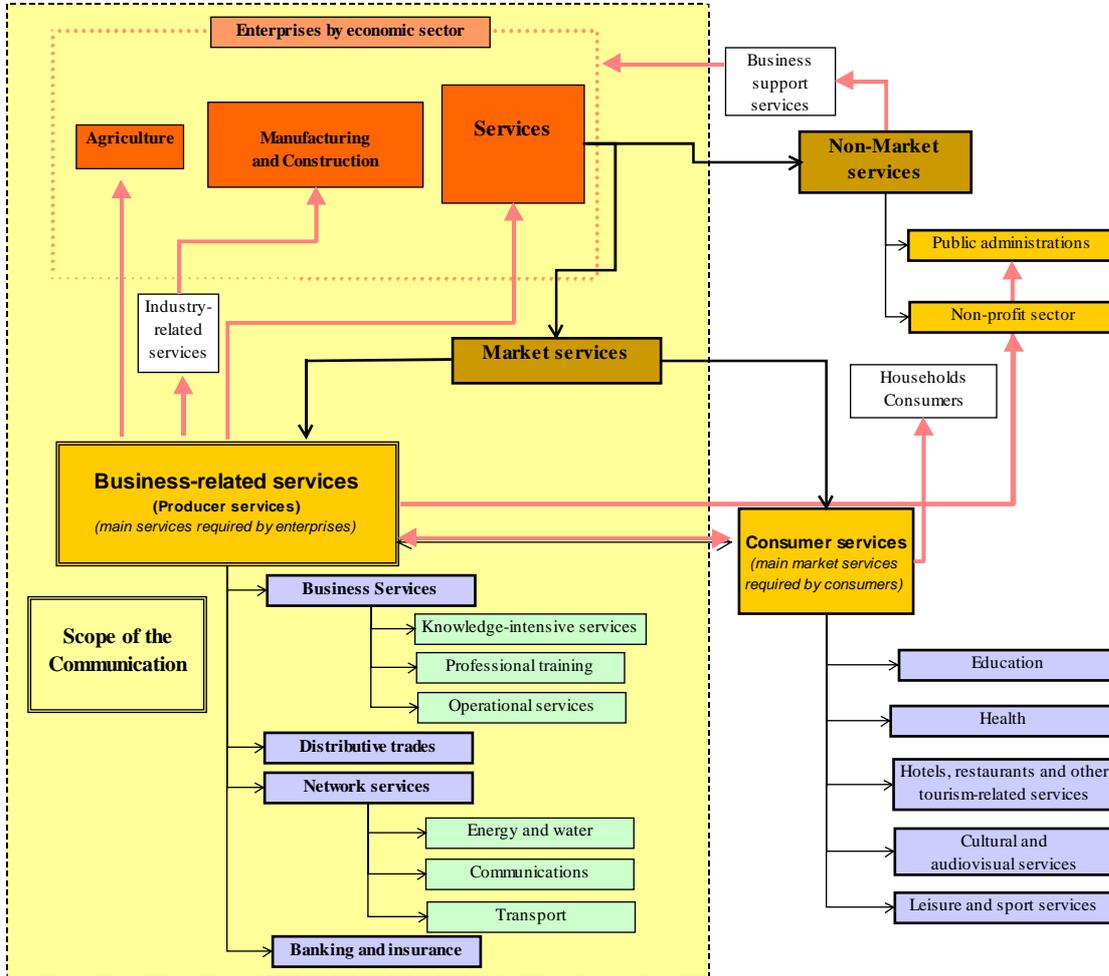
Source: Eurostat. Labour Force survey.

ANNEX II

Scope of Communication

The interrelations between services and enterprises:

The place of business-related services and the scope of the Communication



ANNEX III

Statistics on the services sector - Outline of user needs in a long-term strategy

I. Introduction

Statistical information has in recent years gained a more prominent position in political decision making. The European Council meeting in March 2000 in Lisbon “invites the Commission to draw up an annual synthesis report on progress on the basis of structural indicators to be agreed relating to employment, innovation, economic reform and social cohesion”. Another recent example is the adoption in December 2002 of the e-Europe Action Plan 2005 that includes a comprehensive list of benchmarking indicators. In order to ensure that political decision-making is carried out based on a reliable and sound basis, official statistics need to be capable of meeting the growing demand for supply of statistical information.

The statistical production process is fundamentally based on the approach of measuring the development of and changes in certain phenomena over time. This approach has a potential built-in conflict with user needs being often of urgent and changing character due to shifting political priorities and agenda. In order to develop a long-term strategy it is essential to identify a number of core policy needs of a certain “sustainable” character.

The Lisbon strategy focusing on a sustainable development combining the goals of competitiveness, full employment, social cohesion and environmental sustainability is considered a useful starting point for a long-term strategy on services sector statistics. A third pillar regarding “sustainability” was added to the Lisbon goals in 2001. These policy issues are highly aggregated, and the statistical needs are addressed by the development of structural indicators. The related goals can only be achieved by addressing different policy areas such as economic, social or enterprise policy.

Community enterprise policy addresses the following main areas: Competitiveness, Internal Market, Innovation, Entrepreneurship and e-Business. The Communication on the competitiveness of business-related services and their contribution to the performance of European enterprises (in the following named Communication on Services) constitutes an integral part of Community enterprise policy and addresses those main areas, supplemented with other topics such as knowledge intensive services, skills and intangibles.

Box 1. Policy issues addressed in the Communication on Services.

I	Sustainability (economic, social, environmental)		Competitiveness (productivity, employment, globalisation)
II + IIIa	Entrepreneurship Innovation	R&D	Internal Market e-Business
IIIb	<i>Knowledge intensive services</i>	<i>Intangibles</i>	<i>Skills</i>
Sign: I: Lisbon goals; II: DG ENTR policy; III a and b: Policy issues included in the Communication on Services			

This paper focuses on the user needs for services statistics related to the formulation and monitoring of policies covering the services sector. This field of enterprise policy is becoming more and more important, as the services sector accounts for an increasing share of the economies in the Member States of the European Union. The majority of jobs created since 1970 has been created within the services sector and business-related services create the largest share of value added. As a result, the future competitiveness and prosperity of the European countries is linked to the productivity gains and job creation in the services

industries and their contribution to the competitiveness of manufacturing industry. As the business-related services are very heterogeneous, ranging from highly specialised, knowledge intensive activities such as computer services and engineering services to low skilled jobs in industrial cleaning, growing demands not only for a larger, but also for a more detailed statistical coverage are frequently brought forward by users from governments, branch organisations, researchers, etc..

II. Services sector statistics: current situation

During the late eighties and the nineties national and international statistical institutes began developing statistics on the services sector, due to the growing economic importance of the services sector and the derived needs for statistical information from different groups of users²³.

As a consequence, several EU Regulations covering the services sector were adopted, i.e. on statistical business registers, structural and short-term business statistics. Following the implementation of these Regulations, the European Statistical System has been considerably improved. As an illustration of the improvement: before the adoption of the Structural Business Statistics Regulation December 1996²⁴ harmonised structural business statistics were only available for extraction, manufacturing, energy and water supply and construction. Thus, the implementation of the SBS Regulation also covering business-related services and other services sectors must be seen as a very important achievement.

Nevertheless, serious deficiencies in our understanding of the structure of the services sector and the factors influencing the growth of services enterprises remain. The available statistical material does not reflect appropriately the dominant position of services in the economy and also fails to show the extent of the interdependence between business-related services and the other sectors.

There are several reasons for this situation:

- Services are difficult to define and thus to measure. The main characteristics of the services sector are that the output can generally be characterised as being of intangible nature. However, the introduction of information technology has changed this situation in the sense that services nowadays can be imbedded in physical products and thus delivered and stored via physical means. Normally, a service contains a considerable element of personal contact between the producer and the client – a social inter-action. This social interaction puts focus on the so-called “soft technology”, being the qualifications of the employees in terms of level of knowledge, capability of presenting to and communicating with the customer, etc..
- The development of new technologies, products, types of enterprise relation is fast and changing rapidly; consequently the need for inclusion of new indicators or variables puts pressure on the existing data collection to an extent not previously experienced.

²³ For an overview of the conceptual development and practical measurement issues in the field of services statistics, see UN-Economic and Social Council. Report of the Australian Bureau of Statistics on statistics of services (doc. E/CN.3/2003/12).

²⁴ Council Regulation (EC, EURATOM) N° 58/97.

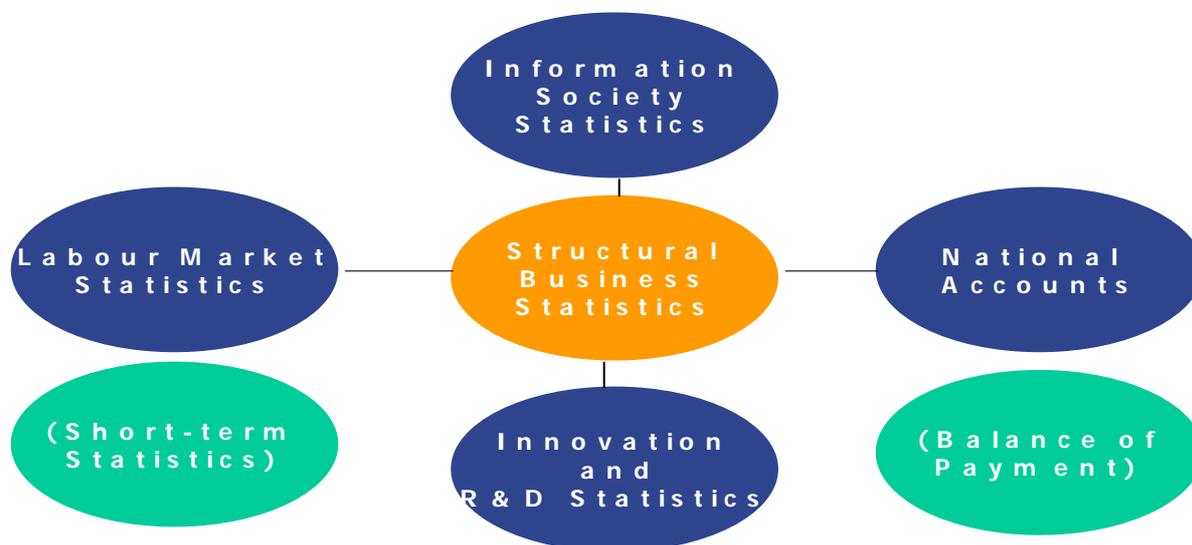
- Furthermore, many statistical offices were faced with severe budget cuts in the nineties, hampering the enlargement of the statistical programmes. Also the political demand for reduction of the respondent burden has made new statistical surveys more difficult in many countries. The improvement of services statistics has to be seen in a global context covering all statistical information to be supplied by enterprises.

III. Proposed building blocks for future services sector statistics

In order to furnish the policy makers with needed and relevant statistical information and indicators on business-related services, the Communication on services presents a strategy for future statistics on the services sector, see chapter IV.1.5. The fact that the duration from the time of presentation of a proposal for new statistical data to the time of data availability is long, explains the approach of presenting a relatively detailed strategy simultaneously with the Communication and the proposed policy actions. There is an urgent need for access to the different types of data described in this paper in order to monitor the economic development and formulate the future policy concerning business-related services.

As a consequence of the dynamic development within the services sector, Eurostat and the national statistical institutes have developed proposals for improving the data availability on services in the area of structural business statistics²⁵. The outline of future user needs and the proposals for new indicators and variables have been built upon the future amendments of the Structural Business Statistics Regulation proposed by Eurostat. The user needs mainly concern the domain of structural business statistics, but due to the cross-cutting nature of services, other statistical domains are addressed as well, see figure 1.

Figure 1. Statistical domains addressed in the strategy.



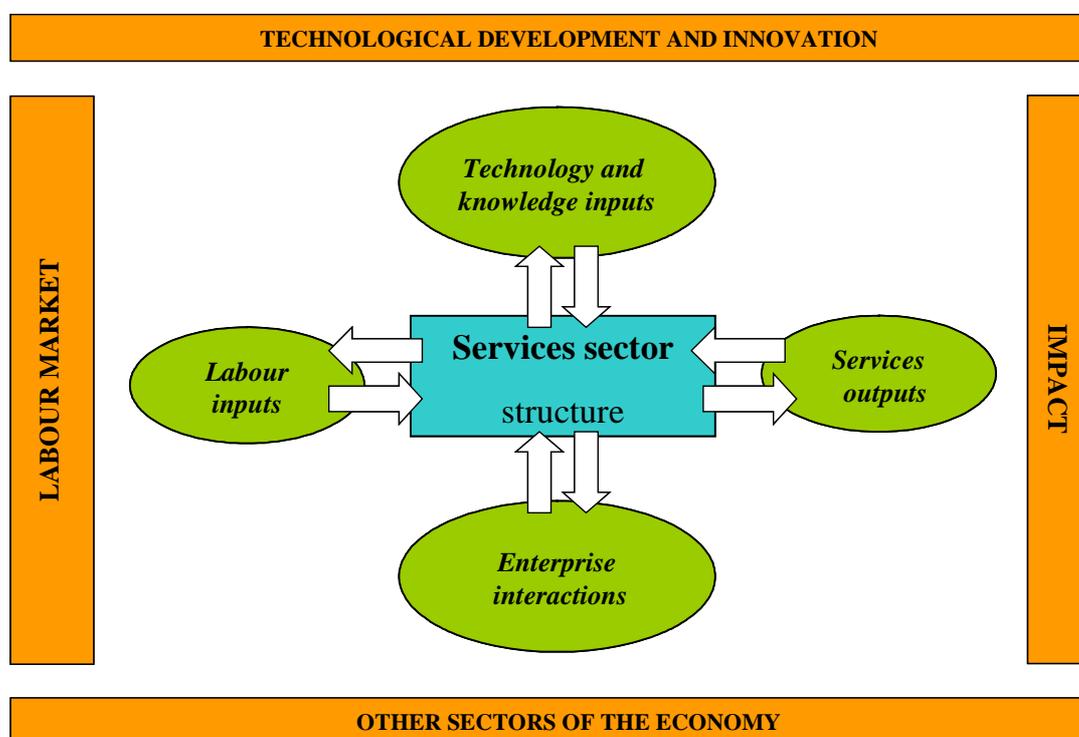
In order to operationalise the policy needs for statistical information, a set of building blocks for the development of new statistics on services has been identified. The building blocks are the following:

²⁵ Concerning the considerations of Eurostat in the field of services statistics, see Eurostat: Services Statistics: Strategy for Services Statistics – a Complement to the Strategy on Short-term Statistics (doc. CPS 2002/46/4/EN) presented at the SPC meeting, Palermo, September 2002.

1. Structure of the services sector describing basic economic and employment variables (including issues such as an enterprise dynamics, entrepreneurship, international trade in services (exports and imports of services, foreign direct investment))
2. Labour input (employment qualifications, skills, education, hours worked)
3. Technology and knowledge input (ICT usage, e-business, e-commerce, research and development, innovation and intangibles)
4. Enterprise interactions (outsourcing, purchases of services, networking, strategic alliances, franchising)
5. Services outputs (products, prices, productivity)

The different building blocks and the reasoning behind the needs are described further in the following.

Figure 2. Building blocks of statistics on the services sector.



III.1. Structure of the services sector

Basic information concerning the magnitude in terms of employment and value added of the individual services activities is fundamental for policy formulation, but is missing for many services activities at the detailed activity level, especially within business services as this sector is very heterogeneous. In the Structural Business Statistics Regulation, manufacturing industry is covered by 241 distinct activities compared to 32 for market services²⁶. In national accounts data, the need for more detailed information is even more profound – users are often

²⁶ See Eurostat : Services Statistics : Strategy for Services Statistics – a Complement to the Strategy on Short-term Statistics (doc. CPS 2002/46/4/EN) presented at the SPC meeting, Palermo, September 2002.

left with “other market services” as a residual. Analysis is hampered by the aggregation of section K of NACE and as a minimum, the split into knowledge intensive services and operational services should always be offered as an alternative aggregation.

Entrepreneurship is one of the key elements in the new economy, and new enterprises are contributing to create a dynamic business environment through economic growth, the opening of new job opportunities and innovation of production processes and products. Issues such as the magnitude, survival and job creation of new enterprises constitute an important part of the Community enterprise policy. Even if the contribution of new enterprises to economic and employment growth is limited in the start-up phase, new enterprises play a central part, as they contribute to increased competition, flexibility and innovation in the economy. Harmonised statistics are urgently needed in the area of business demography.

The interpretation of the performance of new enterprises cannot be carried out properly by only analysing traditional enterprise data. There is a strong coincidence between a new enterprise and the owner behind it – the entrepreneur, as the vast majority of new enterprises start up without any employee. If a policy for creating better framework conditions for new entrepreneurs is to be formulated on a sound basis, questions on the gender and age of the new entrepreneurs, their education, skills and other competencies of the new entrepreneurs should be answered by statistics as well.

The ultimate goal of a policy concerning creation of new enterprises is not only the creation, but also the survival of new enterprises in order to create new job possibilities and new products and services in the ever-changing economy. In order to judge the contribution to and the importance of new enterprises for economic growth, it is necessary to follow enterprises for a longer period than just the initial year of start-up. Not all new activity is sustainable, and a proportion of new enterprises will close down again. The establishment of a new enterprise is not in itself a criterion of success. The decisive element is the contribution of the new enterprises to the creation of value added and employment. Statistics throwing light on the different factors determining business success is a priority area.

The Council meeting in March 2001 in Stockholm stated that “the creation of an effectively functioning internal market in services is one of Europe’s highest priorities”. The exports and imports of manufactured goods are covered by statistics, but we lack detailed product information about the international trade in services. Information about the economic importance of barriers for cross-border trade in services is also urgently needed. Due to the importance of presence in the local market, foreign direct investments in the services area are of relatively greater importance than within manufacturing industries, and statistical information concerning foreign direct investment (also allowing for splitting up into green-field investments and investments in existing enterprises) and other cross border enterprise relations are highly in demand. Especially the last item seems to be of increasing importance in the form of joint ventures, license agreements or other forms of close co-operation across the national borders.

III.2. Labour input

In order to understand the job creation processes in the business-related services, it is not sufficient to rely only on basic statistical information on numbers of persons employed. Much more detailed information is needed on the qualifications of the employees such as level of education, work experience, gender and age. As the learning of the employees becomes more of a continuously on-going process (life-long learning), information about the formal level of qualification is not sufficient. It is necessary to collect information on training activities in

order to supplement the information on the formal qualifications of the labour force. Information technology makes the process of work a mobile process and breaks the physical links between employees and their place of work. The increasing importance of teleworking needs to be reflected in the future enterprise statistics.

The question of skills gaps is highly placed on the political agenda and one way of overcoming the gap is opening Europe up to non-European citizens with the required qualifications. Information about the size of this immigration and their workplaces is needed together with information about the emigration of skilled European citizens in order to identify possible barriers for the European knowledge-based economy. Also the apparently more frequent use of temporary foreign workers, in particular within foreign affiliates, needs to be addressed by future statistics.

III.3. Technology and knowledge input

In many of the activities within the services sector, especially within the knowledge based activities such as IT-services or engineering services, but also within the more traditional sectors such as distributive trades or transport activities (GALILEO), an intensive innovation process is ongoing. Innovation in the services sector is generally brought about by investment in acquisition of new skills, new organisational structures, new ways of co-operation, creation of new enterprises and relations with customers and suppliers. These types of innovation are, as regards contents, different from the innovation in physical products, requiring new methods of measurement of innovation.

Innovation requires investment in R&D, product development, training, customer relationship management and creation of an efficient organisation with appropriate investment in information and communication technologies. These types of expenditures on intangibles are pre-requisites to enterprise product and service output. They lead to the creation of new products, new services and new technology. Examples of intangible assets are organisational infrastructure (information systems, networks, administrative structures and processes), market and technical knowledge, patents, software, designs, brand names and human capital. There is an urgent need for defining “intangible investment” in statistical terms to enable intangible assets to be identified, measured and reported.

The use of ICT in enterprises is dramatically changing the conditions for the business processes of manufacturing and services enterprises. It is essential to monitor this development, not only IT readiness of enterprises, but also the more complicated areas of impact of use of IT on business processes, organisational structures and ultimately on business performance and productivity. The e-Europe Action Plan has identified a number of indicators for benchmarking purposes for which statistical information is still not available.

III.4. Enterprise interactions

In understanding the development of the services sector, the measuring of the outsourcing process is of importance. Statistics covering the services sector have focused on the supply side, but we need more information about the demand for services by manufacturing enterprises and other services enterprises and how this demand influences the development of the business-related services. An example: outsourcing of IT services is important in understanding the development of computer services - does the recent development of more user-friendly software change this outsourcing process? Demand side studies are furthermore required for more detailed input-output tabulations which are important for understanding interactions between business-related services and the manufacturing industry.

The types of co-operation between enterprises are changing, as different sorts of networking is becoming more frequent and of strategic importance for enterprises. This is a difficult area to measure statistically, but information concerning such enterprise interactions is needed for understanding the competitiveness of enterprises.

III.5. Service outputs

Aggregated information about total turnover of business-related services is not sufficient for carrying out in-depth economic analysis. In order to understand the development of a sector, it is necessary to collect information about the detailed breakdown of the turnover by product categories. An example: how large a part of total turnover in computer services is derived from customised software? Which part of the turnover of the branch derives from the selling of services such as training and how large is the part from selling of software or Internet services? As the quality of the existing product nomenclature for services, CPA, must be characterised as poor, there is a need for its revision.

Information on producer prices is essential for deflation of services turnover and for calculating real output from the services sector. To measure the price of a service, it is essential to capture both the content and the quality of the service. Due to increased bundling of different services, not only the identification of the quality, but also the identification of many services offered is difficult.

The reported figures on the continuing productivity gap with the US give cause for political concern, but before analysing and explaining the reasons for the observed slow growth in productivity, the problems related to measurement of services' productivity should be emphasised. The concepts of productivity work well for manufacturing enterprises, but are subject to considerable uncertainty when it comes to measuring productivity in the services sector.

In the absence of physical outputs, productivity improvement in the sector depends heavily on investment in intangibles, such as training, customer relationship management, brand image, and creation of an efficient organisation, as well as investment in software and information and communication technologies. Growth in intangible investment is nowhere more apparent than in the services sector.

The deficiencies in existing services statistics and thus in the measurement of economy-wide productivity are shown in box 2.

Box 2. Methodological problems related to measurement of productivity in services.

Defining the output of services. For several services activities, outputs are difficult to measure due to their intangible nature. Detailed information about the “products” produced by services enterprises are lacking as well as the composition of the turnover of services enterprises. What is the output of banking or retailing?

Price and quality of services. Little information exists about services producer prices and changes in the quality of the outputs produced. How to deflate output and adjust for quality changes?

Impact of labour input. The skills of the employees are crucial for the quality of the services offered. How to measure quality and impacts of skills for services outputs?

Impact of technology input. Currently, no official data are available on the measurement of the impact of IT on business processes. How does the use of IT influence the productivity of enterprises?

Mutual dependency of users and producers of services. The productivity of manufacturing enterprises is influenced by their usage and purchase of business-related services. How is outsourcing of services or take-up of new innovative services products influencing the performance of manufacturing enterprises and how is the increasing interdependence between manufacturing and services enterprises influencing the overall productivity growth?

As the European Union has set itself the goal of becoming “the most competitive and knowledge-based economy in the world”, the development of methodologies to measure output from and productivity within business-related services and the production of the relevant statistics should be given highest priority.

IV. The way forward for development of a long-term strategy on services statistics

As mentioned in figure 1 in chapter III, the above-mentioned user needs mainly address and focus on the need for Structural Business Statistics, but as the knowledge-based economy is of a cross-cutting nature, the paper also addresses the needs for development of new and more detailed statistics in other areas as National Accounts, Information Society and Social Statistics.

The proposed way forward is to elaborate a detailed strategy on statistics on the services sector in co-operation between Eurostat and DG ENTR and other stakeholders. As an input to the development of the strategy, it is proposed to organise a workshop bringing users and producers of services sector statistics together in order to identify the needs and priorities.

The existing Regulations should be carefully analysed in order to see whether they constitute the tools for an enlarged statistical coverage of the services sector (being matching of different, existing registers or adding of new questions to existing surveys) or whether new tools (launching of new surveys) need to be developed. In some of the areas mentioned above, pilot surveys, which are mainly financed by DG ENTR, have already been carried out or are planned to be carried out by Eurostat and the NSIs. The experiences gained should be used in assessing the feasibility of collecting such data and thus include the variables in the existing Regulations or to create new Regulations in order to set up permanent data collections.