

Oliver Holtemöller [ed.]

# How Can We Boost Competition in the Services Sector?



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Halle Institute for Economic Research  
Member of the Leibniz Association

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## Preface

This book summarizes the results of the conference “How can we boost competition in the services sector?” that took place on July 6, 2016 in Berlin. The conference was organized by the Halle Institute for Economic Research (IWH) on behalf of the Representation of the European Commission in Germany.

Productivity growth in recent years has been rather weak in Germany and also in other continental European countries. Barriers to entry in some services sectors may be one factor explaining the productivity gap between Germany and the USA, for example. The European Commission has been hinting at this point for several years, and there have been already some reforms in Germany aiming at lowering barriers to entry in some services sectors. At the conference “How can we boost competition in the services sector?” reforms in the services sectors have been discussed from various perspectives.

The book consists of six parts. After an introduction in part I, part II is devoted to the practical view on service sector reforms. It documents the contributions of representatives of the German Government, the European Commission, and the German Confederation of Skilled Crafts. In part III, an overview of the European economic reform agenda and the role of service sector reforms within the general agenda is given. Part IV contains contributions on past reforms in Germany and their economic effects. Part V consists of contributions that focus on expected effects of potential future reforms. Finally, part VI concludes.

Many persons have helped to make the conference a success. I am grateful to Rahel Künkele, Stefanie Müller and Felix Pohle for their organizational work, and I thank Andreas Schmalzbauer for his effort in putting together the individual contributions in one coherent manuscript. Finally, the financial support by the Representative of the European Commission in Germany is gratefully acknowledged. Of course, I am responsible for all remaining errors and shortcomings of this book.

Berlin, July 6, 2016

*Oliver Holtemöller*



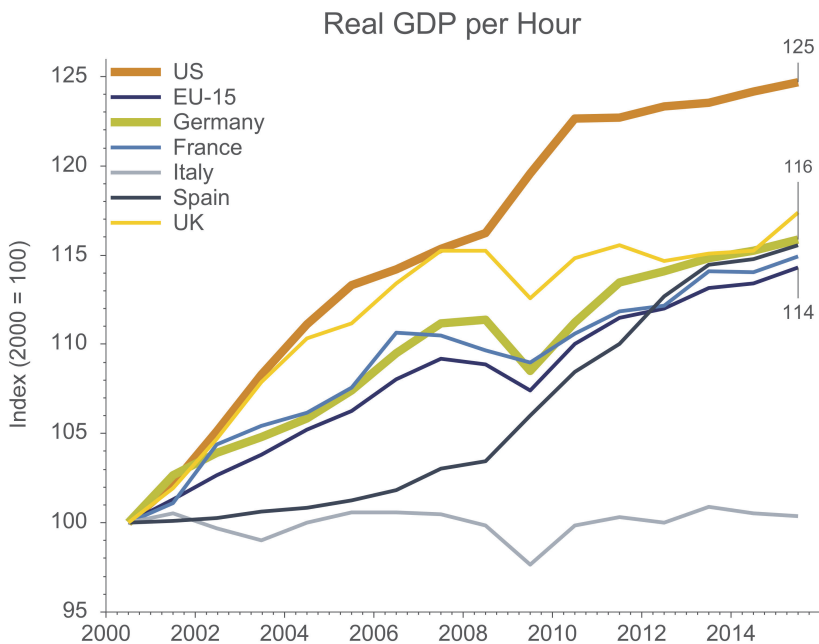
## I Introduction

### I.1 Overall Productivity and Product Market Regulation (Oliver Holtemöller)

Professor Dr Oliver Holtemöller, Martin-Luther-University Halle-Wittenberg and Halle Institute for Economic Research (IWH)

“How can we boost competition in the services sector?” is a topic that has been attracting the attention of the media, of politicians and of scientists for some time now.

*Figure I.1: Productivity in the US and in Europe*



Source: Ameco

The ultimate goal of boosting competition is to foster economic growth and, hence, welfare. Compared to the US, productivity growth has been

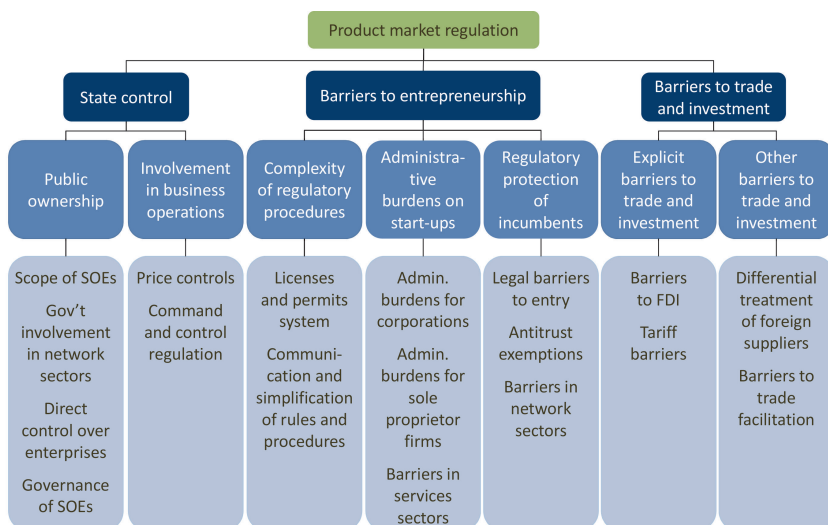


rather weak in Germany and in other continental European countries in recent years (figure 1.1).

A couple of studies have analyzed why productivity growth has been higher in the USA than in Europe. Van Ark, O'Mahony and Timmer (2008) study the period from 1995 until 2006, which is very interesting because the gap widens there, as figure 1.1 shows; more recently, it does not diverge so much. During that period between 1995 and 2006, productivity grew in the USA by 2.3 percent, whilst in the EU-15 only by 1.5 percent. Van Ark et al. point primarily at the knowledge economy as the main source for the differences but also at the high level of regulation of labour and product markets.

What does regulation of product markets mean? The OECD has made a suggestion for breaking down product market regulation into various categories (figure 1.2).

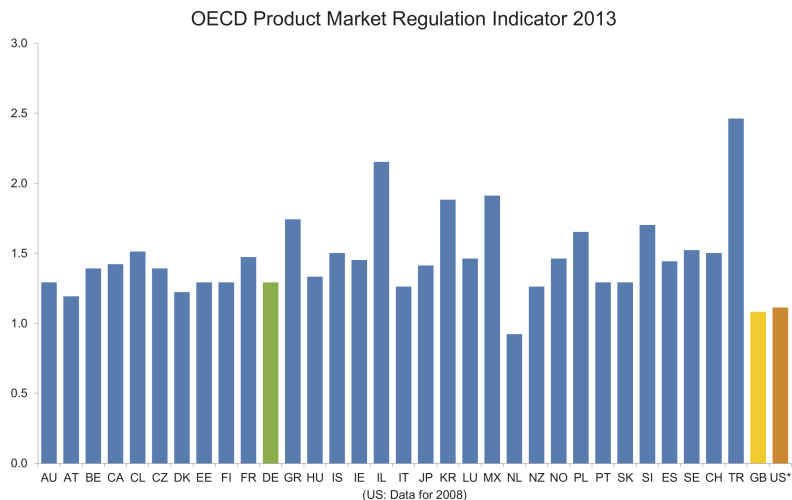
Figure 1.2: Product market regulation



Source: Koske et al. (2015)

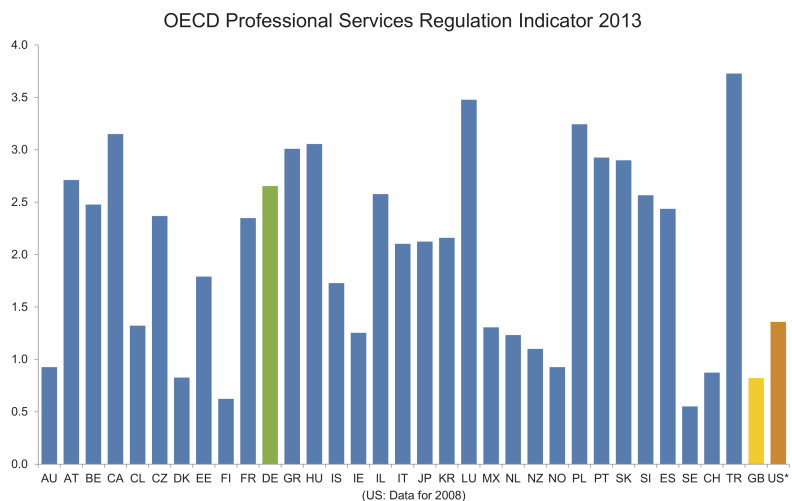
The three categories are direct influence of the state on businesses, impediments to entrepreneurship and impediments to international trade and investment. Overall, Germany exhibits a medium degree of product market regulation (figure 1.3).

*Figure 1.3: Product market regulation: international evidence*



Source: Data source: Koske et al. (2015), graph by IWH

*Figure 1.4: Professional services regulation*



Source: Data source: Koske et al. (2015), graph by IWH

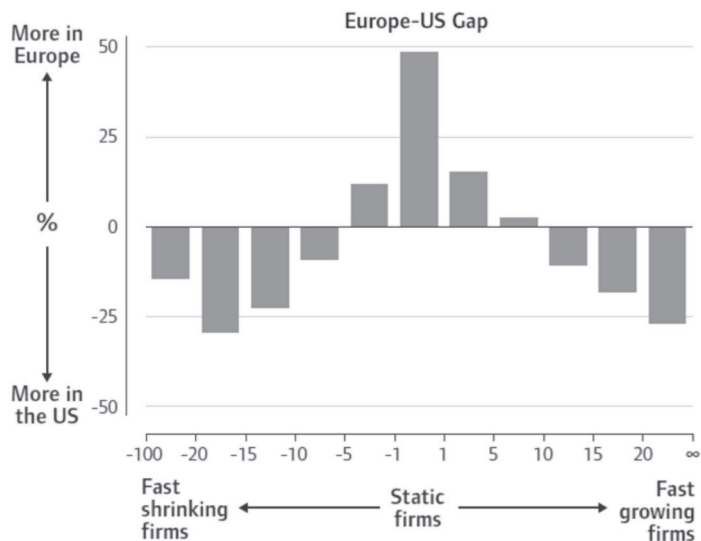
The UK and the USA have the lowest levels of regulation; however, the distance between Germany on the one hand and the UK and the USA on

the other hand is not particularly large. For services, though, the differences are much bigger (figure 1.4).

In the UK and in the USA, the extent of regulation in the services sectors is substantially lower than in Germany and in some other continental European countries. What explains the large difference? What can be done to improve flexibility in Germany? There are also other indicators which support the view that regulation in some special areas may contribute to low productivity growth. The ease of doing business indicator of the world bank, for example, reveals that Germany ranks only on mediocre places for the sub-indicators starting business, register property and pay taxes.

All these factors play a role in explaining the substantially lower degree of firm dynamics in Europe compared to the USA.

Figure 1.5: Firm dynamics in the US and in Europe



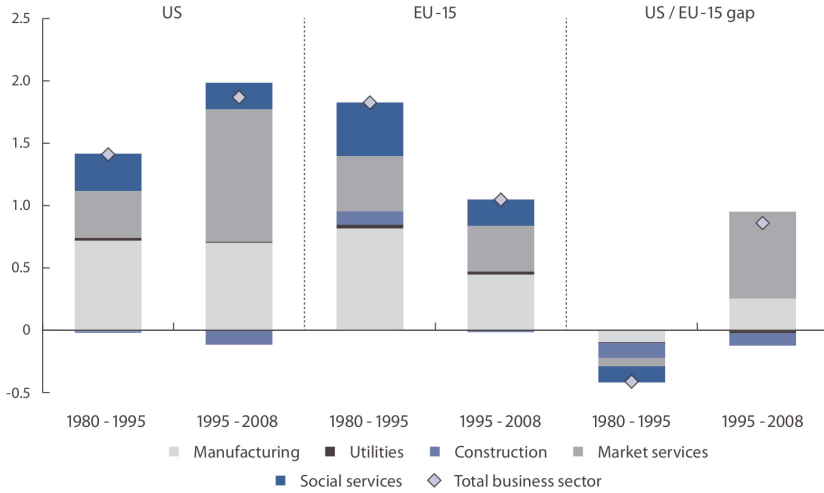
Source: Bravo-Biosca (2011)

Figure 1.5 shows the differences in the frequency distribution of firms between the USA and Europe, sorted by shrinking, remaining static or expanding firms. In the USA, there are many firms that shrink, but there are also many being newly established and many expanding. In Europe, a lot of firms neither expand nor shrink, they are static. The more dynamic en-

vironment in the USA may be supportive for innovations and therefore may be one piece in the productivity puzzle.

The difference in productivity growth can mainly be attributed to the services sector for the period in which the difference in productivity between the USA and Germany widens (figure 1.6).

*Figure 1.6: Sectoral contributions to labour productivity*



Source: Uppenberg (2011)

Between 1995 and 2008, market services explain most of the gap in productivity growth.

Against this background, it is important to better understand productivity growth in the services sectors. More competition and more flexibility may be one way to increase productivity growth in the German services sectors.

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## I.2 Competition in the Services Sector (Richard Kühnel)

Richard Kühnel, Representative of the European Commission in Germany

I will not introduce the European Commission; I believe that in times such as these, we have made it to the media almost every day. It is not always a good sign, but it expresses that in times like these, we need European answers to the big issues of our times.

As we all know, we are in a stage of permanent crisis management. It started in 2008 with the financial crisis, which kept engulfing Europe time and again in different waves, then there was migration and now the British referendum. Those crises are so impolite to come more or less at the same time, or quickly one after another, that we never really get the chance of getting out of crisis mode. Though apart from the crisis mode, for us as Commission and Union it is very important that we do not lose sight of the long-term agenda for a reform process for Europe.

Because on the day that the crises will break, whenever it will come, we will ask ourselves and certainly also the population of Europe what we have done for being able to meet global competition that we are facing, whether we want to or not. It is very important to recognise the signs of time and to give the requisite answers.

The services sector certainly is a sector where, as Europe, we ought to be in a catching-up process in order to keep up with the global pace. And within Europe, that applies just as much to Germany. I hope we will not be stepping on anyone's toes, when we look at that in some more detail today.

Because, notwithstanding all the economic power that Germany radiates, in the services sector not everything is as it should be, also in the way that we look at it. Therefore, within the framework of our country-specific recommendations, we point out every year again that more needs to be done in the services sector in Germany. And today we are here to provide some analytical support to the discussions and to help us understand better what the impediments are – you have already touched upon some of those impediments, professor.

Of course, we can see that Germany is very well regulated in that regard. We know – there are many sensitivities – of the master's diploma, the craftsmen's regime, etc. We understand all that, but one ought to ask oneself: Compared to other sectors of the German economy and also com-

pared to other services sectors in other European member states, is all that still necessary?

And analysing that a little is an important task that may not be put off all the time. My modest contribution, my empirical field study is also my feeling, now that I have lived in your beautiful country for two years: Precisely in the services sector, insufficient services offered on the supply side correlate with low service expectations on the customer side.

I am sure that we have enough material here and also the graphs that you have shown, professor, form a basis for the discussion, I believe. I believe that Mrs State Secretary did not exactly agree with every graph. Perhaps one should also scrutinise a little how things are presented and developed, but for us it is an important process.

A colleague has come from Brussels, Joaquim Nunes de Almeida, who is right now ensuring that we, as Commission, make progress in the services sector. A services directive and services passport are on the agenda. Therefore, the discussion that we will have with you today will also provide very important input for us, because obviously we do not want to formulate our policies, our proposals and our recommendations in a political vacuum, but rather in a permanent process of exchange, at the medium stages also with science and guiding intellectual forces, as is happening today.

I am looking forward to an exciting and stimulating discussion and express my thanks particularly also to Mrs State Secretary Zypries for joining us here, for speaking a few introductory words and paint us the situation from the point of view of the German Ministry of Economic Affairs. Particularly in this reform process, which we are trying to implement as Commission during the European Semester, the German Ministry of Economic Affairs is a very important partner and I believe that in many questions indeed we do share the same or at least a similar opinion.

The recommendations that we proffer are not to be understood as negative criticism or as patronisingly lifted index finger, but as contribution to a political reform process that is in the interest of the whole of Europe and certainly also in the interest of the member states and, in this case, in the interest of Germany.

## II The Practical View

### II.1 Brigitte Zypries

Brigitte Zypries, Parliamentary State Secretary, Federal Ministry for Economic Affairs and Energy (BMWi)

When we are talking in Germany about deregulation in the services industry, then we are essentially talking about professional services. But you have now touched upon many other topics as well: For example, the question about productivity gains of companies, the question about how to register a businesses, how does one handle the cadastral administration, how does one make fiscal declarations – without a doubt, we would all quickly agree that there is room for improvement in Germany. But what about the matter that you have raised now, Mr Kühnel, the situation with the Meister degree: Would it really make sense to deregulate the sector, so that a Meister degree would no longer be needed? What would then happen to our dual education system, which we export with great success to all over the world. We must look at things carefully. There are also some historical issues that one could take into consideration. For example, the topic of equality in co-determination. Twenty years ago, everyone told us that in Germany the economy was in bad shape because we applied equality in co-determination. But today, everyone knows that equality in co-determination is one of the guaranties for success of the social market economy. Another topic surely is the one of the publicly owned banks, in other words, the Sparkassen or savings banks. Ever since I started working, the issue has been that the European Commission wishes to put an end to the German system of public savings banks. It has already been an issue twenty years ago, when I was with Gerhard Schröder in the State Chancellery in Lower Saxony. But today we may say that our savings banks have survived the financial crisis rather well, in other words, they do actually make sense.

Talking about services: I believe that when we talk about changing the way that services are rendered, we must talk about smart and digital services, and we should not so much concern ourselves with whether we should actually have registers in Germany or not. The digitization is an



important key factor for the success of services and for the SMEs who render them. We should mainly focus on this.

Nevertheless, it is right for the Commission to say that it wants to discuss everything that could be an obstacle for cross border services. Just like the Commission we believe that the internal market for services should be further strengthened. However, this certainly must be discussed in individual cases. Personally, I do not believe that our German architects do not build in France and the United Kingdom, just because we have the HOAI (honorarium code for architects and engineers) here in Germany. But I do rather believe that they do not build there (and vice versa), either because they do not speak the language and/or because they are not familiar with the contract legislation prevailing there. I think the actual impediments are that we do not have uniform European contract law or at least some broad similarities. This is what makes it hard for some people to work across borders.

And I strongly believe that deregulation will lead to large companies, such as big law firms and architectural offices. Those big firms can more easily afford to employ specialists, who can deal with these aspects. But one should then ask oneself, whether this is what is wanted. Do we really want the very small offices with two, three or four employees to close down or get absorbed by big firms? Do we want a deregulation which actually leads to “monopolisation” or at least oligopolies? This would not be my idea of a sensible commercial development.

The services sector is rather important in our economy, as you all know. Seventy percent of all value creation occurs in the services sector and it employs three quarters of the entire German workforce. A significant part of that what we refer to as services comprises inputs for other industrial sectors. The major points of criticism of the Commission concerns mostly the professional services. In Germany, professional services are seen as independently exercised activities in the fields of science, authoring and education. It is defined that way in the Income Tax Act, and by that definition we have more than 1.3 million self-employed members of these professions in Germany. With us, many of the professions are governed by so-called codes of conduct and that is the stumbling block that is at issue here. These professions are architects, physicians, lawyers, fiscal consultants, auditors, notaries.

However, employment is developing rather well in Germany. We have a growing number of self-employed as well as employees in the sector of the professional services; a growing number of new business activities in

Germany are established in the field of professional services, though the number of employees with mandatory social insurance has also risen by 3.7 % during the past year.

We may have a rather high level of regulations, compared to some other countries. The Commission is now of the opinion that the professional services cannot develop their full potential on account of the laws as well as the regulations promulgated by professional associations or chambers. However, the existing regulations are not a purpose by themselves, but rather they serve a particular regulatory purpose that must be justified under constitutional categories (proportionality and freedom of choice of occupation). I have myself looked for three years after legislation affecting solicitors and barristers at the Federal Constitutional Court. Any restriction on the free choice and exercise of occupation has to be justified and proportionate. And we find that precisely the professional services have regulations which serve to protect an important common good. In the case of physicians, it is rather obvious that this is about health care. The solicitor or barrister is a constitutionally recognised body of judicature: He or she guarantees access to justice and as body of judicature they hold a special position in the legal system. Auditors carry out the legally prescribed audits of annual accounts. Those professional services do indeed differ from other services, precisely through their orientation on a common good. This clearly is the legitimisation of the regulations. Obviously, the regulated fees do also serve to protect consumers, because they have the comfort of knowing that they can consult a solicitor who does not afterwards send excessive invoices. The same is true for architects, who are bound by minimum and maximum fee levels.

The Federal Constitutional Court holds that those regulated standardisations are also an assurance of quality and most of all of an assurance of independence in exercising the profession.

Any legislation is only justified when it is necessary and required. Therefore the legislator must test again at every juncture to what extent times have changed, leading to the need for a change of legislation.

Now, we have seen the European Union's initiative for transparency and are verifying it also within the framework of our regulations. Following those verification activities, we have submitted our action plan to the Commission at the beginning of the year and presented in it some considerations for amending particular professional rules. And in any case we have plans for relaxing the rules on exercising a range of professions and have, indeed, already implemented some of those. They affect primarily

the professions that are closely linked with the economy, exercised by solicitors, patent attorneys, fiscal consultants and auditors. The market for auditing annual accounts is being opened up further for audit firms, registered in the EU. The legal form requirements have been relaxed. By now, it is no longer forbidden in Germany to run a veterinary practice, incorporated as a legal person. Other reforms concern the mandatory ongoing education of physicians and medical specialists and right now legislative proceedings are under way in the German Second Chamber for unifying and newly organising the occupational training of health workers and nurses. The legislative proceedings are under way, albeit against the strong opposition from paediatricians.

So you can see, the Federal Government is already taking the legal occupational arrangements seriously and is also making the case for modernisation and adjustment of the regulations where necessary. But we also believe that such justified and proportionate regulations must be kept in place in order to ensure the quality of apprenticeship places. The same goes if it serves the assurance of appropriate consumer protection.

As you probably all know, there is a particular problem with the fee regulation for architects and engineers, because currently an infringement proceeding is under way. The Commission is criticising us for having minimum and maximum wages for architects and engineers, as laid down in the HOAI. The Federal Ministry of Economic Affairs will defend the HOAI in this proceeding, because we cannot see any infringement of the services directive or of the freedom of establishment.

From the point of view of consumer protection it makes sense to preserve the fees arrangement, since it gives the principal the certainty that he is not being cheated because verifiable, fixed maximum and minimum prices exist. Therefore, a principal with low income is not forced to make use of the services of a cheap but bad architect. Regarding fiscal consultants we have agreed to a conversion to non-binding prices. This means that, in principle, the fees table is maintained but it will only be applied if no other arrangements have been agreed upon. Furthermore, it means that it is possible to deviate from the laid down fees table, which meanwhile is also the case in the area of legal counselling fees. I see this as quite a clever solution: Consumers have a guideline for what they have to pay, but can deviate from it if they can agree on something else.

Professor Holtemöller, you have started with quoting a study of how regulations affect the development of productivity. In our experience, the available data make comparison of regulations with those in other coun-