

## Box 8

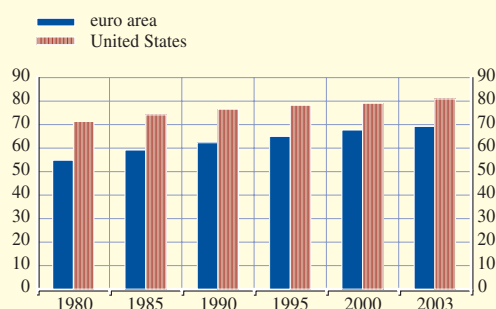
### DETERMINANTS OF THE SERVICES SECTOR EMPLOYMENT SHARE IN THE EURO AREA

Over the last 20 years euro area countries have experienced a significant change in their employment structure, namely an increase in the size of the services sector relative to manufacturing.<sup>1</sup> The share of the workforce employed in services increased by around 14 percentage points in the euro area between 1980 and 2003,<sup>2</sup> to reach 69%. Over the same period, the corresponding share in the United States was consistently higher than in the euro area, increasing by 10 percentage points to 81% (see the chart).

The rise in the services sector's share in euro area employment was mainly driven by increases in finance, insurance, real estate and business services, as well as in community, social and personal services (see the table). The share exhibits a large heterogeneity across euro area countries, ranging from 60% in Portugal to 78% in the Netherlands for total services in 2003. Understanding the main factors behind both the gap in the euro area services sector employment share relative to the United States and differences across euro area countries is an important step towards identifying the key policy adjustments needed to achieve higher employment levels in the euro area.

#### Services sector employment shares

(% of total employment)



Source: OECD Structural Analysis Database (STAN).

- 1 See also "Competition, productivity and prices in the euro area services sector", ECB Occasional Paper No 44, April 2006 and the box entitled "Labour productivity and price developments in the euro area services sector: the role of competition" in the April 2006 issue of the Monthly Bulletin.
- 2 Data in the OECD's Structural Analysis Database are currently only available to 2003.

## Services sector employment share: total services and sub-sectors

(% of total employment)

	Total services		Wholesale and retail trade; restaurants and hotels		Transport, storage and communication		Finance, insurance, real estate and business services		Community, social and personal services	
	1980	2003	1980	2003	1980	2003	1980	2003	1980	2003
Belgium	64	77	19	18	7	6	10	17	28	35
Germany <sup>1)</sup>	54	70	18	20	6	5	8	16	22	29
Greece <sup>2)</sup>	56	61	20	22	7	7	7	9	22	23
Spain	49	65	18	21	6	6	6	10	19	28
France <sup>3)</sup>	58	74	16	17	6	6	10	17	26	34
Ireland	50	66	16	21	6	6	6	13	21	26
Italy	49	67	17	20	5	5	5	14	21	28
Luxembourg <sup>4)</sup>	63	77	22	19	7	8	12	28	22	22
Netherlands	66	78	18	20	6	6	11	19	31	33
Austria	49	64	17	20	6	6	7	14	18	25
Portugal	43	60	17	21	4	3	4	9	18	27
Finland	53	69	16	16	7	7	6	12	24	34
euro area	55	69	17	20	6	6	8	14	24	29
United States	71	81	22	22	5	5	13	18	32	35

Source: ECB calculations on the basis of the OECD's Structural Analysis Database (STAN).

1) Germany: data up to 1990 refer to Western Germany only

2) Greece: "1980" data refer to 1995

3) France: "2003" data refer to 2002

4) Luxembourg: "1980" data refer to 1985

A number of explanations for the upward trend in the services sector employment share have been put forward in academic analyses. These include: a rise in the demand for services as per capita income levels increase and the structure of expenditure switches away from basic material needs towards services; an increase in the proportion of the labour force channelled into service activities on account of slower labour productivity growth in the services sector relative to manufacturing; a rise in the female participation rate (leading, for example, to the substitution of unpaid by paid household services) and in the employment of women in the services sector; a rising demand for services in line with demographic shifts (since older people tend to consume proportionally more services than younger cohorts); and, finally, increased demand for services associated with the process of urbanisation (since urban populations tend to consume more services than rural populations in relative terms).<sup>3</sup>

At the same time it has been argued that differences in the services sector employment share across countries at a similar stage of economic development may also result from differences in the institutional framework affecting the degree of flexibility of labour and product markets. Research exploring this hypothesis for a sample of OECD countries found that the strictness of employment protection legislation, the degree of unionisation and centralisation of wage bargaining, and the administrative burden on the creation of new firms significantly affected the employment share of services.<sup>4</sup>

More recent work finds evidence to support the hypothesis that barriers to labour market adjustment in the EU may have hindered the ongoing process of sectoral reallocation of the

3 For references and a summary of this literature, see R. Schettkat and L. Yocarini, "The Shift to services, a review of the literature", IZA discussion paper No 964, 2003.

4 "Employment in the service economy: a reassessment", OECD Employment Outlook 2000, Chapter 3, 2000; J Messina, "Institutions and service employment: a panel study for OECD countries", ECB Working Paper No 320, 2004.

workforce from manufacturing to services.<sup>5</sup> On the basis of a panel dataset of 13 EU countries for the period 1970 to 2001, the analysis reveals that a set of indicators capturing different dimensions of labour market flexibility explains the employment share in services. In particular, a higher level of structural rigidity is associated with a lower employment share in services. The results also support the hypothesis that the EU countries' relatively low ability to match the skills of their workforce – in terms of skill levels and educational attainment – to changing labour requirements has hampered the shift to services and may have prevented a further reduction in the gap between the European and US services sector employment shares.

Education and labour market policies implemented in individual countries within the context of the European Employment Strategy over the last decade have contributed to increasing both aggregate and services sector employment in the euro area. However, despite these efforts, reaching even higher levels of labour utilisation and enhancing the degree of labour market flexibility are important prerequisites for euro area countries to prepare for the challenges of technological change, population ageing and globalisation. In addition, further structural reforms to address these issues should help euro area labour markets to adjust to local shocks, match workers and job vacancies more efficiently and reabsorb workers seeking employment as a result of sectoral adjustment.

<sup>5</sup> A. D'Agostino, R. Serafini and M. Ward-Warmedinger, "Sectoral explanations of employment in Europe: the role of services", ECB Working Paper No 625, 2006.