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**Book Review: The Economics of Services:
Development and Policy. By JAN OWEN
JANSSON**

Henk LM Kox, *CPB Netherlands Bureau for Economic Policy Analysis*

Steingart, published in 2004. In Steingart's account, the original sin of German welfarism was the decision of the first German chancellor, the Christian Democrat Adenauer, to index pensions to wages, thereby creating unrealistic expectations. Whereas Steingart's account offered readers journalistic élan, Sinn's monograph fits in between political journalism and academic literature without satisfying the demands of either of the two genres. For a start, his source base is narrow. Essentially, Sinn quotes his own earlier writings, illustrating his argument with OECD figures. The book offers a number of stories about the German economy rather than a single integrated argument. Sinn adopts the position of lonely prophet warning the German public that rapid economic decline is to be expected if his wish list of systemic change is not enacted as a matter of urgency. Hence Germany should bring down wages, abolish collective bargaining between unions and employers at sectoral level and replace it with plant-level bargaining, cut benefit spending to increase work incentives, and so on.

The problem with these proposals is at least twofold. First, democratic elections will not provide majorities for such policies. Second, the German political economy is much more complex, and indeed more rational, than Sinn allows for in his account. While it is true that the original *Modell Deutschland* of the 1970s has lost most of its international appeal, its core strength with respect to skill provision and labour productivity, especially in the export sectors, remains unquestioned.

Moreover, Sinn's argument rests on some questionable assertions. In the introductory section he aims to illustrate the thesis of the structural decline of German competitiveness using GDP per capita figures, which show that by the early 1990s West Germany had lost the top position—in comparison with the UK, France and the US—that it had held since the early 1970s (p. 13). But West Germany has lost out only marginally in comparison with its main competitors, and it is German reunification that accounts for the overall decline. Next, he suggests that downward wage mobility will solve employment problems of the lower-skilled workers. The central suggestion is to phase in large-scale wage subsidies at the lower end of the wage distribution and to finance this with savings in unemployment and social assistance benefits (pp. 128–34). Implementing such policy is supposed to increase the takeup of lower-skilled workers by private employers, while all remaining benefit recipients would be forced to enter obligatory public work schemes; the state would then hire out these workers to private employers for a nominal fee. Sinn's suggestion that 'local craftsmen will be happy about it' (p. 132) seems rather questionable, given that small companies would have to compete with the new subsidized low-skill sector.

In summary, Sinn's book puts all the eggs into one basket. Trade unions and high wages are blamed for the crisis of the German political economy. The arguments both of the 'varieties of capitalism' school and of Keynesian analysts are ignored, as is the fact that post-unification, in comparison with other OECD countries, the wage share in Germany has actually declined. Moreover, Sinn enlists support from unlikely historical figures. He states that 'Marx, Bebel and Lassalle would pale if they saw how the unions' cartel policy is creating a new proletariat of people deprived of the hope of ever being integrated into the working society' (p. 84); however, none of these have given any interviews recently! Some other statements are factually wrong. It is not true that 'more and more [German] church holidays have been introduced' (p. 84). Rather, postunification the last remaining Protestant federal church holiday, the *Buß und Betttag*, was abolished in order to raise annual working hours. Finally, a typographical error might irritate the casual reader very early in the book. It is suggested that Germany's Christian Democrats would have flirted with socialist ideas as late as 1974 (p. 2); yet the CDU platform alluded to dates from a party conference in the city of Ahlen in 1947, two years before the West German state was founded.

Whether Germany needs rescuing remains an open question, therefore, and demands a more refined analytical effort.

Brunel University

JÖRG MICHAEL DOSTAL

The Economics of Services: Development and Policy. By JAN OWEN JANSSON. Edward Elgar, Cheltenham. 2006. ix + 345 pp. £75.

The literature on the economics of services is limited in size, so a book with such a title is likely to be read with keen interest. This interest is raised further by Jansson's introduction, claiming that

'some crucial problems—perhaps the most important remaining problems of resource allocation in the economy—so far have been obscured for economists because of the limited applicability of conventional economic theory to services'. The book does indeed offer a number of interesting new analytical perspectives, but on the whole the claim seems somewhat exaggerated.

The first analytical part (Part II) provides the micro foundations for a comparative-static economic analysis of the services sector. Other parts of the book consider the development of the services sector in a more long-term time perspective, linking the analysis to the so-called 'Baumol costs disease' in services. The last part of the book is concerned mostly with the provision of public services and related issues of the welfare state. The descriptive material is based mainly on the Swedish situation.

The section on micro foundations is by far the richest part of the book. Jansson takes the non-storability and non-transportability of most services as a starting point for his analysis. He shows that both aspects have important repercussions for scale efficiency and market forms. In the non-service industries production units generally operate close to the efficient economic size of a plant. Demand fluctuations can be smoothed out by producing for or withdrawing from stocks. In service industries, in general this is not possible. Producers in the services industry can operate at or near full capacity only by creating artificial scarcity and waiting time on the side of consumers. Standardization of service products (less variability in time) is shown to be another possible avenue to achieve of a relatively high capacity utilization. However, queuing time is arguably a major element of perceived services quality, and consumers will be keen to buy their products from a competing service supplier. So the elasticity of substitution between services generally limits the possibilities of achieving full capacity utilization at the cost of queuing time for consumers. The upshot is that many service suppliers cannot achieve a standard of full capacity: they operate on a scale where the falling section of the long-run average cost curve prevails. Hence increasing returns to scale are omnipresent in the services economy. This also holds for branches of services where production technology is relatively simple. Since increasing returns to scale are hardly reconcilable with perfect competition, imperfect competition is the prevailing market form in services.

Owing to non-transportability, services producers incur the additional cost of bringing their products to the consumers. These distribution costs are a positive function of distance and a negative function of population density. By introducing these spatial elements, Jansson establishes a natural link between the analysis of the services economy and his own specialization as a professor of transport economics at Linköpings University. The presence of distribution costs allows him to derive a number of interesting conclusions on optimal market areas and spatial clustering in the services sector. The market form of local *apoly* (no suppliers) is shown to be a nontrivial case for service products.

From this point onwards, there is a somewhat excessive insertion of elements relating to transport economics; a quick and conservative count in the subject index indicates that some 76 pages of the book deal with subjects in transport economics, which seems a bit out of proportion in a book on services.

Jansson concludes from Swedish data that in real terms the share of services in final consumption from 1800 onwards has hovered invariably between 40% and 50%. Leaving apart the measurement issues, this is an astonishing result. Superficially, it is at odds with the fact that the share of services in total employment has increased almost monotonically to a level that is now between 65% and 80% in most OECD countries. Baumol's unbalanced-growth model supplies an explanation for this, based on the fact that many service branches have an inelastic demand and offer few opportunities for labour productivity growth, whereas their wage rates follow the trend in the most productive parts of the economy ('Macroeconomics of unbalanced growth: the anatomy of urban crises', *AER*, 1967). The growing share of health, education and care services in public expenditure can be explained from this development, even though the author argues that the growth of their expenditure share is mitigated temporarily by the cost-lowering process of urban concentration.

Jansson has created a huge blind spot for himself and his readers by focusing his analysis exclusively on services that enter into private and public consumption. In total, he refers to services engaged in information jobs in only a few pages. His 'mesoeconomic subdivision of the economy into sectors' on p. 10 could have come directly from a nineteenth-century physiocrat-economics textbook in which the service sector is largely regarded as a consisting of unproductive activities. Of the economic sectors that produce intermediary services, he states without further substantiating it that their products are 'only contractually different' from factor services. He argues that, because

consumer demand must be regarded as the fundamental driving force of the economy, one does not really need to consider the output of intermediate service industries. I regard this as a gross error of judgment, misinterpreting the nature of technological progress and specialization. The Smithian process of labour division and the associated specialization gains led at one time to manufacturing processes being split off from agricultural activities. In the same vein, today numerous independent services tasks are being outsourced from manufacturing and services industries alike. The process is associated with specialization and knowledge gains, scale advantages and technological advancement. Equating intermediary services industries such as engineering, software development, contract research, management consultancy, specialized banking and insurance with traditional in-house labour and subsequently declaring it not to be analytically interesting is certainly a weak aspect of this book. The author is demonstrably wrong when he states that personal services form 'by far' the largest service sub-category. In Britain, for instance, the service sector in 1998 accounted for 50% of total gross production in the entire economy according to the input-output table; however, only 22% of this entered into final production, so the majority of services were produced as intermediary inputs for the rest of the economy. Britain is not unique here; this is the case in all OECD economies.

Intermediary services may exhibit a slow pace of productivity growth themselves, but they enhance the overall productivity growth in the rest of the economy as a result of spillover effects. Knowledge-intensive business services, for instance, may generate both technological and price-based spillovers to their client industries owing to the public-goods nature of knowledge products. Because these spillover effects relate to intermediary services, William Baumol nowadays regards his 1967 unbalanced-growth model as flawed (see his 'Foreword' in Rubalcaba and Kox's *Business Services in European Economic Growth*, Basingstoke, 2007). Also, Nicholas Oulton ('Must the growth rate decline?' *Oxford Economic Papers*, 2001) has produced a seminal article on this aspect of services development, but nothing about it is mentioned in Jansson's book.

In the last part of the book ample space is devoted to topics such as a policy for the promotion of urban amenities and climate change. Most readers of a book bearing the title *The Economics of Services* would probably have been more comfortable with chapters on the analysis and measurement of productivity growth in services, innovation in service industries, the role of product differentiation, international trade in services and the differences in services development between countries. Perhaps this is something for a future revised edition. Also, a bit more attention to the quality of the artwork could increase the value of the book.

Despite these shortcomings, because of its novel analytical framework the book might well function as a supportive text in courses on the economics of services and urban development.

CPB Netherlands Bureau for Economic Policy Analysis, The Hague HENK L. M. KOX

Development Ethics at Work. Explorations, 1960–2002. By DENIS GOULET. Routledge, London. 2006. xxxiv + 256 pp. £80.

Denis Goulet, the father of what is now commonly known as 'development ethics', died on 26 December 2006. This volume brings together a wide range of his writings over a period of over forty years, from his earliest attempts to articulate the need for development ethics as a distinct field or 'discipline' to more recent essays which engage with specific topics of contemporary interest.

Goulet had already written an introductory text for the uninitiated (*Development Ethics: A Guide to Theory and Practice*, 1995) which, like this book, is dedicated to his mentor and teacher Louis-Joseph Lebret. By contrast, this volume provides insight into Goulet's work over many years. Part I brings together some early writings; Part II is more thematic; and Part III brings together papers on interdependence and globalization. For those unable to find or read Goulet's many essays and books, this volume might serve as a 'Goulet reader'. Viewed in this light, the book is partial in its coverage, but offers a rich selection of work.

Goulet saw development ethics as a distinct 'discipline', the task of which was to clarify evaluative issues in the process of development. Because of the pervasive nature of such issues, he argued that a philosopher needed to be added to the development team. Development could not be seen purely through the lens of technocrats, or promoted through their partial understanding of it.