Franz-Josef Bade

Services

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Contents

Services shape the economic structure and working landscape of industrialised countries. Services are characterised by the fact that their provision depends on the cooperation of the recipient of the service. The causes for their expansion are diverse and can be attributed to their specific conditions of supply and demand. Business services are especially dynamic. Services also exhibit a pronounced spatial concentration. In addition, certain services are of particular importance for the competitiveness of regional economies.

1 Conceptual aspects

Services have long been the subject of spatial planning and spatial research. Three discussion threads can be distinguished: (1) Great interest is shown in the strong expansion of services that can be observed in most industrialised countries. The causes of the expansion and their consequences for economic structure and growth are discussed as well. (2) The spatial distribution of services identified by the characteristics of various locations are also significant. (3) Increasing attention is also paid to the economic and political significance of services. That attention goes beyond the first discussion thread insofar as, in addition to the question of the economic basis of a ▷ *Region*, it focuses on the reciprocal influences of industry (▷ *Industry/trade*) and services.

1.1 Characteristic features of services

Since the beginning of the debate on services by Smith, Say, Marx, et al., scholarly contributions to the subject often contain a statement on what services are not, namely goods, and that they are therefore not productive, material or tradable, for example. This tendency, which can still be seen today, to define services by what they are not, i.e. 'everything that remains' – 'services are everything that is not a material good' or 'what is not manufactured by goods-producing industries' – is facilitated by the ambiguity of the term. Services are both a result (service) and a process (the performance of the service), whereby either the one or the other aspect prevails, depending on the nature of the service.

Two properties are characteristic of services: the necessity of (a) an external factor and (b) synchronous contact between the service provider and service recipient (Maleri/Frietzsche 2008). The external factor designates the object that, from the service provider's viewpoint, is necessary so that a service can be rendered by the service provider for the service recipient. Who or what the object is – the service recipient themselves, e.g. as a patient at the doctor's surgery, or an item, such as their car at the garage – varies from service to service. However, one thing all service providers have in common is that, to render their service, they need an object that belongs not to them, but to the service recipient. If the object is ultimately made available for the service, a synchronous contact occurs between the service provider and the recipient. Thus, the service provider fundamentally depends on the recipient's cooperation, whereby a few services can depend on the situation and the individual case.

The necessity of synchronous contact is also known as the 'uno actu' principle: the service is provided and delivered in one step. However, the delivery of most services presupposes considerable pre-production efforts, so that the entire production process can be divided into two phases: (a) setting up service-readiness (potential production) and (b) the end combination phase, in which the service is called up for the external factor. The properties attributed to the services, such as being customer-specific, intangible, or non-storable, essentially refer to the end combination, which is in most cases particularly dependent on the customer's preferences. However, the significance of the end combination is weakened by the fact that as great a part of production as possible is transferred to the first phase. During potential production, there is also the opportunity to increase the quality and productivity of the service by using capital expenditure and technological advances analogously to the production of goods.

1.2 Recording services

When delineating services, a distinction must be drawn between two perspectives. The sectoral perspective concentrates on services that are sold. The service sector thus includes all companies and organisations that produce services for other economic entities.

The functional perspective expands this viewpoint to include services which are provided and used internally. Accordingly, services entail a (certain type of) work performance that is used as an input for producing other goods (goods as well as services). Companies and households can essentially choose between internal self-provision and obtaining services externally (‘make or buy’). A distinction can be drawn between functional and sectoral results above all according to the extent to which they are provided internally.

2 The expansion of services

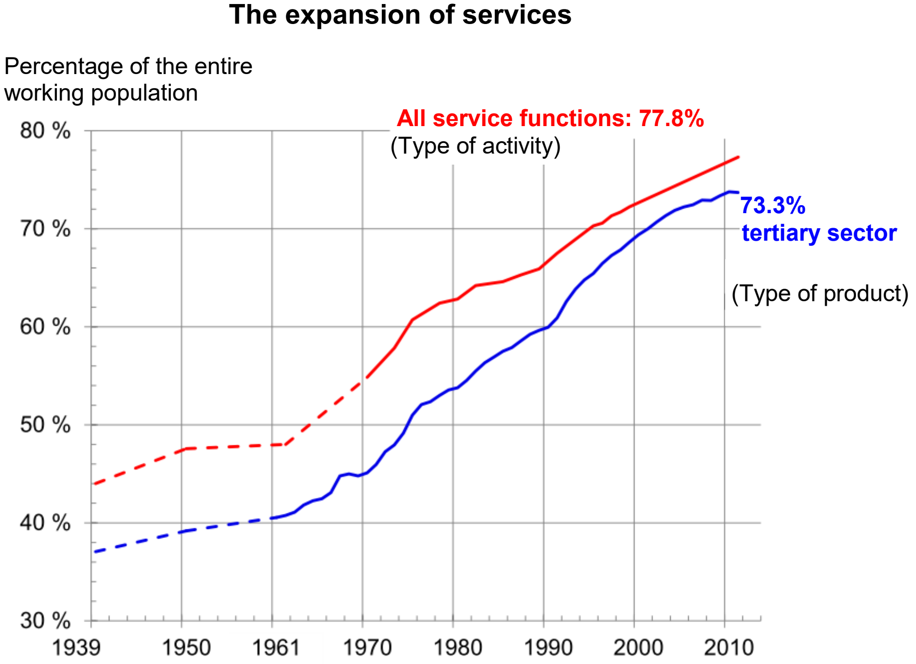
2.1 Empirical findings

The growth of services has long been known by the three-sector hypothesis. ▷ *Agriculture* and ▷ *Forestry* are defined as the primary sector, goods production as the secondary sector, and the remaining economy as the tertiary sector. Steady growth prompted Fourastié to predict (▷ *Forecasting*) in 1949 that the share in the US (which was then 55%) would increase to 80% by the end of the millennium. That estimate proved to be nearly accurate.

The share of the service sector in Germany (around 73% in 2014) is somewhat low in an international comparison, which has led to ‘over-industrialisation’ or a ‘tertiarisation deficit’, as some have proposed. However, it is questionable whether there is in fact anything like a normal structure (to be interpreted normatively) and whether structural change is inevitable. Such international comparisons can merely offer an initial indication of negative structural developments, if only due to the various national delimitations and framework conditions that must be observed when interpreting the statistics.

Moreover, the deficit turns out to be much weaker from a functional perspective. The share of the workforce whose activities can be interpreted as service provision, notwithstanding to which sector they belong – thus including those who are engaged in a service activity within the goods-producing industries – amounted to around 78% in 2014 (see Fig. 1).

Figure 1: The expansion of services



Source: The author, based on data from the Federal Statistical Office *(Statistisches Bundesamt)* **(censuses of 1939, 1950, and 1961; national accounts; microcensus) and the author's own estimates**

2.2 Sectoral determinants

The original explanations for the three-sector hypothesis are relatively simple: a few influences are emphasised that can be differentiated according to their supply-and-demand orientation. The demand-side explanation is based on the observed tendency that, with increasing income, consumer demand becomes differentiated and partly tends towards higher-value goods. The argument is that since services are to be equated with those higher-value, 'superior' goods, growing income means a greater demand for services.

The supply-oriented argument is based on the assumption that, due to the need for synchronous contact, work productivity in the service sector can grow only at a below-average rate. The use of labour input in the end combination can be replaced only to a limited extent, employment as a whole must shift to favour service production.

Both justifications, however, are too generalised to explain the structural change in the sector. To better address the heterogeneity of services, demand is divided into the intermediate demand by companies and the final demand by private households, the state, and foreign countries, according to the use and purpose of those services. Thus, the expansion of services is especially generated by demand by companies and private households: every industry whose services are demanded by these groups (e.g. legal, economic, and technical consultancy, information and communication services, and health and educational services) have experienced the greatest expansion.

Private households: The cause and effect relationships which underpin the demand for services by private households are highly complex and do not by any means point in the same direction, despite the clear increase in overall results. For example, the frequently mentioned income dependency (e.g. in household-related services or trade) does not manifest itself equally in all services, and cannot fundamentally be differentiated from material goods. In addition, the development of preferences is not uniformly aligned with a stronger demand for services. However, the fact that there is still an overall increase is often attributable to structural reasons, because the share of the groups that demand services to an above-average extent, such as the share of older people or one-person households, is growing (▷ *Demographic change*).

A particular feature of this trend is that relative prices have increased for most services demanded by private parties. To some extent, that price increase has led to those services either being replaced by cheaper material goods or being provided in-house. The assessment of leisure time is critical, because it is ambivalent. Increasing leisure time means the scope for the consumption of services (sports, tourism, and culture) has increased, as has in-house provision.

The reason for the increase in relative prices primarily lies in the conditions under which they are offered: many personal services are characterised by a high intensity of labour. The consequences of this for the development of services are controversial and have been discussed at length. A few authors point to the overall economic correlations between productivity, remuneration, and wage share: an increase in those services implies an increase in income disparity, which they attempt to prove through the growth of ‘bad jobs’. In addition, there are consequences for public finances, since a large share of household-related services are offered and borne by the state: either the duties to the state are disproportionately increased, or the offer of state services must be continuously reduced.

Companies: Of all types of services, services for companies are growing the fastest, for which two reasons are principally cited. The first of these is the demand for services caused by a series of developments both within companies and in their environment. These include the continuously growing capital intensity and automation of production, the internationalisation of the markets, the functional diversity of products, and the regulatory density, thus the extent and the intensity of state requirements and controls.

The second reason for the growing demand from companies is the externalisation of services (outsourcing). If the demand for services is no longer met through in-house provision, but through external contracting, in a sectoral analysis their production is attributed to the service sector. Therefore, part of the increase is a statistical ‘artefact’. However, a comparison of sectoral and functional developmental trends indicates that demand has doubtless increased in a few areas, such as research and development or corporate planning.

The trend toward externalisation is supported by influences related to supply. The main reasons given for the positive influences related to supply are the advantages associated with the division of labour and specialisation (namely, higher quality and lower costs). Moreover, the potential production of services demands a higher capital input that can no longer be profitably utilised by internal demand alone. The increasing professionalisation of business service providers creates advantages where transaction costs are concerned. The clearer the service offering and the more frequent and regular the demand for it, the lower the costs of drafting contracts and performance monitoring.

The *state*: The expansion of services ultimately depends on the demand by the state. This is because the state is responsible for the public good, and it must ensure a minimum provision for (certain) individual needs, such as those related to health and education. The state fulfils the sovereign tasks itself; in the first case, therefore, the state not only demands the service but also provides it. Regarding the minimum provision, on the other hand, the state has two additional options: it can commission other companies to produce the service or restrict itself to ensuring minimum provision through obligations or other regulations. In the latter case, the demanding party is no longer the state, but the economic objects affected by the regulation (through environmental requirements, for example).

Due to the interdependence of both private and public demand and private and public supply, the state's overall influence on the expansion of services is difficult to determine. As a producer of services, the state has expanded at an above-average rate, although its growth relates less to the area of sovereign responsibilities and more to services related to individual needs. Whether and to what extent the demand for those services is now of a private or public nature cannot be clearly answered, especially since public demand is also determined by the will of the people.

Abroad: The exporting of services has hitherto been only minimally significant for the expansion of services. One principal reason for this is the synchronous contact with the external factor, as elucidated above. This normally forces the service provider to offer its service domestically such that a mainly domestic office or branch is established and the service is therefore offered locally. Importing services, on the other hand, has a relatively significant, albeit negative, influence: unlike other industrialised countries such as the US or France, many Germans take their holidays abroad. This import of services thus reduces the domestic demand for tourism (inside Germany) (▷ *Tourism*).

2.3 Functional determinants

The strong increase in service activities is connected with the expansion of the service sector in many respects. That connection is apparent in relation to both household-oriented and state services. It largely consists of the employees' work performance, so that the development of the labour input in those industries is largely associated with an increase in the corresponding service activities.

With business services, the connections between the sectoral and functional levels are complex. At first glance, a large part of the sectorally relevant determinants, such as the increase in automation, the functional diversity of the products and regulatory density, can be transferred unproblematically to the growth in the service functions of research and development, corporate planning, marketing and the like. On the other hand, that growth which depends on externalisation is merely a matter of a statistical shift, without the overall demand for corresponding functions being altered. Moreover, the determinants for companies' growing demand for services does not equally apply to each production-related service function. Rather, it should be observed that through the use of new forms of ▷ *Information and communication technology*, a few functions are subject to the same rationalisation pressure that is observed in production.

In fact, there are significant developmental differences between the individual functions within the production service. On the one hand, high rates of growth can be seen in activities whose significance for competitiveness appears to be the clearest, such as research and development or corporate planning. On the other hand, the number of activities that require limited employee qualifications is stagnating or even decreasing.

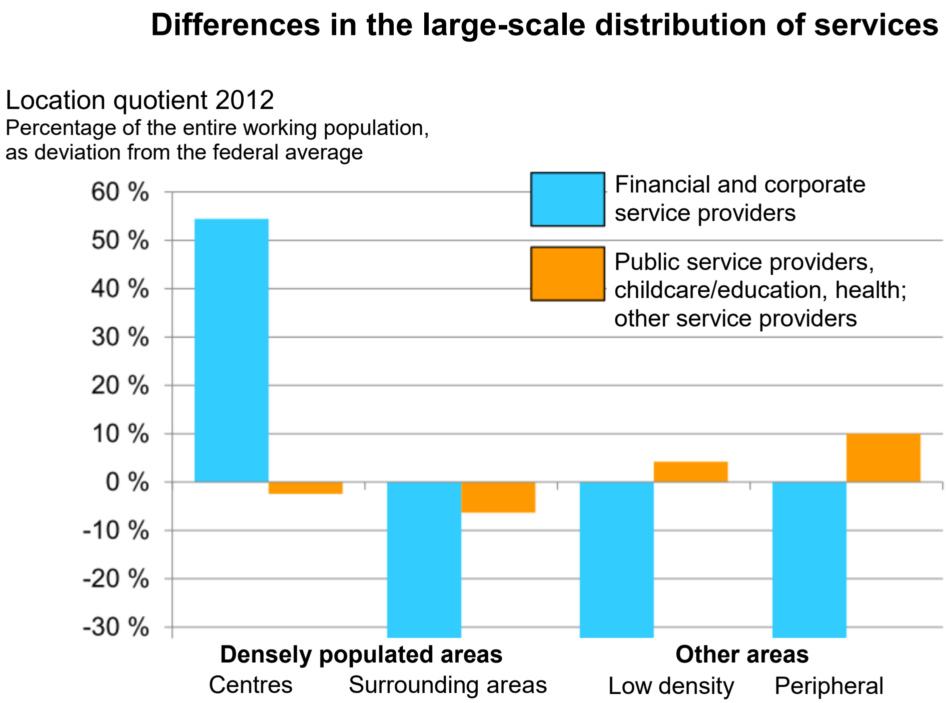
3 The spatial distribution of services

Services are generally urban activities and exhibit a clear preference for central locations (▷ *Metropolitan region*; ▷ *Agglomeration, agglomeration area*). In 2014, more than 80% of the workforce in Germany's major cities was in the service sector.

An earlier theoretical explanation for the centrality of services was provided by the central-place theory (▷ *Central place*), which is thus often also called the location theory of services. According to this theory, the centrality of services originates in the necessity of a certain minimum turnover distance (minimum range) that depends on indivisibility, production batch savings, and the like.

However, the argument is formulated too generally to be able to take into account the heterogeneity of services and their location preferences. Moreover, the service sector also prevails outside of the large, densely populated areas (with about two-thirds of the workforce in those areas). Furthermore, the distribution among densely populated, central areas differs widely between individual service sectors. Services that are the focus of the central-place theory – namely, those which supply the population – tend toward a rather spatially dispersed distribution that corresponds to the population itself (see Fig. 2).

Figure 2: Differences in the large-scale distribution of services



Source: The author, based on data from the official employment statistics of the federal government and state governments Working Group *(Arbeitskreis Erwerbstätigenrechnung des Bundes und der Länder, AK ETR)***, and the author's own estimates**

3.1 Theoretical aspects of location

Contradictions also exist in a theoretical respect. The importance of transport costs emphasised by central-place theory appears to be confirmed by the necessity for synchronous contact between the service provider and service recipient, as elucidated above. With many services, however, a spatial separation between potential production and the end combination is possible, such that the former can be moved to a location better suited to production.

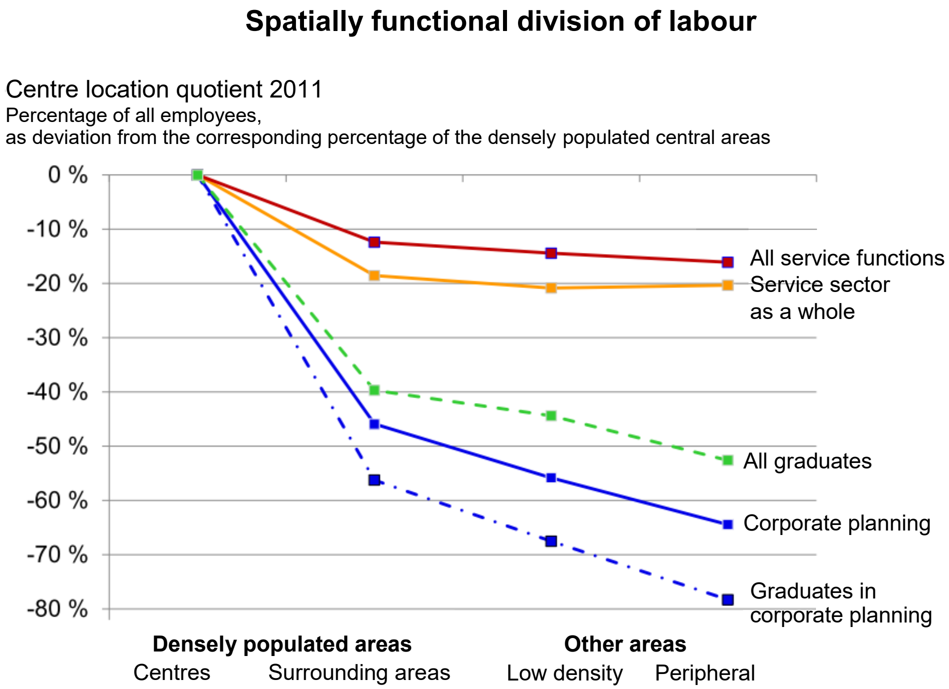
Moreover, the location of the demand is not equally important for all services, since the delivery system can vary: services can be obtained by the user on-site (e.g. doctor appointment), provided (consultation) or conveyed through a medial contact (internet, telephone, or mail-order business). Therefore, the spatial organisation of many services is characterised by a high degree of flexibility in their location (Staudacher 1991). That flexibility allows the service provider to adapt its production to spatial particularities and harmonise locational requirements and locational conditions (▷ *Choice of location*).

In the end, the final location is not decided by location preferences alone, but through the ability to prevail when competing for that location. Particularly for central locations, land is scarce and the competition for its use is tight (▷ *Density*). Due to the intensity and productivity of their use of space, services largely have a clear advantage in comparison with other sectors.

3.2 Functional division of labour

Most companies are not defenceless against the influences of locational preferences and locational competition. Production normally encompasses multiple production levels, such that the production process is divided into individual functional areas that can be separated both organisationally and spatially. The (spatially) functional division of labour or a multi-location organisation makes the spatial distribution of services much more apparent from a functional perspective than with a purely sectoral allocation: the main operation in the centre belongs to the same industry as the branch operations, but it will in fact normally have more service functions than the other company locations. In particular, activities connected with controlling, managing and planning tasks are disproportionately represented in densely populated central areas (Bade 1987). Most functions located outside densely populated areas (besides services for supplying the population on a day-to-day basis) are characterised by relatively low creation of value per unit of area (see Fig. 3).

Figure 3: Spatially functional division of labour



Source: The author, based on data (employment statistics) from the Federal Employment Agency *(Bundesagentur für Arbeit)* **and the author's own estimates**

The influence that the functional division of labour exercises on the spatial distribution of services applies to all economic sectors, i.e. in every sector there is a clear centre-periphery gradient regarding the intensity of the high-value functions (Bade 2001). Yet not all industries have equal potential for a functional division of labour, so the strength of the centre-periphery gradient can vary depending on the industry. Research and development – in a pure service company that specialises in technical consultancy, for example – is almost completely located in one of the large, densely populated areas. In manufacturing industries, on the other hand, the regional distribution of research and development is largely decentralised, because spatial proximity to the production site is in many cases a necessary condition for the seamless coordination of research and production.

4 The economic and political significance of services

Whilst the expansion of services is clear, the interpretation and assessment of this phenomenon are disputed (Cornetz 1998). On the one hand, with a view to conditions abroad, there have been warnings of the 'over-industrialisation' of Germany. A structural change would be unavoidable, and must therefore be facilitated from a political perspective by promoting services. The opposing position argues that industry alone can form a region's economic base. According to this view, ▷ *Regional economic policy* must above all support a region's industrial core.

4.1 Direct influences

To assess the significance of services for a country's or region's economic development, two chains of impacts must be differentiated that diverge from each other in the directness of their effect. The influences that impact the same sector (or the same company) in which they arise are immediately noticeable in the economic development as a whole. In terms of employment, direct influences on employment refers to the contributions that the service sector makes to the development of employment overall by increasing the number of jobs in the region.

Due to their immediacy, the direct influences on employment generally dominate the discussion. In light of the large sectoral differences in growth, the overall development of a region is not independent of the industries which are most represented there. Accordingly, structural weaknesses generally relate to a region having a large proportion of industries that, due to their state of decline or minimal job growth, make a negative contribution or hardly any contribution to the development of regional employment. Yet this impact, sometimes described as structural effect, is in fact significantly weaker than generally assumed. Many regions with a high percentage of industries exhibiting strong national growth have below-average growth, and many regions with an unfavourable industrial structure experience development that exceeds the national average.

4.2 Indirect influences

By definition, indirect influences require multiple levels of impact that can modify the original impulse. Due to the variety of such influences, their strength is difficult to evaluate as a whole. However, the importance of interdependencies can be observed in the regional parallelism of sectoral developments: regions with favourable overall development are normally successful both in the service sector and good-producing industries. Vice versa, shrinking regions are marked not only by strong industrial decline, but also by a weak service sector.

The relationships which underpin sectoral development can effectively be differentiated according to the type of causal relationship in supply-and-demand influences. In the forefront are often the influences related to demand, according to which services are normally assessed as being dependent on regional demand, such as household-related services or trade, which are usually aimed at the local and regional market. They receive impulses more than they give them. In addition, however, many regions specialise in certain services. If they are exported, they are included in the export basis of that region, and have a corresponding influence on the region's income and development of demand.

The supply-side influences of services impact the production conditions of the rest of the region's economy. Through its economic activities, a service provider can change the costs and productivity of other sectors. This can especially be assumed for business services (▷ *Knowledge society*). Furthermore, greater emphasis has been placed on the importance of spatial cooperation between service providers and industry, which can make regional industry much more competitive (▷ *Cluster*).

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