Briefing

September 2016

Understanding the Single Market for services

SUMMARY

Services account for 70% of European Union (EU) GDP and for a similar share of jobs, but only 20% of services, representing 5% of EU GDP, are provided across borders. Intra-EU trade in services has been less affected by the crisis than trade in goods, however, and experts agree that further integration of the market will bring about significant economic gains. The free movement of services was mentioned in the Treaty of Rome back in 1957. Liberalisation efforts started at the end of the 1980s and with the introduction of sector-specific legislation and, more specifically, the horizontal Services Directive, many barriers have been removed. The market is much more open to EU-wide competition than in the past.

Nevertheless, many obstacles to greater integration persist and addressing them is a complex process, cutting through various policy fields and dependent on finding a compromise between sometimes divergent national interests. Also, the implementation of existing legislation is in many instances imperfect and national regulation of services often differs across the Member States making it difficult for businesses, especially SMEs, to provide their services throughout the EU. In its 2015 Single Market Strategy the Commission proposed a number of initiatives to address many of the shortcomings identified and to deepen the integration of the European services market.

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Context

Services[1] account for more than 70% of the EU's GDP and a similar share of employment. Furthermore, they are responsible for generating over 90% of new jobs in Europe. Service providers are also critically important if the manufacturing sector is to remain globally competitive, since services are often combined with goods in business deals, and represent about 40% of the value the EU adds to its exported products. One in three jobs generated by exports of manufactured goods are in fact located in companies that supply the exporters of goods with auxiliary services.[2]

Only 20% of services in the EU are provided across borders, however. Cross-border services account for just 5% of EU GDP in contrast to manufactured goods traded within the Single Market, which represent 17% of GDP. Furthermore, according to the International Monetary Fund (IMF), productivity growth in services in Europe has been slower than in the manufacturing sector partly due to weaker competition, caused by the existence of unjustified barriers. The untapped potential of the EU services market has been noted in the majority of the empirical economic literature, which seems to support the view that further integration should create additional economic growth.

The smaller size of the intra-EU market for services as opposed to goods may be partly explained by the fact that many services are less tradable than goods and can only be provided locally. Nevertheless there is a growing trend in offering services across borders as a result of developments in communication technologies. This is also supported by the phenomenon of globalisation which has led to increasing interconnectedness between economies, manifested by complex international trade flows forming global value chains. This environment, in which many companies operate in a variety of countries and have multiple trading partners across the world, is conducive to increased trade in services between countries. Some estimates show that as much as 25% to 33% of services jobs in industrialised countries may be transferable to another country.

International trade in services

According to Eurostat, the export of EU services to the rest of the world grew from €366 billion in 2004 to around €811 billion in 2015. In the same period the EU trade surplus rose from €45 billion to €150 billion (down from a high of €175 billion in 2013). Using different methodology, the OECD estimated this surplus to be as high as US$334 billion in 2014. The United Kingdom currently has the largest surplus in international trade in services (€122 billion in 2015), significantly more than the levels recorded by Spain (€48 billion), and Luxembourg (€21 billion). On the other end of the spectrum are Germany with the highest deficit for international trade in services (€30 billion) just behind Ireland (€21 billion).

2013 data for intra-EU trade in services show that, when it comes to total international transactions in services, 55.2% of exports and 59.7% of imports take place within the Single Market. The largest surpluses with other Member States were recorded by Spain (€28 billion), and Luxembourg (€20 billion). By contrast Germany recorded a deficit of €26 billion.

Evolution and important provisions

A late starter

The general principle of the free movement of services was first mentioned in the 1957 Treaty of Rome as one of the four freedoms underpinning the creation of a 'common market' in Europe. The process gained momentum with the adoption of the Single European Act in 1986 which set the clear objective of completing the Single Market by the end of 1992. The focus has however remained firmly on trade in goods, which dominated the economic activity of most Member States in the post-war period.

Researchers have suggested other reasons for the relatively late start of the liberalisation of services, including: opposition from national vested interests (protectionism); social and political sensitivities (such as the strategic importance of some services or their obligation to serve the general public); and poor economic understanding of often complex and fundamentally different services markets.[3]

The first initiatives to free up trade in services commenced in the 1980s and covered financial services and transport as well as mutual recognition of diplomas in a limited number of professional services; this was followed by liberalisation in the network industries (e.g. broadcasting, postal, telecoms, and gas and electricity sectors). The introduction of the euro in 1999 further increased awareness of the need for better integrated and well-functioning services markets across the EU.[4]

Core principles

The main legal provisions governing the Single Market for services are the freedom to establish a company in another Member State (Article 49 of the Treaty on the Functioning of the European Union (TFEU)) and the freedom to provide services in an EU country other than the one where the company or consumer is established (Article 56 TFEU). These rules aim to prevent economic discrimination in the Single Market.

Currently, the internal services market *acquis* comprises: (i) provisions enshrined in the Treaties; (ii) horizontal services regime (e.g. Services Directive, public procurement, works and concessions legislation); (iii) sectoral services regime; and (iv) cross-cutting regimes for Single Market activities (internal retail market, digital single market, internal market for logistics and horizontal consumer *acquis*).

The Services Directive

The Services Directive, adopted in 2006, is the most significant piece of legislation in this area. It made it mandatory for each Member State to 'ensure free access to and free exercise of a service activity within its territory' and 'not make access to or exercise of a services activity in their territory subject to compliance with any requirements … that do not respect the principles of non-discrimination, necessity and proportionality'. Certain economic sectors were exempted: non-economic services of general interest, financial services, electronic communications, healthcare, temporary work agencies, audio-visual services, gambling, social services, private security, notaries and bailiffs and taxation.[5] Nevertheless, services falling within its scope account for 46% of EU GDP.

The directive does not address or affect national social security legislation. Many of its provisions codified existing case law of the European Court of Justice. In essence, the Services Directive specifies: (i) requirements that the Member States cannot impose on those who intend to provide services on their territory (e.g. an obligation for a company to establish its main place of doing business in the country in question), and (ii) requirements that may be permissible provided that they are non-discriminatory, necessary and proportionate (e.g. regarding a specific legal form of company). Furthermore, the directive covers the provision of cross-border services, imposing the same conditions as for on-going services, namely freedom of provision and limited grounds for restrictions. A Member State must permit provision of services on its territory by providers established in another EU country. Again, it may only impose requirements on such providers when they are non-discriminatory, necessary and proportionate.

Mutual recognition of professional qualifications

Freedom to provide services across the EU is linked with the formal recognition of professional qualifications by the service-hosting Member State. According to a 2015 survey, at least 21% of the European labour force can be considered as working in a regulated profession. National figures range from 15% in Sweden and Denmark up to 33% in Germany. The 2005 Directive on Mutual Recognition of Professional Qualifications allowed for a system of automatic recognition for professions with harmonised minimum training (seven professions including architects, doctors and nurses), recognition based on professional experience (e.g. in the craft, commerce or industry sectors) and a general system for all other professions.

The directive was revised in 2013 to introduce limited possibility for 'partial access', peer review of regulated professions at Member State level, a new alert mechanism when the profession is no longer regulated and the European Professional Card attesting professional qualifications.[6]

Posting of workers

A posted worker is sent by their employer on a temporary basis to deliver services in another Member State. Posting represents a growing sector of the EU economy: the number of posted workers increased by almost 45% between 2010 and 2014, when approximately 1.9 million European workers were posted across EU borders. The Posting of Workers Directive adopted in 1996 establishes that posted workers are entitled by law to a set of basic rights in force in host Member States (e.g. minimum rates of pay and holidays).

In March 2016 the European Commission adopted a proposal to revise the 1996 directive. The proposal would introduce changes in the remuneration of posted workers (making it equal with the pay of local workers, including when subcontracting), and clearer, more coherent rules on temporary agency workers and long-term posting. Fourteen chambers of 11 national parliaments sent reasoned opinions suggesting that the proposal breached the principle of subsidiarity. However, at the same time five of the higher-wage countries from the EU-15 submitted opinions that the proposal did comply with subsidiarity. Some observers claimed that the majority of countries that published reasoned opinions against the proposal were from EU-13 group and did it to protect their posted workers' businesses. On 20 July 2016 the Commission concluded that the proposal did not represent a breach.

State of play

According to 2015 Commission data, intra-EU exchanges of services, as a share of GDP, have not been significantly affected by the financial and economic crisis. Both in the EU-15 of longer-standing Member States and in the EU-13 Member States that joined from 2004, intra-EU exchanges of services increased more rapidly than GDP over the 2004 to 2014 period. The crisis had a more serious impact on trade in goods, which is showing signs of maturity or even stagnation and where the EU-13 record a higher share of intra-EU trade as a percentage of GDP than the EU-15. Business services,[7] travel and transport are the most significant sectors (with 25%, 24% and 19% respectively) of the total cross-border services exchange. The Commission considers that the steady growth of the intra-EU services sector, despite the crisis, suggests further untapped potential for growth.

The Commission argues that more restrictive Member States have a less efficient flow of resources than would otherwise be the case. Removing barriers would increase cross-border trade and competition in services, benefitting consumers with lower prices.

Current issues

A 2015 staff working document accompanying the Single Market Strategy analysed the shortcomings of the EU services markets. It concluded that in a number of key business services and in the construction sector there are conditions that may make it difficult or even prohibitive for companies, especially SMEs, to participate in services markets in other Member States. Consumers also sometimes face difficulties when accessing services from abroad. For business services and construction, the Commission reported that the main barriers (with restrictiveness varying between Member States) include systems for the authorisations, registrations and notifications required in order to be able to provide services. Other important barriers include requirements regarding the legal form of service providers and their shareholding structure, the allocation of voting rights and management positions, and other multi-disciplinary restrictions. Existing barriers may also constitute organisational requirements to fulfil health and safety standards, mandatory certification schemes and requirements to have a certain financial capacity or to purchase professional indemnity insurance. In addition to these barriers, the Commission recognises that integration within the Single Market for services is restricted by problems such as insufficient enforcement of existing rules, low levels of cross-border public procurement and inadequate political support for structural reforms.

A 2014 study for the European Parliament identified a series of gaps that hamper further integration. Some could be filled by EU legislative solutions such as stronger market monitoring (sectoral performance checks) or increased coverage of intra-EU public procurement markets. The EU could also address problems such as deficits in infrastructure and facilities connecting network industries, fragmentation of financial services, insufficient discipline in mostly national professional services rules, and limited harmonisation of professions and training across the EU. However, the report identified barriers outside of the formal single market remit that nonetheless impact businesses and companies, such as 'regulatory heterogeneity, private law issues, taxation issues; language; networking and trust and informational asymmetries'.

Implementation of the Services Directive

A comprehensive 2012 Commission evaluation established that the Member States had adopted more than a thousand laws to abolish barriers. This has led to the removal of 'thousands of discriminatory, unjustified or disproportionate requirements across the EU.' A conservative assessment indicated that the measures taken would increase GDP by 0.8% GDP over 10 years; a more ambitious implementation could bring about an additional 1.8% rise in GDP. However, recent assessments by the Commission show that only a few Member States have undertaken additional reforms, notably those countries benefitting from financial assistance programmes or implementing wide-ranging national reform programmes), and as such only 0.1% of the possible 1.8% will be achieved. The business community has also recognised that many barriers still persist on account of poor implementation. A recent European Parliament (EP) study underlined that a significant number of restrictions persists, concerning mainly occupational licensing, rules on establishment, and sector specific rules. The same document estimates gains from closing the existing gaps to be as much as €338 billion.

The OECD has been more critical: it claimed that 2013 data 'shows no improvement in the regulatory burden of services, and even deterioration in some countries despite the Services Directive'. The report listed the directive's limited scope of coverage and existing heterogeneity of rules and practices as important reasons. The organisation's 2016 EU economic survey underlined limited progress in the integration of services since the crisis. On the other hand, a study published by the Centre for European Policy studies argued that intra-EU market access has significantly improved as a result of the directive and that EU enforcement is likely to present fewer problems than originally expected.[8]

A 2016 report by the Court of Auditors underlines that a number of obstacles persist and that they have not been sufficiently followed up by the Commission because of a reluctance to challenge the principle of 'proportionality' used by some Member States to maintain barriers. It also criticises the Commission for its hesitation to pursue legal proceedings, and states that consumers are not able to reap the full benefits of the directive.

Regulated professions

Regarding the regulated professions (of which there are 5 000 throughout the EU, averaging around 186 per Member State) there are also differing degrees of liberalisation across the Member States. The Commission mentions studies that indicate that excessive regulation of professions may create market restrictions, limit consumer choice, increase prices, limit the number of workers entering the market and impact negatively the mobility of professionals between jobs. In 2014, problems with the recognition of professional qualifications were reported by 41% of companies (mostly SMEs), principally the length and cost of recognition procedures and the lack of EU-wide harmonisation of definitions of professions and educational training requirements. Sectors such as construction, engineering, IT, consultancy and legal services are particularly affected.

Ways forward

Furthering the Single Market for services is an inherently complex process as it touches upon a large number of policies, some of them requiring the agreement of Member States that may have opposing interests. Many barriers stem from national traditions, and changing these is politically sensitive.

The EP study recommends that the following actions be given priority: (i) elimination of anti-competitive legislation that may disadvantage foreign entrants (e.g. restrictions on opening hours); (ii) standardisation of contracts, liability and insurance rules for professional services; (iii) creation of a genuine level playing field in public procurement; (iv) stricter enforcement of competition law; (v) further harmonisation of rules and regulations; (vi) better transposition of the relevant EU *acquis*, especially the Services Directive; (vii) higher equivalence of training frameworks (e.g. the professional card); (viii) enhanced mutual recognition (a services passport); and (ix) an end to unnecessary rules on company ownership for professionals.

The Centre for European Policy Studies argues that many of the remaining barriers to the Single Market for services are expected to be removed by further developments related to the Services Directive and other ongoing initiatives such as those concerning the Single Digital Market.

Trade agreements and EU services

According to the *Financial Times*, a majority of existing EU trade deals explicitly exclude services from their scope. The deals which include services are quite complex and require acceptance of the free movement of persons as well as common regulations.

A recent major development in the field is the ongoing negotiations on the Trade in Services Agreement (TiSA) currently being negotiated by 23 members of the World Trade Organization (WTO), including the EU. The participating countries account for as much as 70% of world trade in services. By the end of 2013, most parties had indicated the markets that they intended to open and to what extent. By February 2016, 16 negotiating rounds had taken place.

The EP, which will vote on the final agreement, set out its guidelines to the Commission. MEPs supported reciprocity, efforts to open up markets for public procurement, telecoms, transport, and financial and professional services, greater opportunities for EU professionals to work outside the EU, work to curb third countries' restrictive practices, less red tape and increased information for SMEs. They also demanded exclusions for public and audiovisual services, and protection of labour rights, citizens' data and the right to regulate.

Single Market Strategy

The latest comprehensive initiative in the field is the Single Market Strategy adopted in October 2015. It comprises several initiatives, discussed below, which aim to deepen the economic integration of the services market in the EU.

In June 2016 the Commission adopted guidelines on the collaborative economy which specified the application of EU law to this sector. It advised on types of market access requirements, liability in the event of problems, consumer protection, the employment relationship and taxation issues. Also in June 2016 the Commission issued dedicated guidance on services standards, which proposes taking a structured approach by prioritising and promoting the targeted development of voluntary European service standards (currently accounting for only 2% of all EU standards).

By the end of 2016 the Commission plans to adopt guidance on reforms needed for Member States in the regulation of professions. Furthermore, the Commission will develop an analytical framework for Member States to use when reviewing existing rules or proposing the additional regulation of professions.

There will also be legislative action to address specific regulatory barriers in key business services and in construction services, which will seek to increase transparency and certainty for businesses by using harmonised forms.

An important legislative initiative to be proposed is the creation of a services passport to help Member States prove that they meet the requirements necessary to provide services in other EU countries. The services passport will also create a common electronic repository of documents, eliminating the need for multiple requests for information and documentation if these have already been supplied to the home Member State.[9] Possibly under the passport initiative, the Commission will seek to address barriers such as the divergent legal form of companies, shareholding requirements and multidisciplinary restrictions in key business services and (if appropriate) also organisational requirements in construction companies.

Having identified a number of difficulties regarding the application of the current notification procedure[10] (such as selective or late notifications), the Commission will propose modifications to the procedure. New measures will include an obligation to send draft legislation and increase transparency for stakeholders. In the absence of a notification, a measure will be considered void.

Finally, to open up retail services markets, the Commission will issue a communication in 2017 setting out best practice for facilitating retail establishment and reducing operational restrictions in the Single Market.

Main references

European Parliament Policy Department Study, Reducing costs and barriers for businesses in the Single Market, 2016.

OECD Economic Surveys of the European Union, 2014 and 2016.

European Commission, Commission staff working document – A Single Market Strategy for Europe – Analysis and Evidence, 2015.

European Parliamentary Research Service, The Cost of Non-Europe in the Single Market for Services, 2014.

Centre for European Policy Studies, Access Barriers to Services Markets: Mapping, tracing, understanding and measuring, F. Mustilli & J. Pelkmans, 2013.

Endnotes

[1] The term 'services' is very broad and covers a wide range of intangible products and activities. According to Eurostat's definition 'Services are the result of a production activity that changes the conditions of the consuming units (transformation services) or facilitate the exchange of products or financial assets (margin services). Services are also often difficult to separate from the goods with which they may be associated in varying degrees.'

[2] Growth in these jobs has been quite dynamic. A 2012 research paper showed that in the 2000-2007 period jobs dependent on exports grew by about 35% in the services sector while in manufacturing the increase amounted to 7%.

[3] Looking at just the EU nomenclature, services are classified in as many as 12 main categories: (i) Manufacturing services on physical inputs owned by others (ii) Maintenance and repair services (iii) Transport (iv) Travel (v) Construction services (vi) Insurance and pension services (vii) Financial services (viii) Charges for the use of Intellectual Property (ix) Telecommunication, computer and information services (x) Other business services (xi) Personal, cultural and recreational services, and (xii) Government goods and services.

[4] F. Mustilli and J. Pelkmans (2012) attribute the effect to the important role of integrated services markets in supporting both the shock absorption of introducing the new currency and the permanent adjustment process following it.

[5] Some of them, e.g. energy, financial services, healthcare, postal services, telecoms and transport are covered by sector-specific legislation. For details see Annex 1 to the Communication on the implementation of Services Directive.

[6] So far the card is available for five professions (general care nurses, physiotherapists, pharmacists, real estate agents and mountain guides).

[7] According to the Commission, business services cover a number of sectors: 'They range from technical services such as engineering, architecture and IT, to other professional services such as legal services, employment services and facility management.' They contribute to 11% of EU GDP.

[8] The report provides comprehensive lists of remaining barriers in Tables 8 and 9.

[9] Where the business is established.

[10] The rules under the Services Directive specify that Member States need to notify the Commission of new regulatory measures affecting services to ensure that they are non-discriminatory, justified by public interest objectives, and proportionate.

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