

Securing EU Growth from Services

CEPS Special report No.67/October 2012

Jacques Pelkmans & Federica Mustilli

Implementing the Service Directive: Lift-Off for Mission Growth

European Parliament

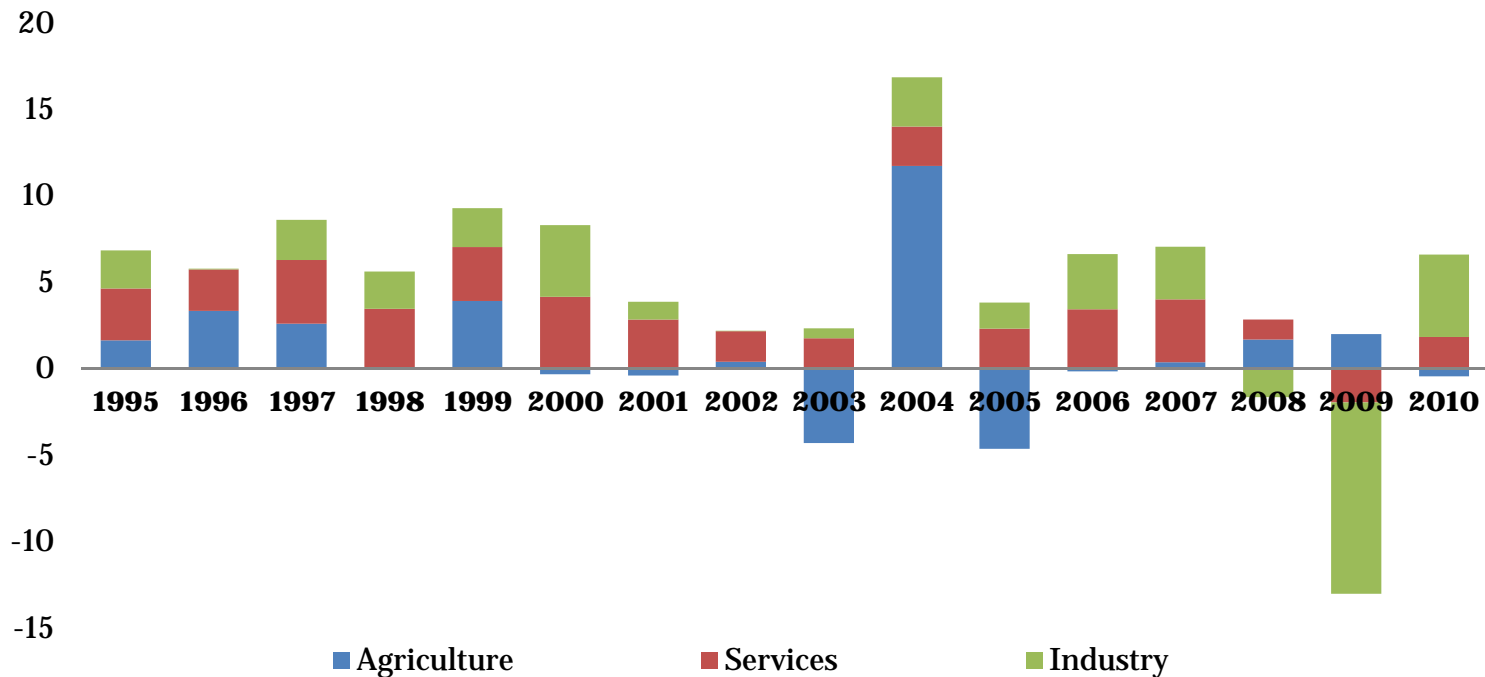
Brussels, 20 February 2013

Rationale:

- Does the EU suffer from an untapped growth potential, to be realized by improving the functioning of the services markets ? [Yes, ... but assertive or analytical ?]
- And....what does this imply? Did the services directive open intra-EU services markets? And what is happening at national level?
- Can the EU do more, also outside the services directive ? And only at the EU level ? Does economic research lead us to expect serious economic gains ?

1. Why emphasize EU growth from service

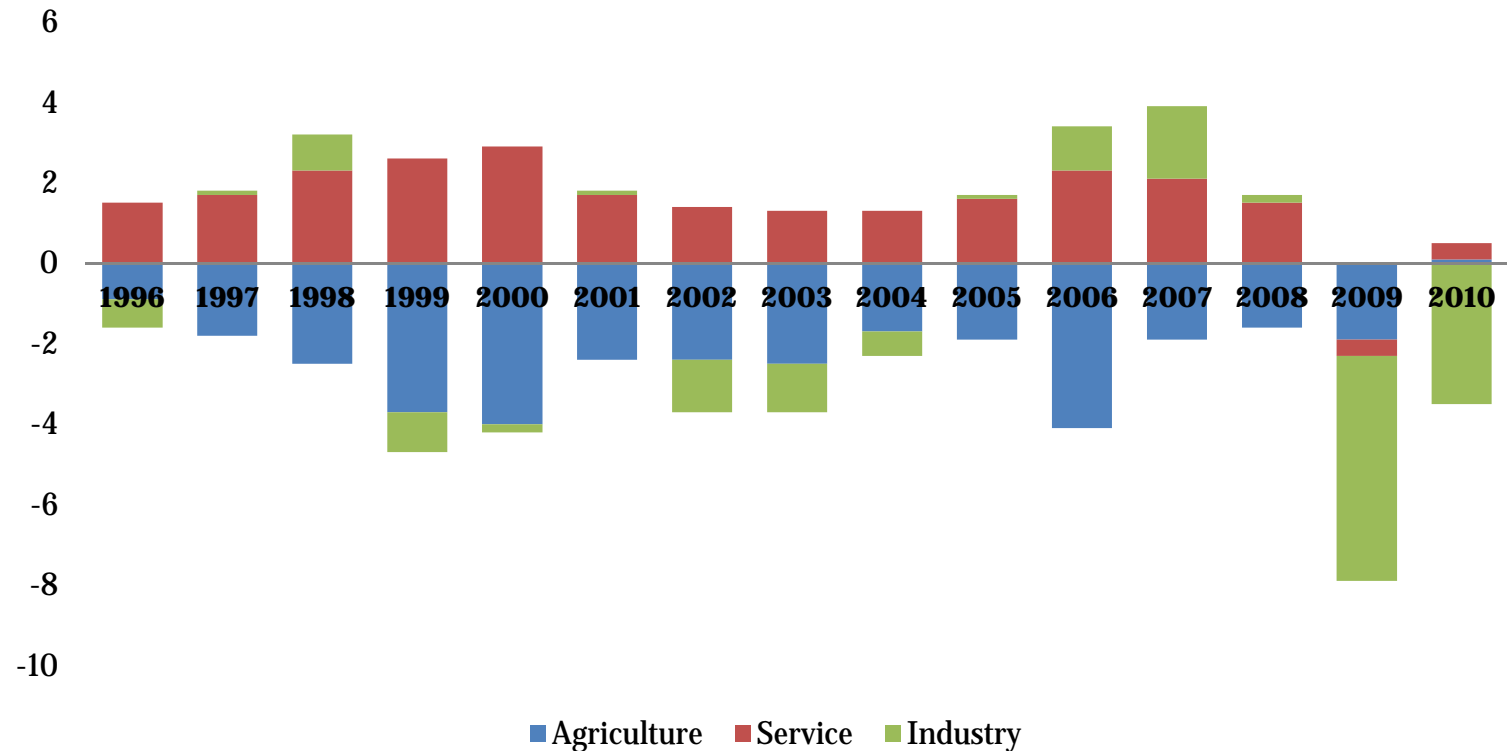
Sectoral value-added contribution in the EU (%annual growth)



Source: World Bank, World Development Indicators (2012).

1. Why emphasize EU growth from service

Sectoral employment growth (% annual growth)



Source: Eurostat (2012).

2. Strategies of Services reform: a two-level game

- Service liberalization is a latecomer to the process of EU integration.
- Slow deepening and widening, initially obstructed by national vested interests, sensitivities, and, last but not least, a lack of economic understanding and data
- Services directive debate dominated by labour, not services, by cross-border and not FDI (though key !)
- EU services strategy distinguishes two ‘tracks’: the single EU market for services and domestic services markets.

2. *Strategies of Services reform: a two-level game*

Services Directive

- Business services (consultancy, certification & testing, services, commercial agents, industrial cleaning)
- B2C and B2B: legal/fiscal advice, real estate services, construction (incl. architects); wholesale & retail; trade fairs, car rental, travel agencies
- Tourism, leisure services, sports centres, amusement parks, household support services
- Private educational services

EU REG REGIME (1)

Financial Markets

- Banking
- Insurance
- Investment services
- Asset management
- REG for market failures and financial (system) stability (national and EU) supervision

EU REG REGIME (2)

Network Sector Services

- Broadcasting
- eCommunications
- gas/electricity
- Postal
- Air/rail transport

EU REG REGIME (3)

Transport

- Road haulage
- River & maritime
- Bus & coach
- Air/rail (see network services)
- REG for SHEC-type market failures
- EU safety agencies (air, rail, maritime)

EU REG REGIME (4)

Professional Services

- nationally regulated
- but diploma recognition under Dir. 36/2005
- new proposal with professional card
- EU-wide self-regulatory codes under Services Dir.

EU REG REGIME (5)

Sensitive Services

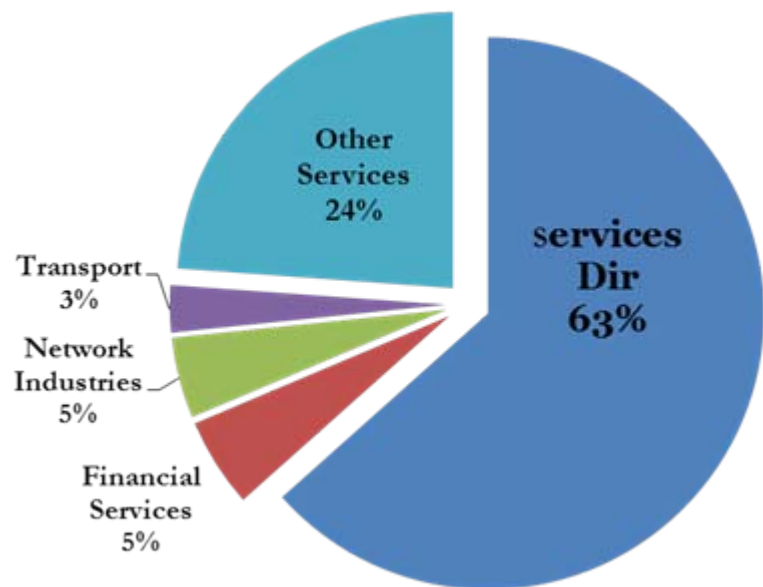
- private security services (blocked)
- cross-border health services (Dir. 7053/2011)
- gambling and related (status?)

EU REG REGIME (6)

Temporary Cross-border Services

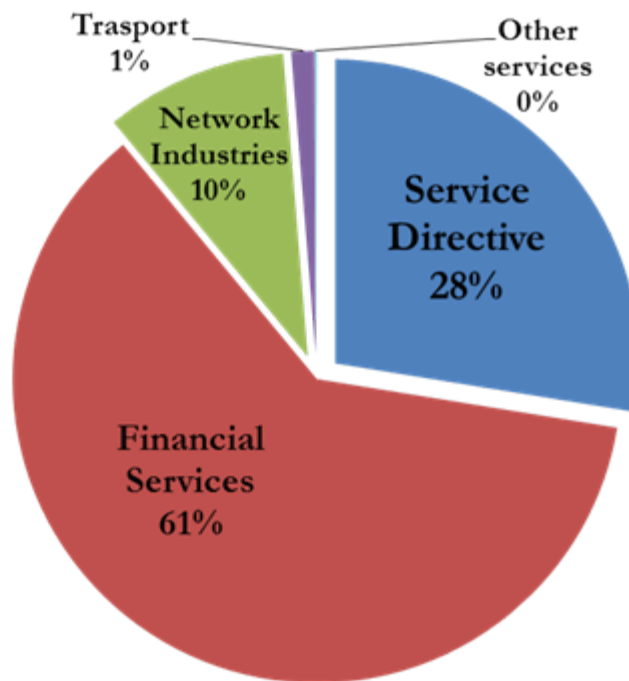
- services themselves (often) under services dir.
- but, for posted workers, host-country control and notification requirements (Dir. 96/71)

2. *Strategies of Services reform: a two-level game*



Intra-EU27 FDI in services,
outward in 2008

Intra-EU27 trade in services,
export in 2008



2. *Strategies of Services reform: a two-level game*

- EU involvement can only be *highly intrusive* for domestic services regimes;
- The removal of intra-EU barriers critically depends on the abolition or reform of *domestic* services regulation;
- Other two reasons that prompted EU involvement in domestic services regimes:
 1. As already noticed by the Cardiff Report (2000):”.... *Further efforts are required to promote stronger competition in service sectors such as retail trade and professional services*”;
 2. Promoting domestic services reforms helps the proper functioning of the monetary union.

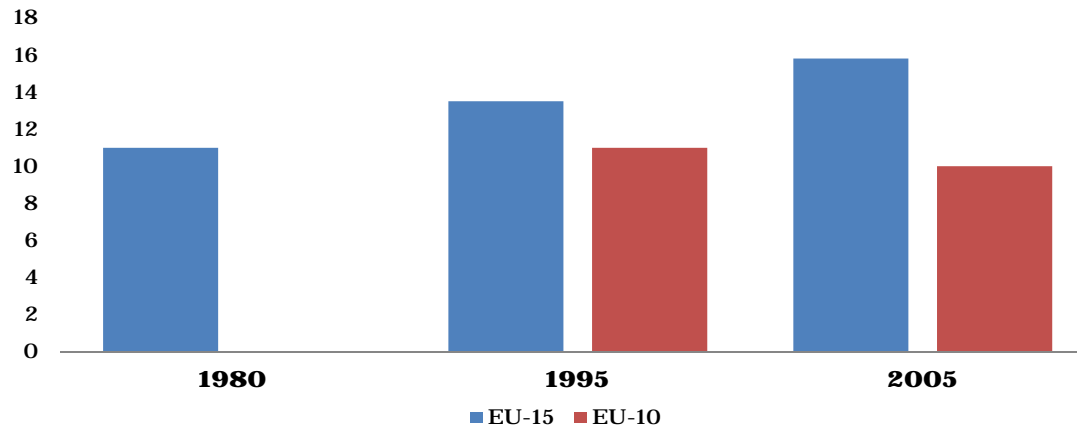
Why the EU grew less in services than the US?

- Low growth in the productivity of services in EU → avg annual LPG in market services: 1% EU versus 3% US, 1995 to 2005, different from productivity growth over 1980-95;
- Whilst the US was experiencing acceleration since the mid-1990s (ICT-using sectors), the EU witnessed a strong slowdown in multifactor productivity;
- The literature finds that i) *labour market and services regulation restrictiveness* and ii) *skills and organisational capital inside firms* explain disparities in ICT-driven productivity growth; moreover, there is a ICT deterrence effect of strict regulation.

3. *What does economic research tell us?*

Why service reforms are good for EU industry?

- Service reforms boost economic growth via interlinkages between manufacturing and services;
- Indeed, the ratio of purchased services in manufacturing increased steadily in the EU15 from 1980 to 2005 (see below);



Note: Indicator is defined as the share of purchased services compared to manufacturing output.

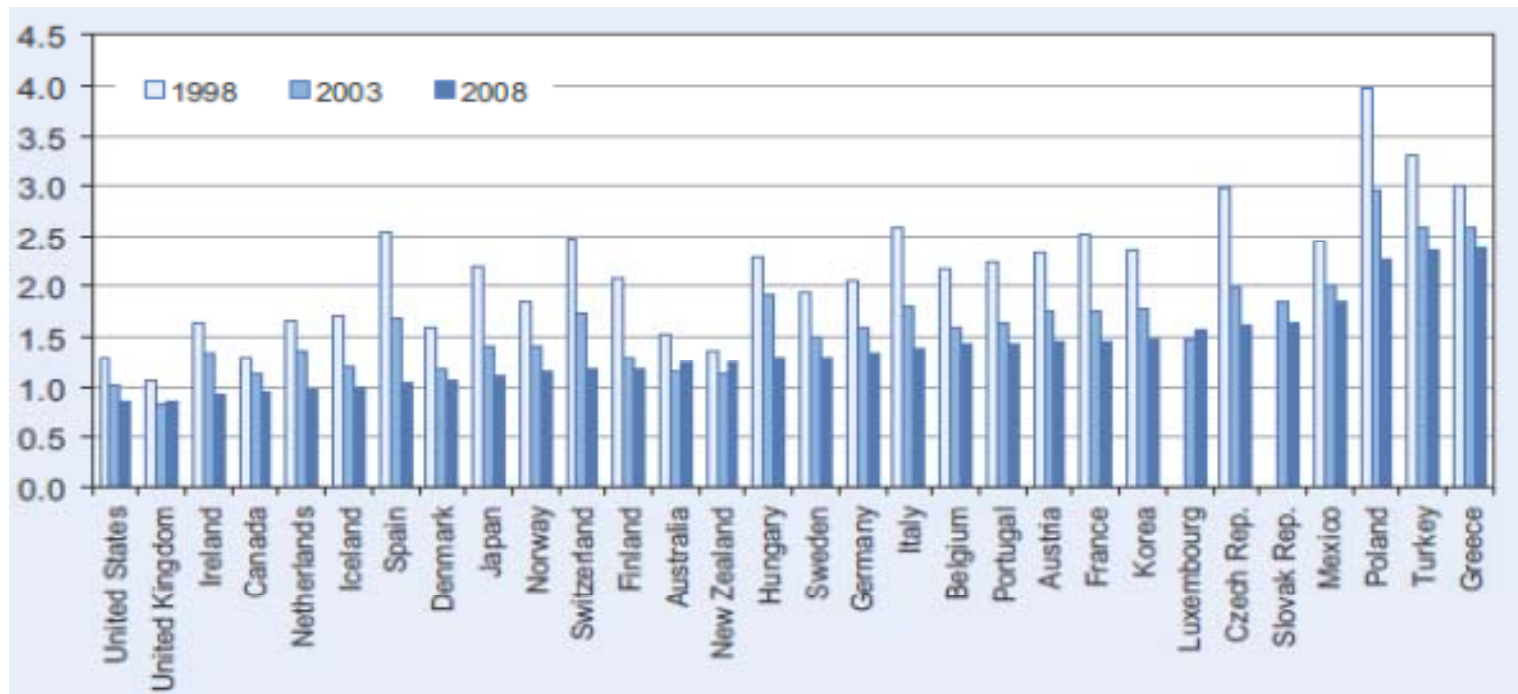
Source: Falk et al. (2011).

- A more competitive and open service market boosts the competitiveness of the whole productive system.

3. *What does economic research tell us?*

On domestic services reforms

- Countries with low PMRs have experienced higher productivity growth.



Note: Index scale of 0-6 from least to most restrictive.

Source: OECD, Product Market Regulation Database, reproduced in "The Revised OECD Indicator of PMR", CESifo DICE Report, autumn 2010, p. 35.

3. *What does economic research tell us?*

- Conway and Nicoletti (2006) define a **‘knock-on’** effect of restrictive services regulation on manufacturing in 2003: Sweden is the less affected (less than 0.1) and Austria the most (almost 0.35); this means that Austrian manufacturing is much less competitive due to costly and/or slow services (a burden)
- Sectoral differences matters: the burden of non-manufacturing regulation is larger in countries with important ICT-using sectors (except UK).

3. *What does economic research tell us?*

Countries	after removing knock-on, Change in labour productivity after 10 years
Spain	7%
The Netherlands, Finland and Denmark	8%
Belgium and the Czech Republic	14%
Poland and Hungary	19%
France	10%
Italy	12%

Source: Arnold et al. (2009)

- The domestic services reform potential in the EU is still quite large.

3. *What does economic research tell us?*

- The internal services market also suffers from intra-EU regulatory heterogeneity, is very costly
- How to reduce costly regulatory heterogeneity ?
 - implementing the Directive a little ‘deeper’ ;
 - promoting pro-competitive domestic reforms that go beyond the Services Directive;
 - Even when domestic regulation is justified, (selective) EU harmonisation may be agreed with a view to lower or eliminate such regulatory variety (like ‘compacts’ of US states)

NOTE : regulatory heterogeneity be distinguished from true”diversity”. Genuine ‘diversity’ should be respected.

Main economic effects of the Service Directive (I):

1. The increase in intra-EU service imports is creating a more competitive environment.
2. The concomitant reform of domestic services regulation insofar as the Directive requires this in order to remove the barriers.
3. Positive impact of better access on intra-EU FDI in services;
4. The (presumably positive) impact on cross-border FDI induced by the greater market opportunities as a result of the concomitant domestic services reforms;

3. What does economic research tell us?

Main economic effects of the Service Directive (II):

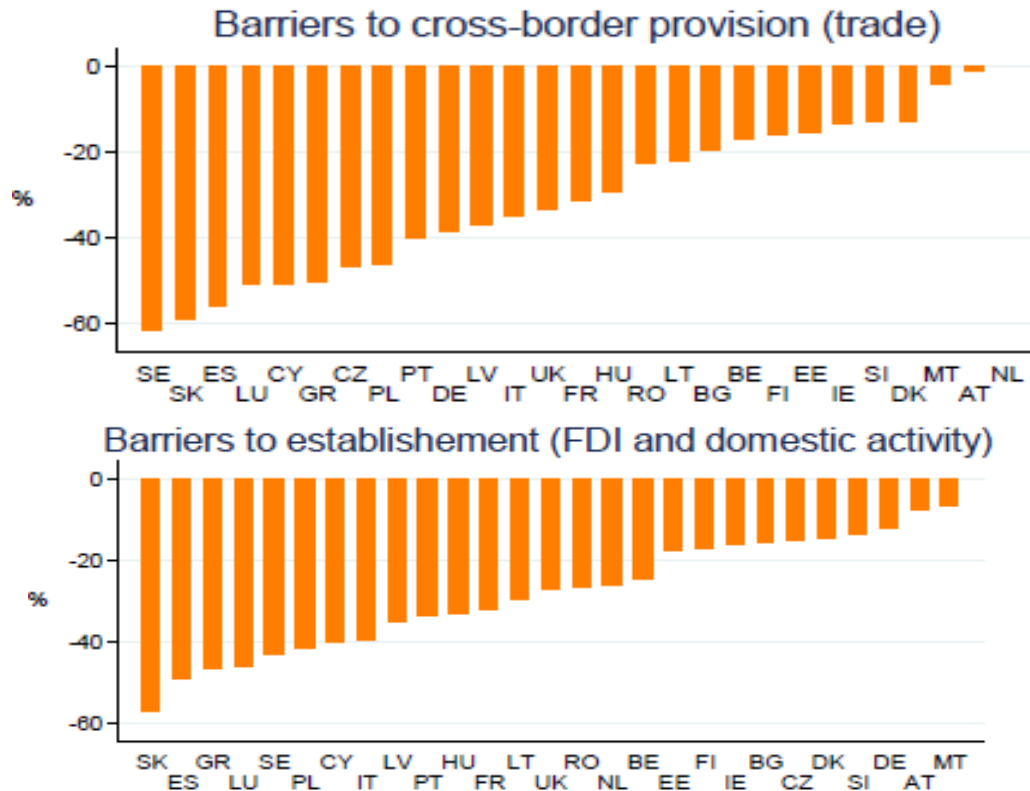
- 5. Pro-growth leadership in market selection by foreign services subsidiaries as they are best able to benefit from the more pro-competitive domestic environment in each member state;
- 6. Benefits from lowering regulatory heterogeneity as induced by the Directive;
- 7. Benefits from selected harmonisation of national regulation justified by market failures, yet distinct in practical (nuisance) details and requirements.

3. What does economic research tell us?

- Academic literature : EU GDP increase 0.7% - 1.5%
- Commission (2012) finds an estimated EU GDP increase of 0.8% (ranging from 0.3% to 1.5%) in 2011 and an increase of FDI inflows of 4%
- Kox & Lejour (2006) and Kox & Nordas (2009) studied the effects of lowering regulatory heterogeneity in services ; are stunningly large

3. *What does economic research tell us?*

Average Barrier Changes under the Services Directive by 2011 (Monteagudo *et al*, 2012)



- On the basis of country data from the 2010 Mutual Evaluation, Monteagudo *et al.*(2012) show :
 - barriers to intra-EU services trade removed/reduced per EU country, ranging from 1 % to 61 %, and for barriers to FDI and their local activity, from 6 % to 58 %;
 - the number of restrictions abolished (around 300 in total) or partially reduced (some 800-plus in total) for each sector;
 - the share of previously existing restrictions abolished or reduced, in each sector, ranging from 83 % (travel agencies) to 61 % (accountants)
 - all in all, the overall barriers to intra-EU services exchange are suspected to have reduced by some 20%

Conclusions and policy recommendations (I)

- i. Domestic and EU-level services reforms tend to be economically intertwined;
- ii. More competitive services markets matter for the competitiveness of European industry;
- iii. EU and domestic services reforms (and to some extent, labour reforms as well) are one among several factors needed to better exploit ICT in EU user industries and user services sectors;

Conclusions and policy recommendations (II)

- iv. Bringing EU countries' regulatory restrictiveness to best-practice levels show very substantial productivity improvements;
- v. The economic gains from realizing a fully-fledged EU internal market for services (that is, much beyond the horizontal services directive) are still not fully understood ; this is particularly so in network industries, professional services and in financial services (when systemic risks are better controlled)
- vi. Reaping the gains from better functioning services markets is not always just a matter of greater competition. In some sectors, infrastructure investment are critical.

Thank you!

Contacts:

Jacques.pelkmans@ceps.eu

Federica.mustilli@ceps.eu