

Service Market Liberalisation in the European Union

Jan Jedlička

EU Office of Česká spořitelna

EU OFFICE

Česká spořitelna, a.s.

Poláčkova 1976/2

140 00 Praha 4

tel.: +420 261 073 308

fax: +420 261 073 004

EU_office@csas.cz

<http://www.csas.cz/eu>

Petr Zahradník

+420 261 073 019

pzahradnik@csas.cz

Jan Jedlička

+420 261 073 484

jjedlicka@csas.cz

Alena Smolíková

+420 261 073 308

asmolikova@csas.cz

Contents:

Introduction	3
Historical Genesis of the Draft Services Directive	4
Basic Outline of Draft Services Directive	5
<i>Free Establishment of Providers</i>	5
<i>Free Movement of Services</i>	5
<i>Other important points of the directive</i>	5
<i>Covered area</i>	6
<i>Relationship to Other EU Policies</i>	7
Future of Draft Services Directive.....	10

Introduction

Services are the engine of economic growth and account for 70% of GDP and employment in most member states. The fragmentation of the internal market in this area has a negative impact on the whole European economy, in particular the competitiveness of small and medium-sized enterprises, and also restricts consumer access to a more varied range of services at competitive prices. The aim of a new services directive is to achieve a services market which really works and benefits the economy of the whole Union.

The single internal market of the European Union is one of the basic pillars of its functioning. It was implemented gradually and not even now, almost half a century after the establishment of the European Economic Community (EEC), can we say that it functions 100% efficiently. One of the reasons this claim is made is the still fragmented services market.

At the beginning of the single market there was a **customs union**, which started on 1 July 1969, i.e. precisely half a year before the end of the transitory twelve-year period (from the start of 1958 until the end of 1969). Under it EEC member states got rid of customs duties, subsidies with a similar effect and quantitative restrictions on foreign trade between them; there was also a single customs tariff for goods from third countries. The customs union was not, by any means, the end of integration attempts. There was still the job of getting rid of other barriers to the free exchange of commercial goods (such as special national technical standards) and also expanding the area of free movement to services, persons and capital, which completed the **transition to the single internal market**.

The basic document enabling the establishment of the Community's internal market was the **Single European Act**, which amended the founding treaties. The Single European Act came into effect in 1987 and, under it, the Community's **single internal market came into being in 1993**. The market is defined as an area without internal borders in which the free movement of goods, persons, services and capital is ensured. Free movement of services is dealt with in the Treaty Establishing the European Community in Articles 49 to 55.

Theoretically, therefore, the services market works in the Union and, in addition, some specific services have been the subject of special directives (financial services, electronic communications, transport services). However, as can be seen from opinions of the European Commission (for example, "State of Internal Services Market" in 2002), there are a number of barriers which prevent the efficient operation of the single market in services in the widest spectrum of activities.

These **barriers affect a wide range of services**, such as distribution, recruitment agencies, certification, laboratories, construction, estate agents, crafts, tourism, regulated professions, etc., and this primarily affects small and medium-sized enterprises, which are dominant in services. **Small and medium-sized enterprises** are often deterred from taking advantage of the opportunities offered by the internal market, as they do not have the funds to assess the risks and to protect against legal risks in each country, which is part of cross-border activities, or to deal with administrative complications.

The above barriers to the movement of services between member states come to light primarily in two model situations:

- **A services provider in one member state wants to establish a branch** in another member state – it encounters complicated and difficult systems for licensing, excessive bureaucracy, discriminating requirements for the nationality of managerial employees, checks on financial management, etc.
- **A services provider from one member state wants to provide its services** in another member state (particularly by moving to the other member state on a temporary basis) – it may be under a legal duty to establish itself in the other member state, to obtain licences there, or it may be subject to regulations of this country on conditions for the exercise of the activity in question or disproportionate procedures for the posting of workers, etc.

The basis of the proposed services directive is to **get rid of these barriers** and enable better functioning of the internal services market.

Historical Genesis of the Draft Services Directive

The services proposal dates back to **2000**, when, at the spring EU summit in the Portuguese capital, the heads of member states approved the **Lisbon strategy**, which set the aim of making the European Union the most competitive knowledge-based economy by 2010.

Services account for almost **70% of the Union's GDP and employment opportunities** and offer marked potential for growth and job creation. Without effective competition and the real implementation of a single market in this, by far the biggest, sector, the implementation of the Lisbon strategy is an illusion. Therefore in December 2000 the Commission reacted to the challenge of the Lisbon summit by drafting "**An Internal Market Strategy for Services**", which was aimed at making the movement of services between countries in the Union as straightforward as movement within one member state.

In **July 2002** the European Commission, in its report "**The State of the Internal Market for Services**", listed the barriers preventing the creation of a functioning internal services market and came to the conclusion that, "Ten years after the expected completion of the internal market, there is a large gap between the vision of an integrated EU economy and reality, as perceived by the citizens of Europe and European service providers."

In **November 2002** the Commission's conclusions were seconded by the EU Competitiveness Council, which called on the Commission to draft legislation on the provision of services. In **May 2003** the European Commission issued a statement called "**Internal Market Strategy – Priorities 2003-2006**", in which it undertook to draft a directive on services on the internal EU market.

This was done in **January 2004**, when the draft directive on services was submitted by a former Internal Market Commissioner, the Dutchman **Frits Bolkestein**, after whom the directive is often called.

Basic Outline of Draft Services Directive

As stated above, since at least 2000, key European institutions have been aware that an efficiently functioning internal services market remains in the realm of theory, thanks to a number of legislative and non-legislative barriers. The idea of the proposed services directive is to **create a legal framework which eliminates barriers** to the free establishment of service providers and free movement of services between EU member states, thereby enabling service providers and recipients to take advantage of their basic rights under the founding treaties.

Free Establishment of Providers

This includes cases where a service provider moves his registered office to another member state or establishes a branch or other organisational component there. In all these cases he is fully subject to the regime of the host member state. To limit barriers to the free establishment of service providers, the proposal contains the following items:

- Measures to simplify administration, in particular to establish **single points of contact**, where service providers can take care of all the procedures related to their business, the duty to enable the procedures to be performed electronically;
- Some principles which have to be respected by **authorisation regimes** used for service activities, in particular principles valid for conditions and procedures for granting licences;
- **A ban on some especially restrictive legal requirements**, which may still apply in some member states;
- An obligation to **harmonise some legal requirements adopted in the future** with the conditions laid down by the directive.

Free Movement of Services

Free movement of services includes cases where a provider travels to the member state of the services recipient; services provided in the provider's country of origin, to which the services recipient travels; services provided in another country, to which the services provider and recipient travel; and services provided remotely. The requirement that the provision of services is only temporary, both in terms of the period of time and frequency, is important. Otherwise, this is governed by freedom of establishment. The proposal contains the following points to restrict barriers to free movement of services:

- The application of the **country of origin principle**, according to which service providers are subject to the laws of the country in which they are established, regardless of the country in which they offer their services. Member states may not restrict services provided by a person established in another member state. This principle is supplemented by a number of derogations, which are either generally or temporarily valid or can be applied to specific situations;
- **Consumers' right to take advantage of services** from other member states without this being prevented by restrictive measures introduced by their countries or discriminatory behaviour by state bodies or private entities;
- **Method of providing assistance to clients** taking advantage of a service provided by an enterprise founded in another member state;
- In the event **employees are posted to another country** in connection with the provision of services, it sets out the division of duties between the member state of origin and the member state of destination and the procedures used for supervision.

Other important points of the directive

In particular for the application of the country of origin principle, it is necessary to establish mutual trust between member states, which will be helped by the following points in the application:

- **Harmonisation** of legislation guaranteeing equivalent protection of the general interest in important matters, in particular as far as concerns the duties of service providers to provide information, conclude professional liability insurance, multi-disciplinary activities, dispute resolution and exchange of information about service provider quality;

- **The strengthening of mutual assistance between national bodies** to guarantee efficient supervision of services, based on a precisely defined division of tasks between countries and mandatory co-operation;
- **Measures focused on supporting the quality of services**, such as voluntary certification of activities, quality certificates and co-operation between members of chambers of commerce or trade chambers;
- Support for **codes of behaviour** in certain areas drafted at Community level by the interested parties, including individual business communications performed by regulated professions.

The aim is that the proposal comes into force by 2010 and it is based on a **dynamic approach**. This means that some of the provisions will be implemented gradually and that it contains a duty of further harmonisation in some specific areas (cash transport, games of chance and judicial recovery of debts), as well as guarantees concerning performance and the opportunity to ascertain the need for all new initiatives.

Basis of Dynamic Approach

1 year after passing	Commission proposals for subsequent harmonisation in (a) cash transport, (b) games of chance, (c) judicial recovery of debts.
Final deadline for implementation (2 years after passing)	Removal of prohibited requirements for performance of service. Removal of barriers to free movement of services, with the exception of derogations. Joint assessment of member states.
No later than 31 December 2008	Single points of contact, right to information, use of electronic procedures, report drafted by Commission (if necessary, with proposals for further initiatives).
1 January 2010	End of temporary derogations from country of origin principle for (a) cash transport, (b) judicial recovery of debts.
No specific deadline; as needed	Implementing measures (procedure for discussion in committee): (a) use of electronic means, (b) assistance provided to service recipients, (c) information about service providers and their services, (d) professional liability insurance and guarantees, (e) mutual assistance, (f) joint assessment. Determination of the need for new initiatives as a consequence of: (i) experience with derogations granted based on a specific situation, (ii) missing codes of behaviour. Review of <i>acquis</i> on consumer protection and subsequent measures in Commission's Action Plan for contract law.
In accordance with progress of harmonisation at Community level	The application of derogations from the country of origin principle as far as concerns contracts concluded by consumers and derogations granted based on a specific situation is limited to areas which have not been harmonised.

Note: the timetable is based on a draft of the directive which assumes it will be passed in 2005, which now seems too optimistic.

Covered area

The forthcoming services directive is a framework directive. **It does not attempt to lay down detailed regulations** or harmonise all regulations on services in member countries. This would lead to excessive regulation. Instead, the proposal exclusively deals with matters which are necessary for the problem-free functioning of the internal services market and tries to remove barriers preventing the achievement of a real internal services market, which are often common to a whole number of various activities and have a lot of common characteristics.

The services directive **is based on and supplements the Community's *acquis***. If a type of service is included within the remit of several Community instruments, the directive and the instruments shall apply and the requirements stipulated by one of them will be added to the requirements stipulated by the others.

The directive states that it concerns **services supplied by providers established in an EU member state**. It understands a service to be any economic activity of an economic operator, under Article 50 of the Treaty Establishing the European Community, consisting of **provision in return for a fee**. Under this Article, services are regarded as acts usually provided for a fee, unless they are governed by the provisions on the free movement of goods, capital and persons. The definition, however, does not say that a service has to be paid for by the person for whom the service is performed.

Services are practically regarded as economic activities corresponding to the **case law of the Court of Justice**, which is the current source of European law. Given the above, the proposal governs:

- Services provided to consumers, businesses and both;
- Services provided by an operator which, for this purpose, travelled to the recipient's member state, remotely provided services (i.e. over the internet), services provided in the country of origin, to which the recipient travelled, and services provided in another member state, to which the provider and the recipient travelled (for example the services of tourist guides);
- Paid services or services which are free to the final recipient.

The definition, however, **does not include non-economic general interest activities** or activities performed by the state free of charge as a part of **social, cultural, education and justice** functions, as well as cases where there is no element of payment. The draft regulation also does not affect member states' freedom to define general interest services and the manner in which they should function.

The definition of the term "service" therefore includes a wide range of developing activities, including:

- **Services of a business character**, such as managerial consulting services, certification and testing; management of building operations, including office and security services; advertising and recruitment agency services; and services provided by sales representatives;
- **Services to business and consumers**, such as legal and financial advice, estate agents' services, construction services, including architects' services; transport, distribution; organisation of fairs; vehicle rental; travel agents; security services;
- **Services to consumers**, such as tourism services, including tourist guide services; audiovisual services; services for leisure time, sports centres and entertainment parks; health care; services for households, such as care for the elderly.

The directive does **not deal with** some specific services, which are dealt with by special sector initiatives:

- **Financial services** – are already dealt with by the comprehensive policy contained in the Financial Services Action Plan, which is already being implemented to create a real internal services market in finance;
- **Electronic communications services and networks** – this is being dealt with by the directive on the "telecommunications package" adopted in 2002 (approach directive 2002/19/EC, authorisation directive 2002/20/EC, framework directive 2002/21/EC, universal service directive 2002/22/EC and the Directive on Privacy and Electronic Communications 2002/58/EC);
- **Transport services** – are also dealt with by a whole number of European Community instruments. They are defined by Articles 71 and 80(2) of the Treaty Establishing the EC. Nevertheless, the directive applies to transport services which are not regulated by special standards, such as cash transport and transporting human remains.

The directive also **does not apply** to activities which are directly and specifically related to the **exercise of official powers**. The directive does not apply to non-economic general interest services, but some activities may be linked to economic general interest services. The directive reacts to this in the form of **derogations from the country of origin principle** to the extent reasonable, given their form. These derogations primarily apply to postal services, electricity, gas and water distribution services and services related to personal data processing.

Exceptions from the country of origin principle are possible for activities where the difference between internal methods is too great, such as notarial acts, activities related to intellectual property, registration of vehicles rented in another member state, activities in a country prohibited for reasons of government policy, public safety or public health, and services subject to special legislation related to specific properties of the place of service provision due to government policy, public safety or the protection of public health or the environment.

In addition to these general derogations, there are also **individual derogations** from the country of origin principle which a member state can only claim in **exceptional circumstances**, provided other conditions are met, and only if they concern the safety of services, the medical profession or the protection of public policy (in particular the protection of minors).

Relationship to Other EU Policies

Service provision in the European Union is affected by other European policies governed by other legislative acts. If services are governed by one or more Community legislative instruments, the services directive and the other instruments shall be used **cumulatively**, which means that the conditions of one instrument apply, in addition to the

conditions specified in the other instruments. In cases where there may be problems with harmonisation, the services directive contains derogations or relevant clauses describing the relationship between the directive and other EU legislative instruments.

Main overlaps with other EU policies:

- **Posting employees** – the conditions governing employment and work valid in the event employees are posted are set out in Directive 96/71/EC concerning the posting of workers in the framework of the provision of services, which ensures certain legislation of the country to which a worker is posted will apply. To comply with this directive, the services directive contains a derogation from the country of origin principle concerning this area. For the purpose of simplifying free movement of services and applying Directive 96/71/EC, the draft explains the division of tasks between the country of origin and the member state to which a worker is posted, as well as the correct supervision procedures. The derogation from the country of origin principle also includes social security, which is dealt with by Regulation 1408/71/EC on social security.
- **Professional qualification** – the forthcoming services directive supplements the draft directive on recognition of professional qualifications, as it deals with matters other than professional qualifications, such as professional liability insurance, business communications and multi-disciplinary activities. The two proposals are compatible and, from the viewpoint of freedom of establishment, their aim is to simplify the establishment of service providers; as far as concerns free movement of services, they are both based on the country of origin principle.
- **International trade in services** – the draft directive is an instrument governing the internal EU market and only deals with service providers established in a member state. International trade in services deals with international activities, in particular as a part of GATS; the services directive does not affect such activities. The proposal therefore does not deal with external activities; in particular it does not govern:
 - Cases of third country operators which want to set up a branch establishment in a member state;
 - Cases of third country operators which intend to provide their services in the EU;
 - Cases of branches of third country companies in an EU member state which are not companies established in accordance with the legislation of a member state and cannot therefore take advantage of the benefits provided by the directive.
- **Unfair commercial practices** – this area is also covered by the forthcoming directive on unfair commercial practices. Its aim is to regulate commercial practices which damage the economic interests of consumers, such as, for example, misleading or aggressive sales tactics. The forthcoming services directive does not deal with unfair commercial practices at all.
- **Consumer protection** – the services directive does not directly affect any legislation or other Community initiatives on consumer protection. However, it states that, if there is a need in the future for further internal service market harmonisation, the Commission may amend European consumer protection legislation. It partially affects consumer protection by mentioning recipients' right not to be discriminated against when consuming services on nationality grounds. The draft directive therefore states the following:
 - Countries – may not introduce restrictions against recipients of services provided by operators established in another member state. Neither the member state from which the service provider comes, nor the member state of destination, may apply discriminatory measures against recipients based on nationality or place of residence.
 - Service providers – their general terms and conditions may not refuse access to their services or make it conditional on the nationality or place of residence of the recipient, or put certain recipients at a disadvantage for such reasons. Exceptions include directly reasonable objective reasons, such as distance or technical aspects of services.
- **Taxation matters** – the directive does not apply to taxation, which has its own legislation. However, in accordance with case law of the Court of Justice, certain tax measures may have a discriminatory effect and prevent an operator from taking advantage of freedom of establishment and free movement of services. This is dealt with in the draft services directive using prohibited requirements in connection with freedom of establishment and the country of origin principle in relation to free movement of persons for taxation measures which are not governed by a Community instrument.

Impact of Services Directive

An independent study entitled "Economic Assessment of the Barriers to the Internal Market for Services" was drafted by the Danish company Copenhagen Economics in January 2005 and examined the effect of the proposed services directive on the EU economy. The study's authors base their conclusions on an analysis of 275,000 European service providers and cover roughly two thirds of all services governed by the directive. The study's main conclusions are as follows:

- I. Price falls in all sectors** – stronger competition will lead to a fall in artificially high prices; better use of resources will lead to lower costs of providing services. Both customers and businesses (in particular small and medium-sized enterprises) will profit from this. For example, in accounting, tax advice, legal and other managerial-advisory services there should be a fall in prices by 7.2%. Thanks to lower prices and higher wages, it is expected that total consumption will grow by 0.6%, i.e. € 37 billion.
- II. Economic performance will rise in all sectors** – total output and added value will rise in all sectors, most significantly in services and goods markets. Gross added value in services will rise by 0.8%. The increase in economic activity will lead to the creation of new employment opportunities. It is expected that revenues generated thanks to the application of this directive should account for up to 60% of all revenues resulting from the implementation of the single EU market.
- III. Growth in job creation in all member states** – total employment will rise, but productivity increases and the relocation of the labour force will lead to reductions in employment in all sectors. Most employment opportunities will be created where the largest reductions in barriers are made. Net employment in the whole Union will rise by up to 600,000 jobs. Consumers will profit from higher wages (+0.4%), businesses will have greater opportunities for international expansion and also greater returns on equity (+1.1%).
- IV. Intensification of trade in services** – after the barriers are removed, the single internal market will become more integrated. Both cross-border trade in services and establishment in foreign member states will rise. This will lead to a greater range of services and stronger competition. For example, the estimated growth in cross-border trade in the EU in specialised services (legal, accounting, economic and advisory) is 9.4% and the increase in establishment is 2.7% for these types of services. In contrast, in IT services, personnel agencies and estate agents the implementation of the directive will lead to an increase in cross-border trade by 1% and growth in cross-border establishment by 2.5%.

Future of Draft Services Directive

The draft Bolkestein directive was approved by the European Commission in **January 2004** and, according to its author, it was to be the greatest push to the single internal market since its inception. Due to the elections to the European Parliament and the start of a new European Commission, the approval process was delayed.

Opposition to the draft, however, was soon seen and came from the richer member states **France, Belgium, Austria, Sweden and later Germany**, which primarily did not like the key country of origin principle. They were supported by **unions and socialist MEPs in the European Parliament**. The reason was that they were worried a massive influx of service providers from the new member states would make domestic companies uncompetitive on price, which would lead to an increase in unemployment in the richer member states. Another reason was fear of “**social dumping**” and a risk to their own social standards, if companies providing services outside their homeland could be governed by the regulations of their home country.

The new European Commission realised the draft was politically impossible and started to discuss “**softening it**”. The services directive is to be approved by a qualified majority in the Council using the joint decision-making procedure, where the Council and the European Parliament have to agree on the text of the legislation.

The key battle over the directive's fate was fought at the spring European Union summit in Brussels, where the highest representatives of the member states agreed that the **directive should be redrafted**, so as not to threaten the European social model. The European Commissioner responsible for the internal market Charlie McCreevy then announced that the controversial **country of origin principle would be altered**, so as not to undermine higher wages and social standards in the richer member states. McCreevy also announced that health care will be **completely excluded** from the directive's remit. The Commission will rework the draft after the first reading in the European Parliament. The fact that service liberalisation in the EU has not been completely withdrawn can be regarded as a partial success.

The draft services directive went to the **European Parliament** in April. The rapporteur for the directive, the German Social Democrat Evelyn Gebhardt, made significant amendments to the draft. She is proposing replacing the key country of origin principle with the term **mutual recognition** of standards of services provided. Gebhardt regards mutual recognition as more related to further harmonisation. This should mean that **the same standards apply in all countries** in an absolutely free internal market. This principle would also not apply to employment legislation, including remuneration, working conditions, health and safety. The European Commission has repeated several times that employment law is not within the directive's remit, although Gebhardt says this was not clear from the original text and thinks it is necessary to say so clearly. Gebhardt is also proposing that “**public interest services**” remain **outside the directive's remit**; this would apply to health care, education, public service media, cultural services and also games of chance and lotteries.

Deputy Chairman of the European Commission Günter Verheugen came out strongly against a change to the main country of origin principle. The same position was adopted by the European Parliament Committee on Industry, when they discussed the directive. The first reading in the European Parliament will probably be **in September**, after which the Commission will present its own proposals for amendments to the directive to make it politically more acceptable.

The Czech Republic supports the **adoption of the directive**, but has several reservations. “For example we want **taxation, lotteries and games** to be excluded from the directive,” said Martin Líčeník of the Czech Ministry for Industry and Trade. Liberalisation should also not concern services performed in the general interest, which, however, should first be defined. According to Líčeník, **social services, education, medical care and transport** should be considered.

It will be interesting to see how the discussion on service liberalisation in the European Union develops. The approval, rejection or excessive softening of the proposed services directive will answer the question of whether member states' leaders mean the Lisbon strategy and attempts to maximise economic growth and employment **seriously**, or whether they will remain mere **political proclamations**.