

Liberalization of trade in services in the EU: implications for larger new member states (NMS)

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Proposal for a Directive of the European Parliament and of the Council of 13.01. 2004



- This proposal for a directive provides a legal framework to eliminate the obstacles to the freedom of establishment for service providers and the free movement of services
- The approach adopted entails the removal of barriers which may be dismantled quickly.
- For the others, the proposal foresees the launching of a process of evaluation, consultation & complementary harmonization of national regulatory systems for service activities.

European Commission's 2004 proposal for a Services Directive: importance of CoOP



- principle whereby once a service provider is operating legally in one Member State, it can market its services in others without having to comply with further rules in those "host" countries (provider is only subject to the law of the country in which he is established)
- *Prohibition of restrictive legal requirements.* This holds for discriminatory requirements directly or indirectly based on nationality or residence.
- The proposals include several elements that will help eliminating the obstacles to the *freedom of service providers to establish themselves* in other Member States.
- In addition: measures *for establishing mutual trust between countries* consist of the harmonization of legislation

Examples of existing barriers to trade in services in the EU:



- local residence of management;
- special licenses, requirements for additional diplomas;
- local professional insurance;
- constraints on the use of home country inputs;
- restrictions on marketing, inter-firm cooperation, or the juridical form of the company;
- a multiplicity of regulatory agencies;
- fuzzy implementation procedures.

Proposed elimination of barriers to the freedom of establishment for service providers



- Under the proposed directive, the Member States undertake to remove unnecessary barriers which prevent or discourage efforts to establish.
- establishment of single points of contact & the obligation to make it possible to complete these procedures by electronic means;
 - the prohibition of certain particularly restrictive legal requirements; particularly discriminatory requirements based directly or indirectly on nationality
 - the obligation to assess the compatibility of certain other legal requirements
- restrictions on the number of documents required and the introduction of electronic procedures.

Need for establishing the mutual trust between Member States



- the proposal advocates:
 - the harmonisation of legislation in order to guarantee equivalent protection of the general interest on vital issues, such as consumer protection:
 - particularly as regards the service provider's obligations concerning information,
 - stronger mutual assistance between national authorities with a view to effective supervision of service activities the development of measures to promote the quality of services, such as voluntary certification of activities, quality charters or cooperation between chambers of commerce and of crafts;
 - encouraging codes of conduct

Arguments of advocates of liberalization of trade in services



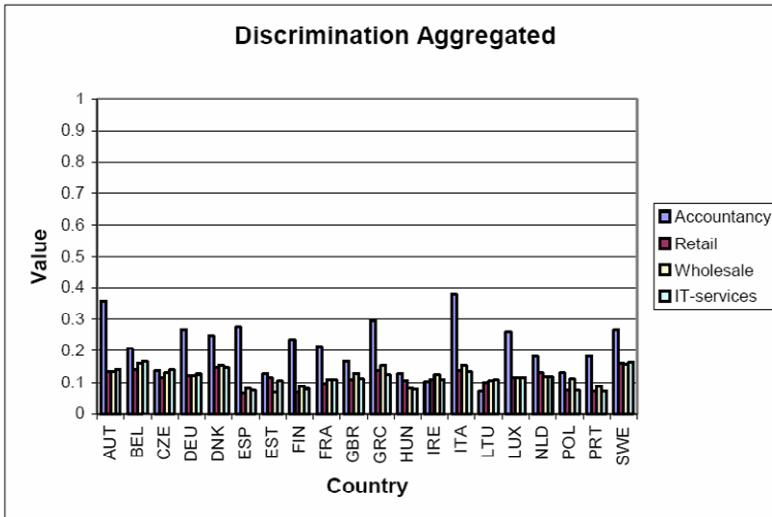
- Reducing barriers to service provision: intensifies competition and forces firms to cut prices to the benefit of consumers, governments and businesses both within and outside the service sectors.
- Barrier reductions also reduce costs and increase productivity, because barriers waste real resources.
- → The economic effects are thus caused by both stronger competition and reduced costs in the EU services sectors.

Implications of barriers



- additional fixed costs for entering a particular foreign market.
- a loss of potential scale economies.
 - fixed qualification costs are *specific* for a national market,
 - regulation heterogeneity restricts the realisation of economies of scale in complying with regulations,
 - increases costs for internationally operating services firms.

Example of barriers in some sectors: foreign discrimination aggregated



Source: Copenhagen Economics IMRIS database.

Estimated gains from single market (COP) Directive: according to *Copenhagen Economics* (2005, p.12-13)



- Reducing all barriers by 50%: largest reduction for regulated professions (accountancy), the smallest for business services;
- Real wages will grow up by approximately 0,4 per cent;
- Total welfare gain 0,6 (as a percentage of comprehensive consumption), or € 37 billion & 0,7% in extended scenario;
- Reduction of prices & costs of provision of services: EU become more competitive *vis-a-vis* external world;
- Expansion in output in service sectors by approximately € 33 billion;
- New employment opportunities: about 600 thousand new jobs; (about 0,3% of active population)
- Expansion of trade in services

Estimated gains from Services Directive: The estimate made by *Copenhagen Economics 2004*: summary



Table 2-5: Economic effects of the Services Directive

	Direct policy impact scenario	Extended impact scenario
Economy-wide effects		
Welfare	0.6 %	0.7 %
Real wages	0.4 %	0.4 %
Employment	0.3 %	0.3 %
Services sectors		
Employment	0.5 %	0.5 %
Value added	1.1 %	1.1 %

Note: All results are reported as percentage changes from the benchmark. Welfare is measured as comprehensive consumption.

Source: CETM model - Copenhagen Economics.

Expected impact of proposed EU measures on intra-EU policy heterogeneity, by sub-domain, with CoOP; by: *European Network of Economic Policy Research Institutes (ENERPI) 2006, Tab 2.2.* R. De Bruijn, H. Kox, A. Lejour



Components of heterogeneity indicator & covered policy domains	Average bilateral heterogeneity between 14 EU members states (1998)	Reduction due to implementation of the EU directive
Regulatory and administrative opacity	0,38	66-77%
Explicit barriers to trade	0,21	73-78%
Administrative burdens on starts-ups	0,55	34-46%
Barriers to competition	0,32	29-37%
State control	0,42	3-6%
Overall PMR heterogeneity indicator	0,39	31-38%

Based on detailed item-wise consideration of the match between the EU directive and the 184 specific regulation items selected from the OECD data base

European Network of Economic Policy Research Institutes (ENERPI) 2006: the model used to simulate impact of liberalization



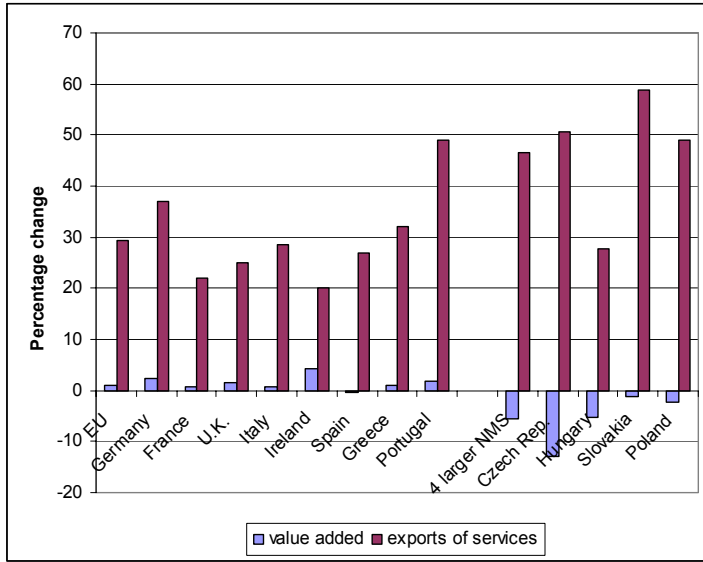
- Analysis of trade induced effects only
- The increase in trade will affect trade and production patterns, consumption and prices.
- The sector of other commercial services will be most affected; but changes in the demand for factor inputs, and shift in the provision of commercial services in Europe will also affect other economic sectors.
- They use an applied general equilibrium model, WorldScan (based GTAP data base)

European Network of Economic Policy Research Institutes (ENERPI) 2006: the scope of the model

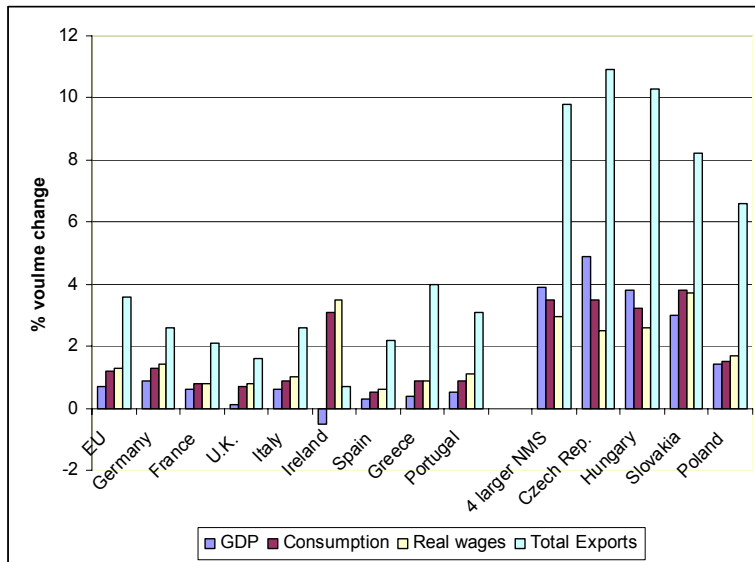


- 23 countries in the EU and regions and the U.S., rest OECD, and rest of the world.
- 10 sectors: agriculture, energy (primary energy and electricity), four manufacturing sectors (high, high-medium, low-medium and low technology), three services sectors (transport, other commercial and other) and a R&D sector plus a labor market, and a capital market
- Scale economies
- Consumers demand the various goods and services, and provide labor and capital to the firms. They consume goods and services in different proportions, depending on their prices and the income elasticities of these goods and services.
- Calibration of the model: GTAP data base (version 6). The time path between 2001 and 2004 has to include the accession of the new member states to the internal market.

Estimated: changes in other commercial services as a result of Services Directive (upper bound, % change), ENERPI 2006, Table 4.4



Estimated macroeconomic effects of Services Directive (upper bound, % change in volume): ENEPRI 2006, Table 4.2.

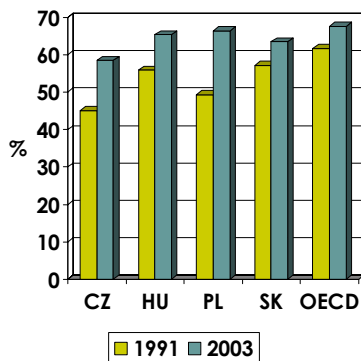


The importance of CoOP in liberalization of services for new members states (NMS)



Contribution of all services to GDP

Contribution of services
to gross value added

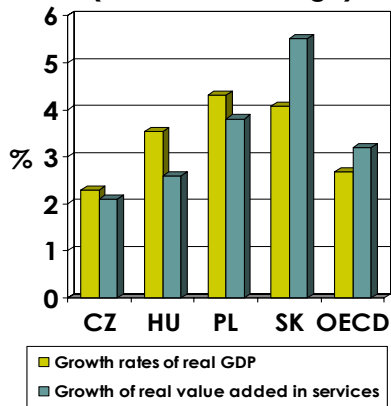


Source: OECD in figures, various editions.

Growth rates



Growth rates of real GDP and value added in services (1995-2003 average)

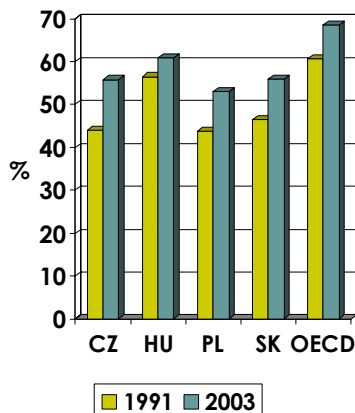


Source: OECD Factbook 2005.

Employment



Civilian employment in service sector



Source: OECD in figures, various editions

The country-of-origin principle (CoOP) is formulated in article 16 of the proposed Services Directive (EC 2004):



- Member States shall ensure that providers are subject to only the national provisions of their Member State of origin which fall in the coordinated field. [... This] shall cover national provisions relating to access to and the exercise of a service activity, in particular those requirements governing the behaviour of the provider, the quality or content of the service, advertising, contracts and the provider's liability.”
- Member States **may not**, for reasons falling within the coordinated field, restrict the freedom to provide services in the case of a provider established in another Member State, in particular, by imposing any of the following requirements:
 - (a) an obligation on the provider to have an establishment in their territory;
 - (b) an obligation on the provider to make a declaration or notification to, or to obtain an authorisation from their competent authorities, including entry in a register or registration with a professional body or association in their territory;

Departure from COP requires, in many case, requires the establishment of the company in the host country (usually high cost)



- Departure from CoOP requires, in many cases, the establishment of the company in the host country (be it by acquisition, branch office or new company).
- Establishment was seen as necessitating relatively high fixed costs. Because of this, large case study firms were more likely to establish than small and medium-sized firms (according to PWC report)
- Approximately 40% of the barriers to establishment cited by case study firms will potentially be reduced by the Directive:
 - for example, multiple requirements from different organizations for the same information but in different formats and with different certifications; restrictions over the legal form which a branch can take;

Implications of CoOP: expected impacts of proposed EU measures



Components of heterogeneity indicator & covered policy domains	Full implementation of Services Directive		Implementation of Services Directive without CoOP	
	Reduction due to implementation of the EU directive	Remaining policy heterogeneity average all EU countries	Reduction due to implementation of the EU directive	Remaining policy heterogeneity average all EU countries
Regulatory and administrative opacity	66-77%	0,09-0,13	39-45%	0,21-0,23
Explicit barriers to trade	73-78%	0,05-0,06	41-45%	0,12-0,12
Administrative burdens on starts-ups	34-46%	0,30-0,36	34-45%	0,30-0,36
Barriers to competition	29-37%	0,20-0,23	19-25%	0,24-0,26
State control	3-6%	0,39-0,41	3-6%	0,39-0,41
Overall PMR heterogeneity indicator	31-38%	0,24-0,27	22-27%	0,28-0,30

Based on detailed item-wise consideration of the match between the EU directive and the 184 specific regulation items selected from the OECD data base, ENERPI, 2006, Table 2.3.

Simulation effects: Impact of proposed Services Directive (with and without the CoOP) on intra- EU bilateral trade in services (in %)



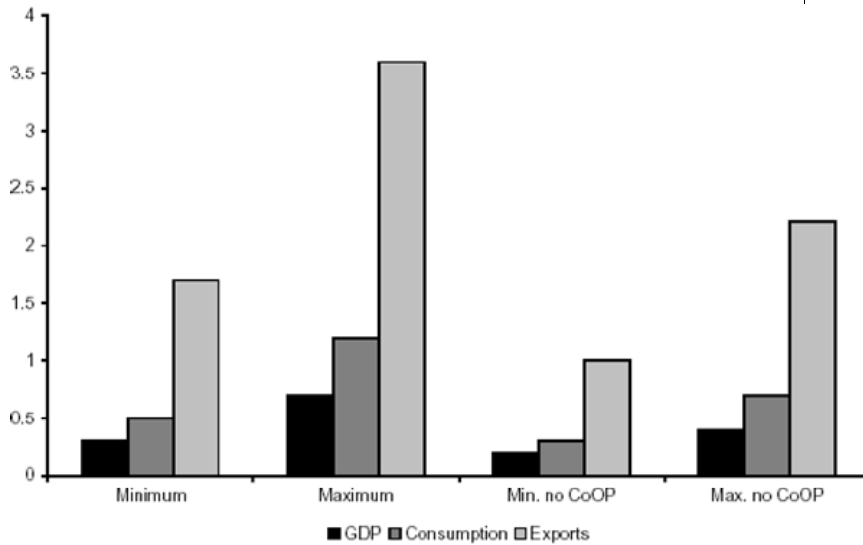
	Minimum	Central	Maximum
Effects for total intra-EU trade in Other Commercial Services, Directive without CoOP	19	28	38
Effects for total intra-EU trade in Other Commercial Services, full implementation of Directive	30	44	62
Difference -	-11	-16	-24

Source: Kox *et al.* (2004a) presents the details of this analysis. Effects are derived from the parameter estimates in Table 2.1 and the reduction in heterogeneity (Table 2.3)

The trade effects differ substantially by country. In the case of the maximum effect:

- The new Member States, Poland, Czech Republic and Hungary will at least double their intra- EU trade.
- Greece and Portugal could expect a doubling of intra-EU service exports;
- Four countries may gain between 70 and 90 per cent (Austria, Italy, Spain, and Denmark);

Macroeconomic effects of Services Directive with & without the CoOP for the EU ENERPI



Comparison of result with & without CoOP for NMS (upper bounds), ENEPRI 2006,

