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How to build European services markets

By John Springford

CENTRE FOR EUROPEAN REFORM

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★ Europe's leaders are casting around for ways to improve the EU's economic performance. In the long term, a more integrated single market for services could improve Europe's weak productivity growth.

★ The EU's services markets are mostly national. So markets are small, Europe's services firms do not face enough competition, and productivity growth is slow.

★ The EU should make member-states fully implement existing directives designed to free up services; move towards mutual recognition of each other's services regulations; and stop member-states watering down Brussels directives when they are incorporated into national laws.

The single market is one of the EU's greatest achievements. Much more than a free trade agreement (which eliminates tariff and subsidy barriers to trade), the single market tackles trade constraints arising from non-tariff barriers, such as different regulatory regimes among member-states. Most economists believe that these barriers are the biggest impediments to cross-border commerce.[1] However, the single market is far from complete, and greater integration could play a significant role in addressing some of Europe's long-term economic challenges.

Europe has two growth problems. The first is cyclical: several member-states are struggling with a hangover of private sector debt which is driving some countries towards insolvency and hampering recovery in others. The second growth problem is structural. The EU's productivity growth has been weak since the mid-1990s. Developed countries' long-term growth is mostly founded upon increases in productivity, so Europe's poor performance in this regard is troubling.

Structural reforms are necessary to improve Europe's rate of productivity growth and lift its long-term growth potential. Most structural reforms are national in scope: Spain, Italy, Portugal and Greece must all reduce the cost of hiring and firing employees, which would help to boost employment. Germany's services sector is over-regulated. French workers need to work longer hours and retire later. The UK's planning decisions need to be made far more quickly, and give more encouragement to development.

But action can also be taken at the EU level. A more integrated single market is one tool to squeeze more growth out of the EU's land, labour and capital. The single market, by reducing barriers to entry to national markets, allows more productive firms in one country to take market share from less productive ones in another. In doing so, it encourages firms to make their current products cheaper or to come up with new, better products.

It is therefore unsurprising that economically liberal governments are championing a deepening of the EU's single market. Mario Monti has played an important role in this process. In 2010, when president of Bocconi University, he submitted a report to the European Commission president, José Manuel Barroso, identifying a host of restrictions that still hamper cross-border trade. In February 2012, as prime minister of Italy, he enlisted 11 other EU leaders to sign a letter calling for greater market integration across the EU.[2] The 12 signatories are right to use the region's economic malaise as an opportunity to push for a deepening of the single market: although it would do little to boost economic growth in the short term, over time further single market integration will help to raise productivity growth.

Alongside reforms at the national level, extending the single market is one way to improve the European economy's long-term growth prospects. EU member-states must integrate national markets in services – which make up the majority of output across the EU economy, and where the productivity gap with the US is largest.

1: Paul Krugman, 'Growing world trade: Consequences and causes', The Brookings Institution, 1995.

2: *Daily Telegraph*, 'David Cameron and EU leaders call for growth plan in Europe: Full letter', February 20th 2012.

This policy brief provides an overview of the development of the single market since 2008. It surveys the differences between the EU and other developed countries in productivity and trade integration and suggests what action is needed to promote further integration in services where markets remain stubbornly national. It concludes by asking whether there is much appetite for further liberalisation of cross-border trade in services.

1. The state of the market

The single market has held up well during the economic downturn. Deep recessions tend to give rise to protectionist pressures as governments are tempted to help out struggling industries. Some individual cases have been widely reported in the press as evidence of a lurch towards protectionism: France's €6 billion bail-out of its car industry in 2009 being one such example. Yet the amount of state aid that governments have been handing out to industry has not risen significantly over the course of the crisis: it increased by only 0.07 per cent between 2007 and 2010. This slight rise was sanctioned by the EU: state aid rules were temporarily eased between 2008 and 2010 to allow governments to help struggling firms get access to capital. Sectoral and ad hoc state aid, which is direct subsidy to single firms or industries, declined slightly over the period (see chart 1).

Banks in many EU countries have of course been recipients of vast amounts of direct and indirect aid – and in some cases have been fully or partly nationalised. Yet aid to the banks, reluctantly given, does not denote enthusiastic protectionism. Governments had no choice but to step in to stabilise financial systems.

Other measures suggest that the single market has held up well. Governments could have tried to protect their economies by delaying single market legislation, or refusing to sign it into law. Yet there is little evidence that governments have done so. The number of infringement cases, brought against member-states for erecting regulatory barriers, fell from 212 in 2007 to 128 in 2010. The proportion of single market rules transposed into national laws dipped slightly, but hardly catastrophically, from 99.3 per cent in 2007 to 98.6 per cent in 2009 (see table 1).

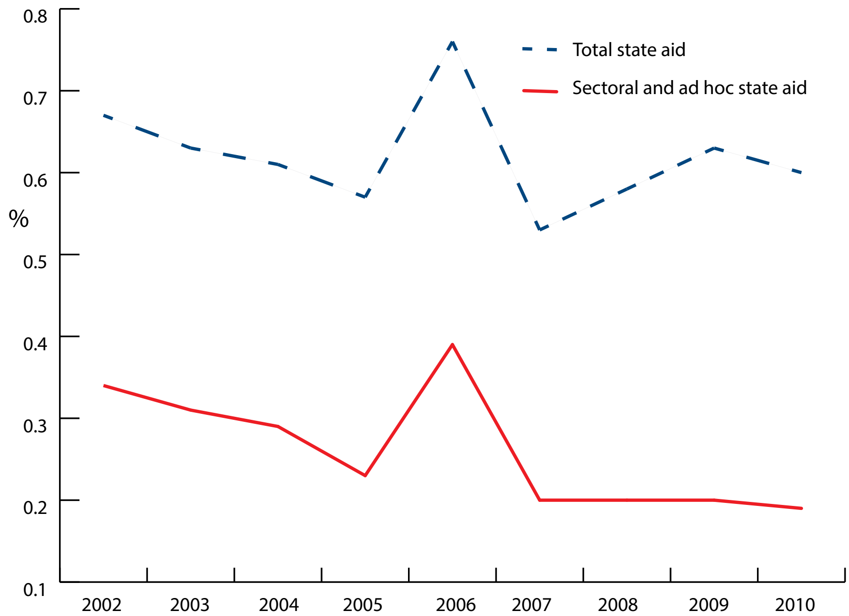

Chart 1: EU member-states' state aid, 2002-2010, per cent of GDP

Source: Eurostat

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Percentage of single market rules transcribed	98	97.7	98.9	99.1	99.3	98.5	98.6	98.8	98.8
Number of infringement cases heard at the ECJ	214	193	170	193	212	207	142	128	no data

Table 1: Infringement cases and single market laws transposed, 2003-2010

Source: Eurostat

However, member-states have been taking longer to pass single market directives into national law. In 2011-12, member-states have taken eight months longer than the deadline set by the Commission, on average, up from five-and-a-half months in 2010-11. A proportion of directives are wrongly transposed, as national parliaments add more rules to the original text – so-called 'gold-plating'. Sometimes gold-plating is intended to make legislation clearer than the original directive. Often, however, it weakens the directive's impact by creating loopholes and reservations. But this is not significant – only 0.8 per cent of directives were gold-plated in 2011-12, the same proportion as the year before.[3]

Europe has suffered a severe decline in trade over the course of the financial and euro crises. Intra-EU exports and imports fell by a quarter from the 2007 peak to the 2009 trough. But the cause was financial turmoil, rather than resurgent protectionism. The rules and institutions governing the single market remain intact.

The single market is still incomplete

The fact that the single market has proved resilient does not mean that it is complete. In this context, a comparison with the United States is instructive. Both economic regions are highly developed. Both are economies on a continental scale, and comprise states that conduct most of their trade between themselves. However, the US is a single continental market, with a single set of regulations covering almost the entire economy. Non-European OECD countries are also helpful as points of comparison; these countries have tried to boost trade mostly through the reduction of formal tariff barriers. The US and the rest of the OECD offer us rough comparators to appraise the performance of the single market in recent decades. They also point to priority areas for further single market integration.

Trade between EU member-states has grown significantly more than between other OECD countries since the single market was formally introduced in 1992 (see chart 2). Among the twelve original members of the single market, the proportion of GDP accounted for by trade grew by an average of 1.6 per cent per year between 1992 and 2009 (from 34 per cent to 55 per cent). The Nordics that joined in 1995 have done even better, averaging 2.1 per cent, and central and eastern European countries' trade has grown by an average of 3.7 per cent per year since 2004, when they joined. In comparison, other OECD countries' trade only grew by 0.8 per cent a year between 1992 and 2009.

> *"The fact that the single market's rules and institutions have proved resilient does not mean that it is complete."*

This comparison only tells us so much. Non-European members of the OECD are all geographically further apart, which raises transport costs: they do not have the natural advantage of EU states' proximity to one another. However, trade between Mexico, the US and Canada, which signed the North American Free Trade Agreement in 1994, only grew by 0.7 per cent per year as a proportion of the region's GDP. This suggests that a single market that tackles both tariff and regulatory barriers is far more effective than a free trade agreement (see chart 2).

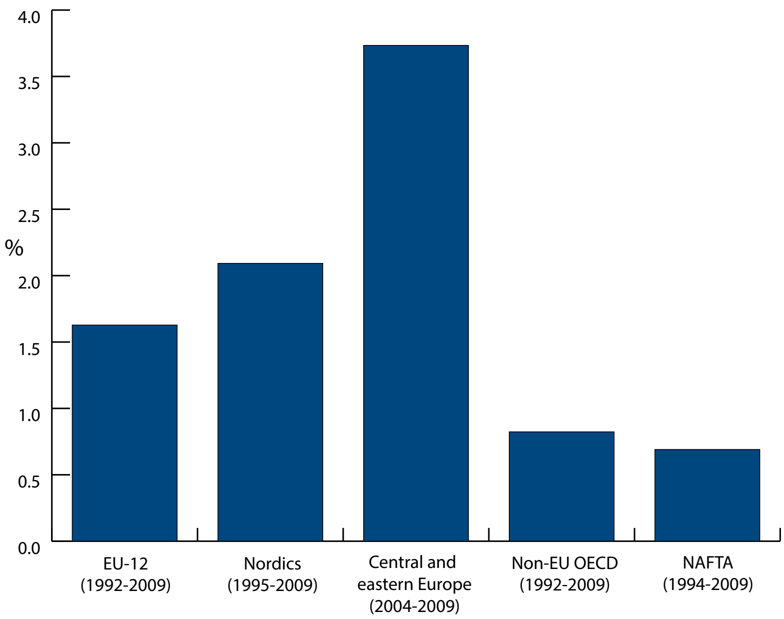

Chart 2: Trade growth, EU, OECD and NAFTA (per cent of GDP)
Source: OECD

3: European Commission, 'Making the single market deliver: Annual governance check-up,' 2011.

In aggregate, therefore, the EU has integrated faster than the rest of the world since 1992. However, it still has a long way to go to match the degree of integration achieved by the US. Trade between the American states, as a percentage of their GDP, is 70 per cent higher than the EU-15.[4] In 2009, the EU-15 traded 55 per cent of their output, while the American states traded 93 per cent.

That difference is down to the US's much more integrated services market. The large majority – three-quarters – of the growth in trade within the EU has come from rising trade in goods.[5] There is still significant 'home bias' in services: citizens of the EU-15 buy 94 per cent of their services from firms based at home. Services make up 70 per cent of the EU's output and employment. With less trade comes less competition: the EU's services markets are still national, by and large, which hampers productivity growth.

The absence of an integrated market for services explains part of the divergence in productivity between the US and the EU over the last 20 years. Between 1995 and 2007 EU productivity grew by 1.5 per cent a year, compared to 2.1 per cent in the US. The long-term productivity gap between the US and EU has been almost entirely attributable to the slower development and take-up of information and communication technology (ICT) in the EU, and the failure of service providers to implement new organisational methods that maximise ICT's benefits.[6]

Productivity has grown fastest in mature economies that design and manufacture information and communication technology and deploy it. ICT has a large impact on productivity growth in services. It allows firms to break up services production into bits, as mobile phone companies subcontract customer service to specialist call centre firms, for example. It makes production faster: contemporary academic researchers struggle to imagine how their predecessors coped before Google Scholar or databases stored on the internet. It speeds distribution, as services can be delivered remotely via the internet or telephone: stock exchanges have gone almost entirely digital, allowing them to conduct faster transactions between more traders. Electronic technology also provides economies of scale in some sectors. The global supply chains of large retailers would be impossible without it.

> *"The EU still has a long way to go to match the degree of integration achieved by the United States."*

To accelerate the deployment of ICT and close the productivity gap with the US, Europe needs much greater competition. This is where a more integrated single market could help. The threat of firms entering home markets would create incentives for firms to invest more in ICT and to reorganise themselves in order to make best use of the technology. Firms would have access to larger markets, which would encourage them to make the investments needed to take advantage of economies of scale.

Weak competition leads to divergences in prices across the EU, as incumbent firms can sell at high prices without fear of losing market share to foreign firms. Price dispersion has been falling since 2004 in the accession member-states in Central and Eastern Europe, as they have integrated with the west. But prices have been converging much more slowly in the 15 Western and Nordic member-states (see chart 3).

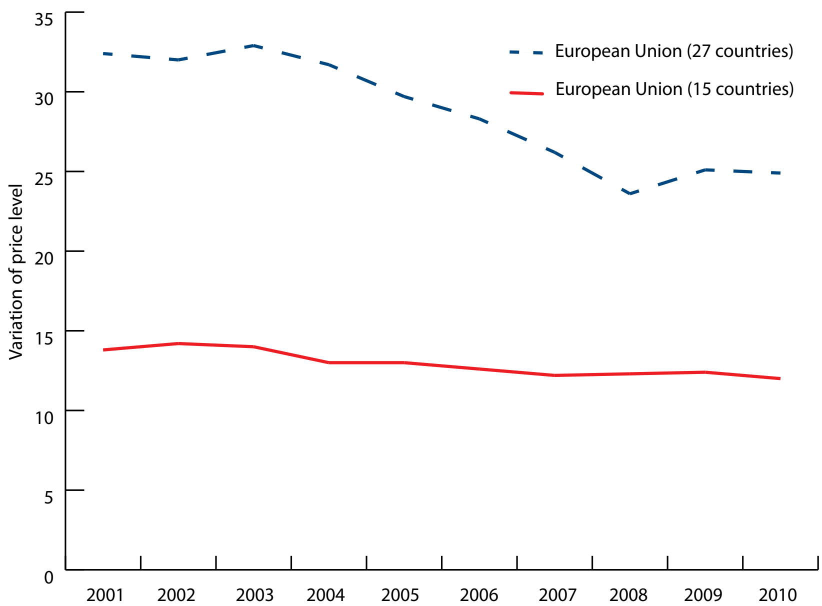

Chart 3: Price convergence between EU member-states, 2001-2010

Source: Eurostat

4: European Commission, 'Steps towards a deeper economic integration: the internal market in the 21st century', January 2007.
5: OECD, Macro trade indicators data.
6: Bart van Ark, Mary O'Mahony and Marcel P. Timmer, 'Productivity and economic growth in Europe: A comparative industry perspective', International Productivity Monitor, 2011.

Europe's services industries are far less dynamic than those of the US. The EU has nearly three times as many services firms as the US, despite their being similar-sized economies. These additional firms are small, with fewer than ten employees.[7] Small firms are less able to split up tasks between employees and they use technology less intensively; they therefore raise costs to consumers. In competitive markets, more productive firms take market share and grow, boosting competition.

The economic evidence is overwhelming that trade liberalisation between developed countries improves economic growth. There is a growing European political consensus that further single market integration can help improve Europe's economic performance. Services regulation and industrial dynamism should be the priority. But what reforms should be made?

2. Next steps

To help close the productivity gap with the US, the EU needs to lower the barriers created by the costly patchwork of national regulations and open national services markets to competition.

The European Commission recognises this, as do the 12 signatories to the 'Monti letter'. The Commission has accordingly proposed a new Single Market Act, to 'complete' the 1992 original, which the parliament plans to adopt by the end of 2012. The details of various proposals to give substance to the Act are currently being discussed in Brussels. They include a single market for venture capital; further efforts to harmonise product standards in services; a 'European Professional Card' (to ease recognition of diplomas across the continent); a unified patent system; stronger public procurement rules (to boost foreign firms' access to public sector contracts); and steps to improve energy, transport and telecommunications connectors between member-states, in an attempt to create a common infrastructure for the single market.

"Services make up the great majority of economic activity in most developed economies."

All of these measures are welcome. Yet the 2006 services directive, which attempted to reduce barriers to entry in national services markets has only been a partial success, new data shows. Europe needs a plan that goes beyond the Single Market Act, which does more to help firms to cross borders, and steps up enforcement of member-states' implementation of single market legislation. Such a plan is outlined below.

How to knit services markets together

Services make up the great majority of economic activity in most developed economies. In France and the UK, they constitute nearly 80 per cent of economic activity. Even in Germany, which has a large manufacturing sector, services make up 72 per cent (see chart 4).

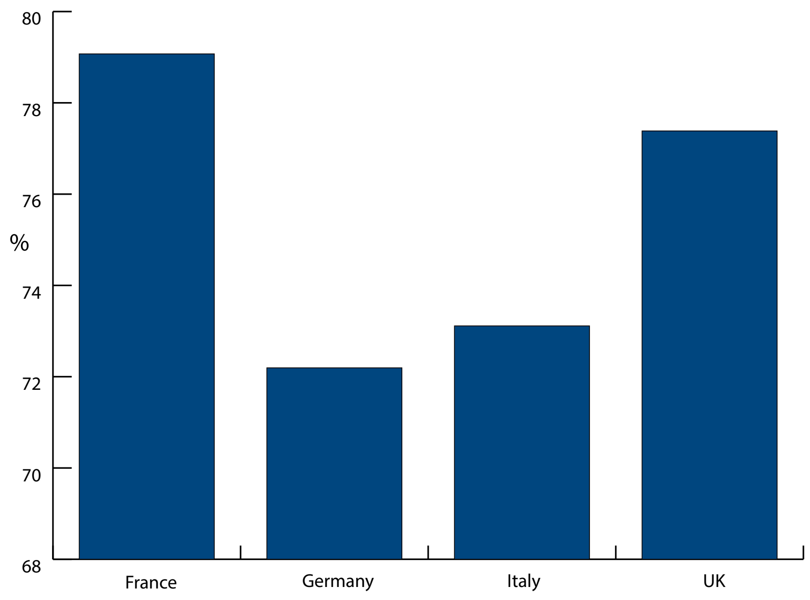

Chart 4: Services value added as a percentage of total value added

Source: Eurostat

7: OECD, Structural business data.

Services markets tend to be heavily regulated. And many EU member-states have had a tendency to jealously guard their right to police these markets: they argue that since their citizens face potential risks from poorly regulated foreign firms, with inferior product standards and working conditions, and low wages, they should retain a certain degree of regulatory discretion. High levels of regulation, as well as big divergences between national regulations, have hampered the provision of services across borders. Richer member-states also worry that services liberalisation will stoke tensions over immigration. It is difficult to differentiate trade in services from labour migration, in many instances. A Hungarian care worker may move to Germany to work, and send money home, which helps German social care firms and the elderly, as well as the care worker. But other care workers may fear for their wages. Thus services migration causes political and social problems for national governments.

Many in Brussels argue that the 2006 services directive provides the framework to solve this problem – but that some member-states have been slow to implement it. The directive aimed to open up services markets in two ways. First, it enshrined the freedom of establishment for services companies in another member-state, by stopping host countries from demanding a more onerous registration process or more stringent regulation for foreign companies. Second, it made member-states set up 'points of single contact', so that companies entering the market do not have to register with multiple agencies.

However, the services directive left national governments with too much discretion to decide what constitutes a barrier to establishment, or a barrier to the provision of services across borders. This has meant that the total reduction in barriers to entry has not been as large as the authors of the directive hoped.

For example, in professional services (business consultancy, law and accountancy) many member-states require a partnership model with minimum shareholding, so that the firm's partners hold a minimum level of capital in the business. Foreign companies that do not use this model are denied access, unless they change their ownership structure. The services directive allowed member-states to decide for themselves whether this was 'proportional', and did not constitute a barrier to entry for firms in other countries. Hence many governments decided to leave the law unchanged. Some member-states also decided to leave their laws on company insolvency insurance unchanged: many still require that firms buy insurance from a local provider, and do not recognise insurance held in another member-state.[8]

In 2010 and 2011, the Commission and national regulators conducted a 'mutual evaluation exercise', through which member-states reviewed each other's implementation of the directive. In June 2012, the Commission released an analysis of the results, which showed the extent to which member-states have reduced barriers to entry. Using the Commission's data, it is clear that member-states did not cut barriers to entry to the degree initially hoped (see chart 5). Some member-states, such as Slovakia and Slovenia, cut the numbers of barriers significantly – by more than half. Yet France, Germany, Italy and Austria retain highly protected services industries, compared to the leaders, Ireland and the UK. Across the EU, the average number of restrictions on establishment or cross-border provision fell by a third; the majority of barriers still remain, as member-states labelled them 'proportionate'.

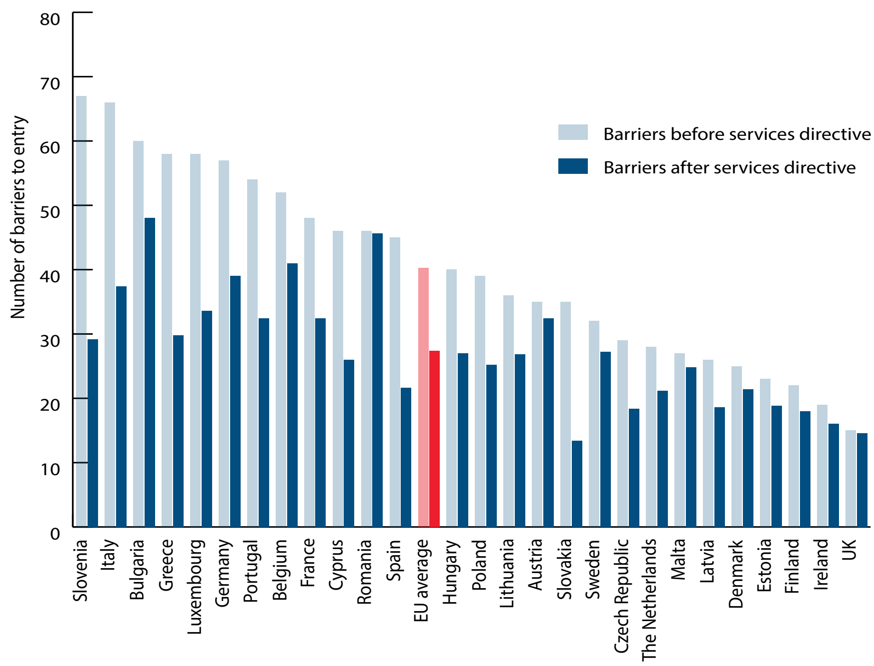

Chart 5: Member-states' reduction of barriers under the services directive

Source: European Commission, 'The economic impact of the services directive: A first assessment following implementation', June 2012, Annex II.

8: European Commission, 'Communication on the implementation of the services directive', June 2012.

While the reduced barriers to entry achieved by the directive are a good start, large gains are evidently still to be made. The Commission calculates that the services directive, as implemented, will boost EU GDP by 0.8 per cent, with most of that growth coming in the next five years. But if member-states reduced barriers to the level of the top five countries, it would double that figure to 1.6 per cent.[9]

Furthermore, there is little to stop countries rebuilding barriers to entry. The mutual evaluation exercise was a one-off, and the Commission lacks the skilled manpower necessary to sift through all future national legislation to stop member-states reinstating rules or coming up with new ones.

The mutual evaluation exercise should therefore become a permanent review of services regulation. National regulators could meet – perhaps every two years – in regulatory colleges to review each other's legislation and point out which national rules hamper market integration. This should encourage reluctant national regulators to change course. For those rules which must be changed through primary legislation – those which regulators do not have the discretionary power to alter – the college should report its findings to the Commission, which should put pressure on the member-state concerned to remove them.

Such a method would make the implementation of the services directive a continuous process for the removal of barriers to entry in services markets. However, in the medium term, the EU needs a plan to remove more of the barriers to trade that national services regulations erect. The services directive was limited to explicit barriers to establishment and firm entry. Different national regulations that are not explicitly protectionist still impose barriers. For example, if a travel operator seeks to establish branches in another member-state's market, it must sign up to a whole new set of regulations: professional qualifications, rules about cancelled trip insurance and consumer information, and so on. This process is costly, in terms of both completing the paperwork and re-organising the firm's production process.

The original draft of the services directive sought to resolve this problem through the 'country of origin' principle. This would have allowed a services firm to set up temporarily in another member-state and be regulated at home. France and Belgium, in particular, feared that the principle would have resulted in a race to the bottom in services standards, as companies could enter their markets but be regulated abroad. Trade unions and some professional organisations were heavily opposed. The principle was eventually excised by the European Parliament. Yet it would have reduced the cost of cross-border commerce considerably, as a firm would have faced no additional regulatory requirements in order to sell services in the host country, at least temporarily.

9: European Commission, 'The economic impact of the services directive: A first assessment following implementation', June 2012.

The country of origin principle is, in essence, 'mutual recognition' – member-states recognise each other's regulations, and allow firms regulated abroad to enter their markets. Yet the 'big bang' approach taken in the services directive draft – trying to push the country of origin principle across many markets – inevitably led to opposition. Instead, the EU needs a plan to gradually extend mutual recognition, market by market. By advancing slowly, it would be less painful for national politicians and MEPs, who face opposition from labour and producer interests at home.

> *"The 'big bang' approach taken in the original services directive inevitably led to opposition"*

Arguments about mutual recognition in the services sector are miniature versions of the wider debate about globalisation, and nation-states' responses to it. By allowing foreign producers and workers in, do societies enjoy cheaper products and a higher standard of living, but force their citizens to accept more risk? After all, firms and workers might be forced out of the market, or a service might be dangerous or of poor quality. These arguments were repeatedly made during the wrangle over the services directive, especially by producer interests. And many continue to make them. While national politicians and MEPs tend to argue that opening markets is beneficial in aggregate, they find reasons to argue that it is a bad thing in particular cases.

There is little empirical evidence that mutual recognition of goods and services created in one European country endangers consumers in another. Those who oppose the principle of mutual recognition argue that less-regulated services in one country enter markets with stricter rules, exposing consumers to more dangerous or mis-sold products. Yet all EU member-states try to protect consumers from harm, prevent environmental damage, and stop producers from making misleading claims about their products. In addition, since consumers in stricter countries are used to higher quality, those selling to them must cater to their tastes, which ought to drive standards up rather than down.

Similarly, there is little evidence that mutual recognition encourages a 'race to the bottom' in terms of regulatory standards. Opponents argue that regulators are encouraged to slash red tape to win business across the single market for their home firms. But regulatory competition can in fact make regulation more efficient. The single market process forces regulators to appraise which rules are really necessary: the European Court of Justice (ECJ) and the Commission push regulators to make the case for specific regulations, prove that they are not protectionist and address clear failures in the market. This constant process of review encourages regulators to get rid of superfluous rules.[10]

There are reasons to believe that in many services markets integration can rely on mutual recognition with a minimal degree of harmonisation of regulations, but that in others a higher level of harmonisation is necessary. Services markets differ from goods markets in two ways. Services are often intangible – haircuts, football matches and retail sales are classic examples. As a consequence, services markets are often dogged by information problems. First, a buyer of legal services finds it difficult without some form of regulation to know whether one lawyer is better than another (the buyer of an apple can more easily appraise its quality before purchase). Second, many service sectors have monopolistic characteristics. Bank accounts, for example, are contracted services that continue over time, and many consumers face costs, in hassle and expense, in checking the market to see if they could get a better deal. So they stick with the same bank. Consumers may also lack information, and so producers can charge more than their product would be worth in a more competitive market.

These types of markets require different policy interventions at the single market level. Where a service is not contracted over time, and is not the sale of expertise, harmonisation is unnecessary and mutual recognition should suffice. Retail services fall into this category: while it may be difficult to tell whether a pair of shoes will break, if they do, consumers can go to another shop. Thus increased competition will not have an effect on quality: declining sales will force lower quality suppliers to improve or exit the market.

In sum, mutual recognition can be safely introduced to those services where purchases are one-off, and severe information problems are not apparent. Many services covered by the services directive fit into this category: these include tourism; many business services where the purchaser has good information about the quality of the service; data processing; logistics; books, TV, film and music; and retail and distribution.

Potentially, construction is one such sector, and one where the biggest gains from mutual recognition could be made. It could be the first market to open up. It constitutes 6 per cent of EU GDP;[11] there are thousands of very small and inefficient companies confined to national markets; and productivity growth in Europe has been slower than in other services in recent decades.[12]

Buildings construction requires a mix of architects, skilled and semi-skilled builders. For a housebuilding firm based in Sweden to build in Germany, it must find its way through a thicket of regulations. Architects are not regulated in Sweden, but they are in Germany. The 2005 recognition of professional qualifications directive lists only three architecture schools in Sweden whose qualifications must be recognised by all member-states, so if the firm's architects did not train there, they must hire new ones. Similarly, the German regulator requires proof that foreign architects have good standing with their national regulator. But Sweden does not regulate architects. Electricians and plumbers must submit a certificate showing they have taken a vocational qualification. But Sweden allows electricians and plumbers to train on the job, so many do not have them.

> *"Many services markets could benefit from mutual recognition: tourism, business services, construction and retail in particular"*

Yet the quality of Swedish housebuilding is among the best in Europe, because of stringent energy efficiency and building quality standards. Swedish firms are entering the markets of member-states with less onerous registration requirements, such as the UK. They are free to build houses that meet the UK's building quality standards.

More mutual recognition in the construction sector would help to boost productivity: as long as buildings erected by foreign firms meet the host country's quality standards, there is little reason why it should demand evidence of the professional qualifications of those doing the building. If the construction does not meet quality standards, consumers can demand that the work be redone, or take the company to court.

Free movement of services firms does not necessitate a race to the bottom in quality and labour standards. Employment rules and the minimum wage could continue to be set by the receiving country, allying fears about immigrants eroding wages and rights. And most services – other than network services such as water and gas distribution, and public services, like healthcare – do not threaten the environment or the health and safety of employees or consumers. Those that do already have specific EU legislation to regulate them.

In some markets, however, a higher level of regulatory harmonisation may be necessary for the mutual recognition principle to work. This will generally be the case in two types of services markets: those where consumers are 'captured' in contracts that go on for months or years, or where there are wide 'information asymmetries' between consumers and producers. In insurance, consumers pay a premium to cover the risk of something bad happening. But producers can fail to tell

10: Jacques Pelkmans, 'Mutual recognition in goods and services, an economic perspective', Centre for European Policy Studies, March 2003.

11: European Commission, 'Communication on the implementation of the services directive', June 2012.

12: Mohamed Abdel-Wahaba and Bernard Vogl, 'Trends of productivity growth in the construction industry across Europe, US and Japan', Construction Management Economics, 2011.

them about exemptions – or bury them in small print – which make the insurance less valuable than consumers perceive it to be. And in those areas where the well-being, opportunities and health or life of the consumer are potentially endangered – education and healthcare, in particular – member-states will insist upon complete authority even in transactions that do not involve the state; services that keep citizens alive or turn children into citizens will always be too inherently national for most countries to be willing to give up control.

A staged approach to services liberalisation will only work if national regulators trust each other's rules. Colleges of national regulators, such as those set up for the one-off mutual evaluation of the services directive, would help. They could gather and publish information about the levels of regulation in all of the member-states (evidence which is sorely lacking at present). This information could be used to assess whether a particular member-state's rules constitute a threat to others. If so, it could be made to raise them to a common minimum standard before the EU introduces mutual recognition in that market.

The reasons why mutual recognition has been so hard to achieve in services markets are two-fold: first, member-states do not trust each other, and second, the first draft of the services directive was too sweeping, trying to free up all markets at once. A staged approach, that involves regulators' colleges conferring legitimacy on the process and building trust, would be far more likely to work.

How to sharpen enforcement

Brussels may create an array of directives to promote further services integration, but member-states may not implement them.

Member-states often drag their feet on the implementation of directives, or gold-plate them to water them down. According to the Commission's annual check-up of the single market, Sweden, Malta, and the Netherlands take longest to transpose new rules. Belgium, Poland and Italy have the largest backlogs of directives yet to make it into national law. Italy, Poland and France are the worst gold-platers.

Member-states have also prevented the Commission from policing national legislation, to ensure that it accords with EU law. They thwarted the Commission's attempts to force them to show how they had transposed the services directive – and as discussed above, many took advantage of the discretion the directive allowed. National courts have defined various aspects of the e-commerce directive differently, which has forced companies seeking redress to take court action in several member-states at once. The 'SOLVIT' system gives regulators and businesses an informal resolution mechanism for difficulties when doing business in another country. SOLVIT centres in each country put businesses in touch with regulators, to get them to amend rules that constrain freedom of entry, or offer ways around such rules. But the numbers of businesses using the system has been disappointing. In 2011, less than 200 cases were resolved through SOLVIT across the entire EU.[13]

There are three simple things that could be done to give the enforcement process more teeth. First, the Commission could be given the power to take member-states automatically to the ECJ if they fail to transpose law within agreed time limits. In 2011-2012, it took member-states an average of eight months after the agreed deadline to transpose rules. Second, member-states should supply 'correlation tables' – evidence of how well their national legislation fits with each EU directive – so that the Commission can easily tell if a directive has been gold-plated when put on the statute books, and whether the gold-plating is justified. Currently, the Commission has to go looking for the information, but it does not have the resources to do that. Third, the Commission should have powers to enforce automatic time-limits for the removal of gold-plating that has a clear impact upon the functioning of the single market, with the laggards being referred directly to the ECJ.

> *"Member-states often drag their feet on the implementation of directives, or seek to water them down."*

The gold-plating problem could also be tackled by encouraging national regulators to be more involved in the legislative process at EU level. The European Parliament's internal market committee is making encouraging moves in this area: when the Commission proposes new directives or regulations, the committee brings national regulators together to discuss them, as well as putting out the usual consultation documents. This process encourages national regulators to revisit their own rules to examine whether they are proportionate, and helps to create legitimacy for new rules, which in turn discourages gold-plating at the national level. This could be extended. Colleges of regulators could offer advice to the Commission, the internal market committee and others which are involved in the drafting of single market directives.

This process would help to create a 'mutual recognition culture'. The lack of such a culture means that the EU institutions are constantly aiming at a moving target, as national regulators create new red tape which creates barriers to entry. Colleges would help regulators to trust each other, and allow them to share best practice.

13: European Commission, 'Making the single market deliver', 2011.

3. A political opening?

A number of the member-states that have historically thwarted the liberalisation of service sectors remain opposed to it. Countries such as France and Germany still prefer a more managed services economy, and have stood in the way of services, intellectual property and infrastructure liberalisation in the past. They remain sceptical about liberalising the professions, energy, transport and public services. According to the OECD, Germany, France, the Netherlands and Austria have all made fewer efforts to free up their markets than the eurozone periphery has over the last year.[14] However, the arrival of Monti as Italian prime minister has shifted Italy into the liberal camp – at least for a while, if he can survive opposition from the right and left. Previously Italy was one of the main obstacles to more integrated services markets.

The OECD points out that the dire economic straits in the periphery are forcing governments to liberalise their economies. The core countries in the eurozone have made noisy demands for this to happen, while making few similar moves themselves. The current process of liberalisation is therefore one-sided and unfair: it is unreasonable for the core to lecture the periphery on the need for structural reforms without practicing what it preaches. The eurozone's peripheral countries must make structural reforms to their labour and product markets in order to boost their productivity growth. The eurozone crisis offers liberalisers the opportunity to ask Germany: why are you opposing for Germany what you are insisting upon for others?

Now that Italy and Portugal have made large structural reforms, more liberal countries outweigh those in favour of tighter regulation of service sectors. In January 2012, the Monti government introduced legislation to bolster competition among taxi firms, pharmacies, petrol stations, lawyers, and healthcare providers as well as among providers of local public transport. Portugal has allowed longer opening hours for shops and abolished licensing restrictions for many services. The Nordics, UK and Ireland favour freer services markets, as do the central and eastern European member-states.

EU member-states were becoming more liberal in their regulation of services before the crisis. According to OECD data, member-states together reduced the regulatory burden by 9 per cent in three year period between 2003 and 2006 – the last year for which comparative data is available.

France remains overtly hostile or ambivalent about many sorts of liberalisation – and under Socialist president Hollande it may become even more so. While France's services sector is less regulated than Germany's, it retains a protectionist attitude to foreign competition. Yet all single market legislation is now covered by majority voting, and it is difficult for a single country to block liberalising efforts. And Germany may not be a reliable ally in the future. Germany's services sector is still strongly regulated: it still believes that central control of professions and network services improve consumer outcomes. It has, however, taken small steps towards reforms in these areas. Architects are now freer to charge as they see fit; childcare provision has been expanded, and some small energy and transport reforms to boost competition have been pushed through.

Furthermore, tighter labour markets in Germany may encourage a more liberal outlook. Wages are rising in many services industries, especially in skilled work like architecture, law and business consultancy. In other areas with labour shortages, German consumers have to pay comparatively high prices. The government is considering reduced employment taxes for social care workers to reduce costs, for example. Countries are far more likely to be open to services trade when they lack a supply of suitably skilled workers. They recognise that cheaper and more productive firms and workers would be beneficial to consumers struggling with high costs, tipping the balance against producer interests.

> *"Closing the services productivity gap with the United States must be the EU's long-term priority."*

Despite superficial bickering, more member-states are in the process of liberalising their service sectors than are not. Noisy rows about fiscal policy, the governance of the eurozone, migration and financial services' regulation disguise a growing coalition in favour of structural reform. If the single market for services can be extended step-by-step, through mutual recognition, Europe's economies will be able to integrate further while sparing the EU from political paralysis.

14: OECD, 'Economic policy reforms: Going for growth', 2012.

Conclusion

Closing the services productivity gap with the US must be the EU's long-term priority. Services markets constitute the majority of Europe's economic output, and yet they remain frustratingly national. Small, fragmented national markets for services do not generate the competitive forces that the US economy does. So, on a range of measures, the EU comes off poorly: US services firms invest in and deploy ICT much more than European firms do; US firms grow and shrink faster than Europe's; and its productivity growth in services has been faster.

The single market is one tool Europe can use to close this gap. National governments can do much to remove impediments to services growth in their markets – by making planning simpler and faster, reducing the regulation of professions, and freeing up labour markets. All of these should boost competition, and therefore productivity. But a more integrated single market can help too: by making it easier for foreign firms to enter national markets, the EU can apply extra competitive pressure. More mutual recognition of services firms would help break open protected national markets.

The recession and the eurozone crisis have encouraged many countries to embrace structural reform. So far, however, 'uncompetitive' economies in the periphery have been under strong pressure to liberalise their economies. A broader – if weak and fragmentary – coalition has coalesced around policies to promote a more integrated single market. France and Germany should join that coalition.

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