DEEPENING SERVICES MARKET INTEGRATION - A Critical Assessment

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Abstract: *The greatest asset of the European Union is undoubtedly its internal market. However, the internal market is not completed: it suffers from a giant hole with respect to many services. The present contribution addresses the status of services in the internal market and, in particular, the horizontal liberalisation (or, the lack of it) of services outside the two large sectors which greatly deepened market integration (6 modes of transport and 3 financial services markets). Because a horizontal perspective on services in the EU is still little understood, it is briefly summarized what services really are and how their regulatory logic in the internal market can help to classify them. The (strong) economic case for deepening services market integration is built on recent empirical economic analysis as well as simulation. This is followed by a discussion, with flowchart, of the Bolkestein draft directive, against the backdrop of the frustrating lack of, or at best, selective progress on services for decades. A survey of economic impact studies of the draft directive is provided, too, underpinning its importance even when the infamous origin principle is taken out. Some light is subsequently shed on the tumultuous politicisation of the services debate. Emphasis is laid on the socio-economic context (which, it is submitted, sharpened the discussion at times into polarisation) and a series of other factors such as the diversity of the national regulatory frameworks of services and the labour employed, the complexity of the draft directive, the potentially radical nature of the origin principle (especially for those not aware of the case law of the ECJ), the dominant role of the EP and the opportunism of leading national politicians.*

Finally, directive 2006/123 meanwhile in force is explained and briefly assessed. Apart from the conspicuous manifestation of 'Angst' in drafting the directive, the (de) merits are set out. The conclusion is that a badly drafted directive with excessive emphasis on exclusions and derogations, and which lacks a driving principle, nevertheless comprises several functional obligations in general (e.g single window, administrative cooperation in dedicated networks, etc.), significant advantages for free establishment (which imply equally significant economic gains) and a firm discipline for (or prohibition of) bad practices with respect to temporary provision of services.

1. Introduction

The greatest asset of the European Union is undoubtedly its internal market. Nevertheless, the internal market is not, as many people believe, almost completed. It is not correct to suggest that the remaining issues for the internal market are just technical, politically and economically of minor importance and too trivial to expect political leaders to develop credible strategies for, with all the political energy and exposure that this would imply. Quite the contrary, the internal market suffers from a giant hole which has been ignored for far too long. The internal market is indeed

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developed and 'deep' in goods, capital and codified technology (except the EU patent). However, there is in fact no such thing as a European labour market and the 'free movement of workers' is crafted in such a way that it remains a "residual" issue for national labour markets[1] . Yet, few analysts would expect a genuinely integrated internal market for labour to come about in the longer run, even if free movement were given more chance by removing discrimination and obstacles. The giant hole can be found with respect to services. The conglomerate of economic (and non-economic) activities called 'services' generates some 70 % of the Union's GDP but there is neither a wide nor a deep internal market for services. The EU is now paying a (low growth) price for this failure, in particular in the EU-15 countries. Even so, the Union remains profoundly ambivalent about firm initiatives towards 'completion' of the internal services market, that is, widening its scope and deepening its meaning for business and consumers.

The present contribution will address the status of services in European integration, the economic and regulatory meaning of the severely truncated internal market for services after the adoption of the services directive in December 2006, some of the 'framed' or genuine misunderstandings during the debate on the 'Bolkestein draft directive' on horizontal liberalization of services in the internal market and, finally, the way forward in the medium-run. Section 2 will discuss what services really are, what the regulatory logic is, how services can be usefully classified such that the internal market aspects can be readily understood and, with the help of this classification, what (broadly) was covered by the draft Bolkestein draft directive and what not. Section 3 makes the economic case for a firm and wide-ranging initiative on deepening the internal market for services. Section 4 sketches the Bolkestein draft, in the light of the frustrating lack of, or at best selective, progress on services for decades, followed by a summary of economic impact studies. Section 6 provides an insight in the politicization of the services debate, without any claim of trying to be more than selective. Section 7 summarizes the directive as finally adopted and attempts to interpret its meaning. Section 8 concludes with a few recommendations.

2. About services and their regulatory logic[2]

Imagine, the reader would first attempt to answer the question 'what services are, exactly'. Some would say, presumably, that services are all economic activities which fall outside agro & fisheries and outside manufacturing and mining. Such a negative definition suggests that it is a left-over category and tells us nothing about the common economic characteristics of these activities. Other readers might recall the famous definition that services cannot 'drop on your feet'. One might also note that the GATS (WTO) distinguishes four modes of delivery of services (not very different from the EC treaty), without however, defining services themselves. In economic terms, services are credence or experience goods, usually (but not always) for simultaneous consumption when produced, intangible and unsuitable for e.g. tariff duties (though not for taxation) and highly differentiated. In the EC treaty services can be temporary (subject to free movement)

[1] *See Pelkmans, 2006, pp. 178 187 and pp. 203 - 206 for why this is so and further detail.*
[2] *This section draws in part from Pelkmans, 2006, pp. 125 - 132 and Pelkmans, 2007-a.*

and permanent (subject to the right of establishment). The temporary services can be pure cross-border, or, the consumer crosses the border to enjoy the service, or, the producer crosses the intra-EU border(s) to deliver the service (frequently, with temporary [so-called 'posted'] workers performing the actual work). All these elements cannot be missed if one wishes to understand the internal market for services but they are anything but sufficient.

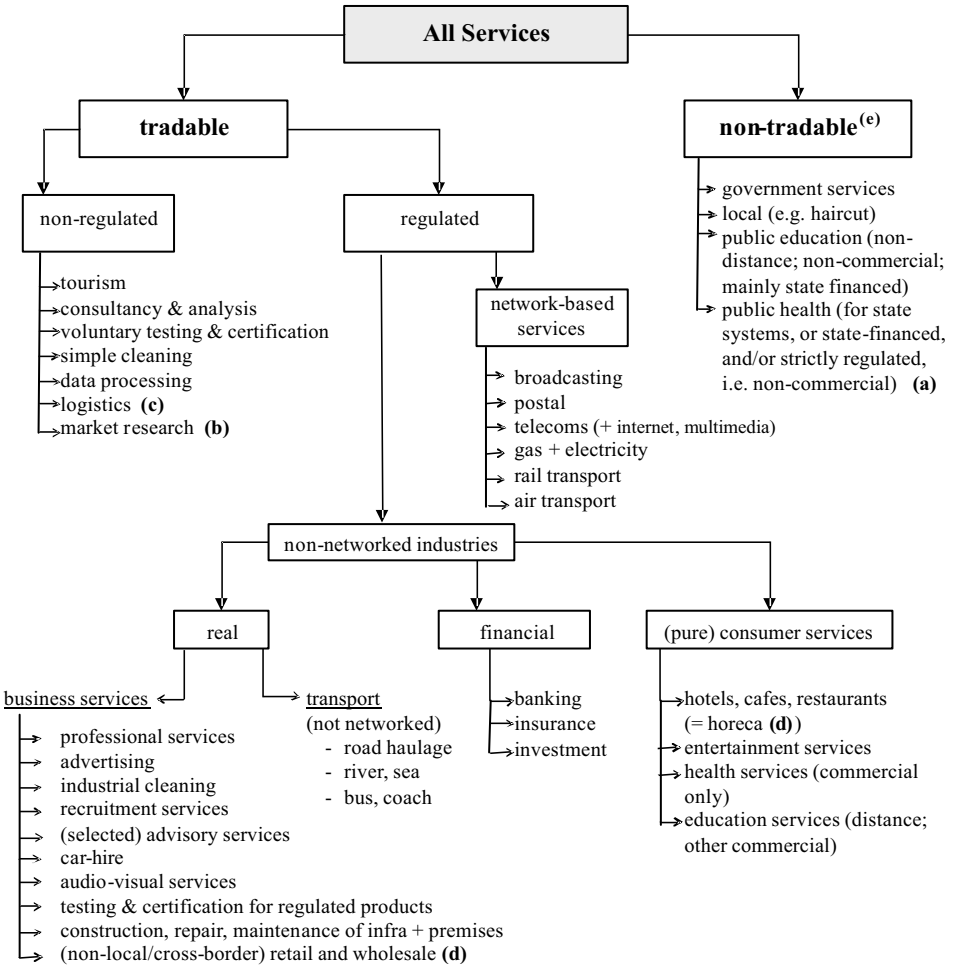
A better appreciation can be obtained if one converts the statistical classification of services into a schema based on the relevant properties for the internal market regime. Doing this carefully can prevent serious misunderstandings, which played a disproportionate role in the debate on the Bolkestein draft directive, while facilitating a better 'reading' of the Commission proposal. Of course, this is critical for economic analysis, too. A fairly comprehensive overview is provided in Figure 1 (Pelkmans, 2006, p. 127). What is required is to apply the internal market 'regulatory' logic to services categories. In order to do this properly, one has to go through five consecutive steps, as follows. First, distinguish economic from non-economic (e.g social) services; only economic services fall under the internal market. Second, distinguish B2B from B2C services, the reason being that consumer protection can be justified in the latter case, and, in turn, this might lead to cumbersome harmonisation issues (which should not normally apply to B2B!). Third, distinguish tradable from non-tradable services; if non-tradable, free movement is irrelevant, though the right of establishment still applies. Fourth, if tradable, are services regulated or non-regulated?[3] Fifth, if regulated, are services network-based or non-networked, as this is treated quite differently in the treaty.

Assuming services to be only 'economic' (although there are some issues of interpretation hidden in the 'untradable' category), Figure 1 incorporates all the answers to these questions. Many examples of services are mentioned so as to help the reader identify what could be at stake, without ever claiming the Figure to be exhaustive. A few remarks may illustrate how to use the Figure for the internal market debate. The tradable/non-regulated category is of huge economic importance to the EU, yet, was hardly or not discussed in the Bolkestein debate. To give just one example, the voluntary testing & certification sector represents an important economic activity for quality control and third party certification for many reasons. In actual practice, in testing houses and certification bodies, the work is often closely related to compulsory conformity assessment (e.g. under the EU New Approach), a regulated but highly competitive business. Non-regulated is a broad characterization, it is even possible that no Member State has ever regulated or restricted any of these activities; it might also mean that self-regulatory practices (e.g in voluntary testing & certification) or broader horizontal rules (e.g. privacy laws and data processing) do cause some problems in the internal market. In any event, the internal market should be allowed to work here and it matters little or not at all whether the origin principle (see below) applies or not. Plain free movement (and truly unhindered establishment) as well as competition policy should do.

The non-tradable category is a complicated mixed bag, many services of which are non-economic (including most

[3] *The term 'non-regulated' should not be taken too literal. Thus, tourism is hardly regulated. Even so, the EU has minimum fire prevention regulation for tourists and other travellers. If regulation is light and exceptional, one should not expect regulatory barriers between Member States to be of great importance.*

Figure 1
Services in the Internal Market
[trade or 'establishment'; services may be B2B or B2C]



Note: The examples mentioned in the various categories are illustrations for the reader; these lists are not exhaustive.

a) patients can of course move across borders and EU case-law exists about who pays what for hospital and non-hospital care;

b) unregulated, other than laws on privacy (partly EU);

c) unregulated, other than transport itself (which is regulated);

d) retail and wholesale and horeca are almost entirely domestic; however, to a limited extent there might be 'establishment' in other EU countries;

e) non-tradable, commercial services, might still exploit the right to establishment across intra-EU borders.

government services, of course). However, a small percentage of certain subsectors might not be so clearly 'non-economic', and at times also become potentially 'tradable'. This has led to sensitive problems of drawing clear demarcations (be it by the European Court of Justice or in EC directives to come) between non-economic and (sufficiently) market-based. Lack of clarity or resistance against the discretion of EU bodies to decide such demarcations caused turmoil in the EP and the Council, if not in many Member States, primarily illustrated by the sectors of health and education. In particular, the health sector has a complicated position in the internal market. The organisation and financing of healthcare and social protection systems is a clear responsibility of the Member States under public health provisions (art. 152, EC). Nevertheless, aspects of these systems or their effects may be influenced, perhaps even eroded, by activities or mobilities under the internal market. The mobility of patients over intra-EU frontiers seeking medical services abroad has been the subject of many recent ECJ cases, protecting in essence the right of the patient to exploit free movement. The (competitive) internal market for (life or health) insurance might come in conflict with the financing of social insurance based on solidarity. The price-setting of medicines as a part of different national public health reimbursement systems sits uneasily with free movement of medicines, especially parallel imports from low-price Member States. At the same time, health services are clearly for remuneration and, as such, cannot be regarded as 'non-economic' in most instances. The demarcation in (higher) education is somewhat easier but the trend to go for higher student fee + tuition in more and more EU countries may eventually create fuzziness, too. Some non-tradable are economic, yet truly local (e.g. the haircut or the bulk of retail shops) and thus irrelevant for the internal services market. However, supermarkets, hypermarkets, branded shop-chains and wholesale activities might well be potentially or actually active on a cross-border basis due to establishment.

Many services are regulated as is clear from Figure 1. Network-based services fall under art. 86, EC and have become subject to special regimes combining liberalisation, regulation and competition policy (see Pelkmans, 2001, for a survey of all 7 sectors specified). The confusion caused by the first Bolkestein draft was that some of these sectors were placed under a derogation and other ones not, thereby inevitably prompting the suspicion that the draft proposal amounted to a further liberalisation through the backdoor of horizontal liberalisation rather than sector-specific. The non-networked sectors are subdivided into real versus financial, as well as pure consumer services. The real ones include the dynamic class of business services, with some subsectors nevertheless remaining quite resistant to cross-border competitive exposure (e.g. professional services, with often anti-competitive self-regulation; also, repair and maintenance of larger infrastructure and premises, including e.g. railways infra) or subject to sensitive local rules (e.g. advertising). Cross-border retail & wholesale belong to the cases where the 'economic needs' test was still required in no less than 7 Member States in 2002, a major violation of the economic freedoms in the treaty. Non-networked transport, road haulage above all, is long liberalised and regulated under a separate chapter in the treaty and hence falls outside horizontal services liberalisation. The same goes for the three financial sectors, ever

since EC-1992 and even more after the successful Financial Services Action Plan, completed in 2005. This leaves the pure consumer services which do fall under the first Commission proposal, but entail some demarcations issues.

A simple fact worth reflecting on after studying Figure 1 in the light of the Bolkestein draft, is that the current services trade over intra-EU borders (a mere 20 % of intra-EU goods trade) is largely made up of activities of the very sectors *not* falling under the Bolkestein draft ! One should think of tourism and some other 'non-regulated' services (true, they fall under the draft but as non-regulated, the impact is minimal), the three financial services, the transport sector (with road haulage dominating all) and the network sectors. The consternation about the non-economic (and often local, too) services was about socio-politically sensitive demarcation, hardly or not about expected impact of economic significance. Apparently, the remaining sectors, for which the Bolkestein draft was designed, have so far hardly generated cross-border services trade! And when the Commission at long last suggested they should be subjected to the internal market in earnest, the sensitivities came out in the open for the first time in 45 years.

3. The economic case for a major EU services initiative

In the EU-27 nearly 70 % of GDP is generated by services activities: almost 72 % in the EU-15 and over 60 % (and rising) in the new Member States. Thus, even if EU agriculture and industry together would exhibit steady technical progress and better management and would permanently come up with new products, it is bound to have only a limited effect on overall economic growth and employment, merely because of their small and slowly decreasing share in overall activity. Insofar as services are inputs of the production and delivery of such products as indeed is increasingly the case - it will be essential to the competitiveness of European industry and the agro-sector that such business services are themselves dynamic and competitive, stimulated by an internal market which facilitates entry, innovation and variety. Where services are directly consumed by individuals or constitute inputs for other services, and these inputs are not necessarily local, the impetus for greater dynamism can be strengthened by opening up these markets to actual or potential cross-border competition from the entire Union. In the internal market for goods, these statements have long been accepted as elementary and a balanced combination of market forces, economic freedoms, competition policy and appropriate regulation ensures its effective functioning. When it comes to services, and despite a very similar obligation in the treaty, such convictions are less widespread or even selectively denied. Policy makers and analysts, when making the case, have to row against a tide of anxieties and suspicions. It seems that many service suppliers in the EU have become so accustomed to operate in a sheltered environment that liberalization is a priori regarded as a threat.

A few basic facts and results from economic research underline the urgency of addressing the performance of services in the EU:

i Annual growth rates of value added (in constant 1995 prices) between 1979 and 2003 (EU-15) amounted to 4.2 % for *business services*, against 2,2 % for manufacturing, 2,3 % for distributive trades, 2,4 % for

transport and 2,5 % for finance (source: Kox & Rubalcaba, 2007). The shining performance is explained by the close link with the Europeanisation of manufacturing (services following goods), by the trend forced by fiercer competition in the internal goods market to go back to 'core business' (thereby often divesting internal services and thus boosting the statistical growth in business services) and by a relatively high share of knowledge-intensive services in the category of business services. Nevertheless, cross-border business services are often unnecessarily costly due to cumbersome obligations and entry barriers, greatly discouraging SMEs to enter cross-border activities, even though these SMEs are dominating services in their home markets. B2C services across intra-EU borders are small (apart from tourism) and there is little evidence of growth except internet sales.

ii Services in Europe may not be dynamic enough, as is often held, but they are by no means stagnant. Thus, when focusing on all new firms created in the EU-15 in e.g. the year 2000, the European Commission (2003) found that new entrants in services added up to 65 % of all firms on average. It is also crucial to realize that the share of SMEs in services is extremely high and far higher indeed than in manufacturing. This characteristic makes it the more important that access to other EU countries should not be discouraged by extra burdens of protectionism because such features have a disproportional negative effect on SMEs.

iii What matters for the internal market are 'tradable services', that is, they can be traded across intra-EU borders. Taking into account the diversity of the services sector in the respective Member States, the non-tradable sector (e.g. government services, local ones, be they for profit or non-profit) can range from 20 % to over 30 % of GDP. In other words, services potentially tradable in the internal market could amount to some 40 % or more of GDP which is much higher than the actual intra-EU trade in goods today. In sharp contrast, the actual services trade in the EU hoovers around one-fifth of intra-EU goods trade! Knowing the many cumbersome restrictions in the internal market for services (European Commission, 2002), it is hard to escape the conclusion that EU countries could greatly boost intra-EU services trade by opening up radically towards each other. How far one could expect this boost to go, is difficult to know because goods and services are not fully comparable. Services are based on trust and well-established relationships because they are so-called 'credence' or 'experience' goods, unlike most tangible goods which can be characterized as 'search' goods and hence easier to verify. Therefore, proximity to customers is crucial for most services and, therefore, local establishment, rather than distant trade, is the preferred mode of delivery or market access. New

technologies have changed that somewhat, but there is no doubt that the potential share of services trade cannot be mechanically derived by a comparison with goods. Indeed, any overall study of the internal market for services must provide reliable data on local production of services by establishments from other EU countries, besides intra-EU trade. This is difficult because many services establishments are so small that they are not caught by cross-border FDI data.

iv There are other indicators pointing to a serious under-exploitation of the internal market for services. Two examples. Kox, Lejour & Montizaan, 2005, construct a trade-openness index for EU countries and find services trade openness to be low, with very low indices for relatively big countries such as France, Germany and Spain. Turning to establishment, data on services generated by foreign establishments are scarce; what data there is (based on OECD FATS data) shows for e.g. 2002 that the share of their employment in overall services employment in the relevant country never exceeds 20 % and is as low as 5,6 % in France, 2,9 % in Germany and 5,1 % in Italy. Employment shares in foreign establishments in manufacturing are higher than the ones for services in every EU country and the gap is never smaller than one-third, often more than half. When observing these discrepancies, one should not forget that precisely in services the mode of establishment is far more attractive, if not imperative, for durable presence in the market than for goods. What this implies is that one should expect services to have higher, not lower, shares than manufacturing, so the contrasting facts of today are worrying.

v In the last few years, analysts have drawn attention to high growth rates of selected services in the US, compared to the EU, as the main explanation of the transatlantic growth gap between the mid-1990s and (say) 2005. For example, in Van Ark (2004), aggregate labour productivity growth of the US and the EU-15 are decomposed by sectors for the period 1995 - 2002. He finds that 4 of the 5 sectors with the highest labour productivity growth are services: retail (except that of motor vehicles), wholesale trade, financial intermediation and activities auxiliary to financial intermediation. Of the 8-years average of 2.46 %, these 4 services sectors explain 1.16 %. In the EU, by contrast, the 4 sectors make up a mere 0.16 %-point of the 8-years EU-15 average of 1.64 %. These findings would seem to suggest that the regulatory environment for services and/or restrictions to exploit the internal services market seem to hinder a more or less similar development of such sectors in the Union. This would seem to be consistent with the results of the wide-ranging OECD work on the impact of restrictive regulations (including market entry and cross-border access) for the period up to 2003 inclusive (Conway, Janod &

Nicoletti, 2005). Restrictions and lack of rivalry might also be a major reason why ICT-usage in services is falling ever more behind that in the US (see e.g. Denis, McMorrow, Roeger & Veugelers, 2005).

Careful consideration of these points underpins a strong economic case to exploit the potential opportunities a well-functioning internal market for services would offer. As the well-known Commission (2002) report on the barriers in the internal services market amply demonstrated, this requires a wide-ranging horizontal initiative, possibly accompanied by selected sectoral areas.

4. The Bolkestein draft directive

Understanding the proposal for horizontal services liberalization[4] requires at least three steps: grasping the treaty sections on services, appreciating the massive recent case law (so large because the EU institutions failed to take services serious for far too long) and taking a careful look at the draft text. When doing this, one must realize from the start that services are labour intensive which implies that especially services trade (practically always a temporary movement over intra-EU borders) is bound to be closely associated with labour aspects, in sharp contrast with goods trade. Building on earlier case law, the Posted Workers directive 96/71 states that temporary provision of services in another Member State by posted workers performing the actual work is, or can be made, subject to host country control for crucial aspects such as minimum wages and e.g. days of vacation, but not for social charges (as these charges can be imposed by the state of origin, given that the service in the other country is a temporary one). Thus, although directive 96/71 might seem to belong to labour market regulation, in fact it is part and parcel of the acquis of the internal market for services.

The present article will not go into detail about the legal (de)merits of the Bolkestein draft and the finally adopted directive 2006/123.[5] A mere sketch of the approaches should do for our purpose.

4.1 The treaty on services

The treaty text has never been changed in the successive revisions of the Rome treaty. The free movement of services would seem to be a broad, horizontal obligation but there are (1) significant 'carve-outs' in separate articles or chapters in the treaty, such as the six modes of transport, financial services (banking, insurance and investment services) and the seven network industries (see Figure 1), besides (2) considerable scope for derogations (e.g. art. 46, EC). The right of establishment seems to benefit from obligations of close cooperation and removal of administrative obstacles (art. 44, EC) - an area where the Commission (2002) report demonstrated serious failure of compliance by Member States - , yet, is weakened by open derogations (e.g. art.s 45 and 46, EC) and the capture of EU bodies by the professions in the elaboration of the 'mutual recognition' of diploma's under art. 47, EC, until the early 1990s, if not longer. What essentially happened about free movement since the transition period of 12 years was over (i.e. 1970), amounted to a slow but steady intensification of the role of the ECJ

[4] *COM (2004) 2 of 13 January 2004, Proposal for a directive on services in the internal market.*
[5] *See, for instance, Do (2006), House of Lords (2005/6), de Witte (2007) and Micossi (2006).*

in the absence of serious horizontal action by the three Brussels institutions and, since 1985, an emphasis on the sectoral approach in transport and financial services, accompanied since the late 1980s by a gradual opening up of the seven network markets. In terms of Figure 1, this leaves the non(lightly)- regulated services, business services other than the sectorally ones mentioned above and pure consumer services. The Bolkestein draft (in so far as free movement is concerned) is no more than a belated attempt to tackle horizontal services liberalisation, shown to be riddled with barriers and discrimination. The right of establishment in services turned out to be legally less difficult in principle, given the acceptance of host country control for incoming companies and individuals, but in actual practice turned out to be biased against non-locals in many subtle and less subtle ways. Moreover, in not tackling obvious violations of EC law (such as the 'economic needs test') and not harmonizing almost anything (whilst the so-called 'mutual recognition' directives for the professions were little more than attempts of 'maximum harmonization' so as to prevent non-local professionals to enter), the regulatory heterogeneity inside the internal market caused national markets to be so distinct that no single services markets would ever emerge. This raises costs and reduces the competitiveness of European business using these services as inputs. Once a new approach to diploma recognition had been initiated, building on directives 1999/42 and 2001/19, it was time to tackle the obstacles to a free exercise of the right of establishment once and for all. This was the other major aim of the Bolkestein draft directive.

The case law of the last two decades and especially the last few years (Hatzopoulos & Do, 2006 for a survey) has become a major driver of selected liberalisation, but it suffers from the lack of an overall regulatory framework based on politically agreed guidelines, adopted with the political legitimacy of the EU legislature. The ECJ is understandably afraid of substituting political for judicial decisions and therefore often falls back on generally worded derogations, which it subsequently tries to discipline with principles such as proportionality and a duty for national authorities to take into account the measures already taken by the country of origin (a soft kind of mutual recognition, subject to much legal debate).

4.2 Case-law and the origin principle

The case law on the free movement of services has gradually become similar to that for goods, with a delay of a decade or so. Of course, this applies to the principles, not to the specific details.[6] This interpretation has helped the integration of the services market to move forward.

As with goods, there is first the distinction between discriminatory and non-discriminatory barriers. Discrimination on account of the provider's nationality[7] or the provider's Member State of establishment is prohibited, but broad derogations under Art. 46 are possible. For non-discriminatory restrictions, it would seem that the case law on goods (that is, Art. 28) has inspired the jurisprudence on services, too. In the Säger case[8] and later, there is an analogy with the

[6] *An extremely detailed survey of ECJ case-law on services is published by the Commission (DG Internal Market) as Guide to Case Law, Freedom to provide services, 2001. The text above only highlights a few basic principles.*

[7] *Services provisions cannot be reserved for nationals only, except when the derogations in Art. 46 make this restriction indispensable (but the Court assesses this carefully, see further).*

[8] *Case C-76/90, ruling 1991.*

Dassonville case[9]: restrictions 'liable to prohibit or otherwise impede' cross-border services of the 'temporary' type are not allowed. This economic approach covers those measures affecting the ability to provide, those increasing the cost of the relevant service (a very wide-ranging prohibition, like in Dassonville), and those discouraging its provision. Interestingly, it also explicitly protects consumers who are prevented from receiving the services of their choice.

It is then a small step to introduce the analogy with Cassis de Dijon. A Member State cannot normally prohibit the provision, in its own territory, of a service lawfully provided in another Member State, even if the conditions in which it is provided are different in the country where the service provider is established. This looks like mutual recognition. But is it mutual recognition? The case-law for regulated goods makes this dependent on the *equivalence of the objectives* under derogations (like on safety, health, environment and consumer protection) in the origin and destination countries. If equivalent in objectives, the differences in specific details in the laws of the Member State(s) of origin, and of destination are irrelevant for free movement, in other words, the derogations no longer apply. However, if 'equivalence' is *not* specifically mentioned, and therefore does not matter, one often denotes the Cassis-de-Dijon quote (above) as the *origin principle*[10]. What matters is whether the derogations are disciplined (i.e. limited): equivalence of objectives, versus a weaker or no discipline. If and in so far as the discipline is weaker or absent, the origin principle in combination with these 'undisciplined' derogations leaves *more* discretion to Member States. However, exactly for that reason, 'equivalence' (hence, mutual recognition) would give more certainty to firms and Member States *and help free movement more*. The case-law on services is not entirely clear on the distinction. It is crucial to understand why.

The ECJ has been faced with many cases, because, especially in service sectors, for possible market failures not clearly specified in the treaty (thus, other than transport, finance and the professions), the EU legislator has long failed to engage in (minimum) harmonisation. Without guidance from what Council and EP wanted to regulate, the ECJ was forced to stress a fairly radical free movement approach, but also prudently permit very wide and many derogations in fairly general wording. Rather than a consistent and straightforward application of the origin principle, which might have undermined much regulation in destination countries, the ECJ could do no more than 'wait' until the EU legislator determined what the proper limits of the derogations should be. The EU legislator took up this challenge in a few remarkable directives where the origin principle is explicitly the basis of free movement (e.g. the TV-without frontiers directive and the e-commerce directive 2000/31) but refrained from doing so more generally for services. It is only after the discovery of many obstacles to service trade and establishment in 2002, that the Commission was finally in the position to propose horizontal services legislation.

In analogy to Art. 30, the wide derogations of Art. 46 and a host of related

[9] *Case 8/74, in [1974] ECR 837*

[10] *See Pelkmans, 2007-c, for a flowchart juxtaposing mutual recognition and the origin principle (in goods markets)*

other objectives[11] legally need not be incompatible with free movement of services. To verify whether this is so, national regulations have to pass three tests. The first one is the justification test, that is, overriding reasons related to the public interest. But this is restrictively interpreted (indeed, like Art. 30). Thus, economic aims or administrative convenience do not qualify. Second, there is a kind of home country control test. Statutory conditions (if equivalent), already satisfied in the home country, cannot be duplicated by the host country, and the supervisory authority of the host country must take into account supervision and verifications in the home country[12]. Finally, there is the proportionality test: the restrictions should be indispensable and least restrictive (that is, no less restrictive means should be available).[13]

4.3 Horizontal liberalisation logic of services[14]

The combination of a highly conditional 'free' movement of services, a lack of treaty specifications on how to actually accomplish the process of horizontal liberalisation (that is, outside sectoral liberalisation), and extensive ECJ case law compelled to employ broadly formulated derogations (in the form of principles, much more than 'rules') given the failure of the EU legislator to engage in clear harmonisation, did not augur well for the completion of the internal services market. It is only once a 'services strategy' had been agreed in 2000, in the framework of the Lisbon goals to make the EU perform economically far better, that decisive improvements of the functioning of the single market of services could become a serious priority for the EU legislator. Given the tremendous specificity of services and the complicated ECJ case law, the regulatory design of the legislation matters a lot. In particular, what combination of liberalisation, prohibitions of types of national measures, harmonisation for aspects which the ECJ placed under 'derogations' (and the limits of them) as well as cooperation between the Member States for purposes of home-country measures and in avoiding red tape hindering free establishment, is desirable? How could that combination be optimal in balancing the great need to finally liberalize and the justified minimum regulatory protection in the public interest? Figure 2 provides the regulatory logic of the so-called services draft directive[15] which has been widely misunderstood.

As noted before, but too often forgotten, services liberalisation in the EU is always about free movement *and* free establishment. Moreover, it solely applies to economic services, hence not to non-economic services of a social or cultural nature, or, indeed, to publicly financed and/or (non-commercially) regulated services such as (most) public health and public education. Figure 2 is relatively clear about free establishment, the right-hand

[11] *The Court has referred to all the essential requirements specified in the old Art. 36 as, in principle, applicable to services, too, as well as to some other ones (which it calls 'mandatory') e.g. 'coherence in the tax system' (C 204/90, Bachmann; ruling 1992). See the Commission survey of 2001 (in footnote 6).*

[12] *In goods there is an analogy with the Court's principle that identical testing should not be duplicated.*

[13] *This is a drastic simplification of the case-law. See Hatzopoulos & Do, 2006, for an extensive legal survey.*

[14] *The following draws, in part, from Pelkmans, 2006.*

[15] *COM (2004) 2 of 13 January 2004, Proposal for a Directive on services in the internal market, informally known as the Bolkestein draft directive. It leaves out some special issues such as the possible interference of the draft directive with international private law, and the choice (in labour or consumer contracts) of the applicable national law (e.g. Rome I, etc..)*

side. Whilst a number of overly restrictive or unreasonable measures or requirements of Member States, or regional authorities, should be unambiguously forbidden (the 3rd arrow), positive measures include conscious administrative simplification like one-stop-shopping for licenses or other red-tape (where Member States should act in the common EU interest which they evidently did not, thus far) and cooperation between authorities in different jurisdictions for quickly retrieving the proper information, and some degree of harmonisation of criteria for licensing and procedures. Given the existing uncertainty for a myriad of services, a screening process of national laws in EU working groups should provide all necessary information about further simplification or abolition of red tape, or, in exceptional cases perhaps harmonisation.

The problem of free movement is a good deal more complicated and the sensitivities are not to be underestimated. If one ignores sectoral liberalisation, dealt with under special regimes in the EU, the starting point of horizontal liberalisation is to ask what core principle ought to be applied over the range of services sectors: mutual recognition or the origin principle. What they have in common is the idea that, except for derogations, a Member State cannot normally prohibit the provision, in its own territory, of a service lawfully provided in another Member State, even if the conditions in which it is provided are different from those in the country of destination. Where the two principles differ is that the origin principle stops right there, whereas mutual recognition (at least, if inspired by the tradition in goods markets) adds a qualification for the derogations: if the objectives behind the derogation(s) are 'equivalent', free movement still applies. There are two certain ways to determine whether objectives are 'equivalent': the ECJ case law and (minimum) harmonisation, focussed on goals only. The upshot is that the origin principle may override some of the worst, protectionist rules for services that cannot be justified, but otherwise will merely invite a litany of derogations, the limits of which are hard to foresee and for which only generally worded disciplines, like necessity and proportionality, will be available. This is indeed what happened with the draft services directive of 2004. In Art.16 the origin principle is defined: "Member States shall ensure that providers are subject only to the national provisions of their Member State of origin which fall under the coordinated field". Wisely, this is first followed by a list of what in any event is prohibited for Member States. But, as Figure 2 shows, the economic meaning of the origin principle is hard to determine in the light of many derogations.

The discipline of the derogations is mentioned in the box left/below the derogations and comprises, inter alia, the criterion whether or not the 'interest is already protected by the rules of the State where the service provider is established'[16]. The difference between the origin principle and mutual recognition vanishes if this quote of the case law is interpreted to mean that the objectives of the relevant laws of the two countries are 'equivalent' (what the ECJ calls 'interests .. already protected'). But that is clearly not the case, the meaning is a more limited one. (see e.g. Hatzopoulos, 2007). Four types of derogations are indicated in Figure 2.

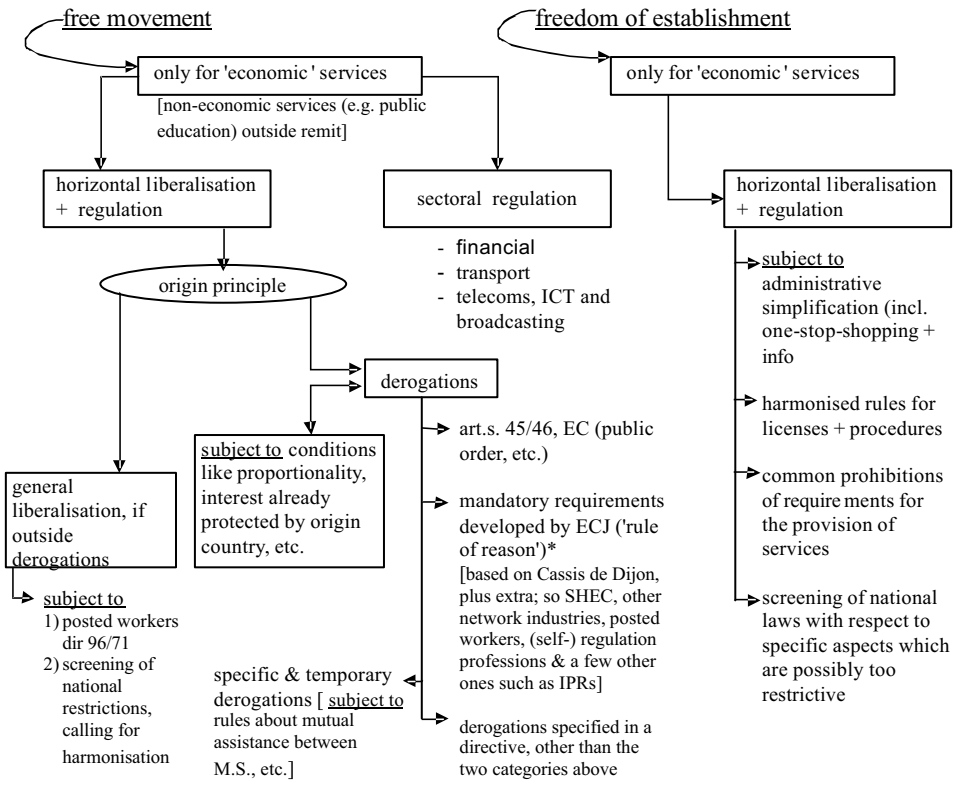
Apart from treaty derogations, which are simply given, two types of derogations

[16] *Quoted from the Guiot case C-272/94, in [1996] ECR-I-1905 par. 13; see Commission survey, 2001, as in footnote 6, p. 116. Similar, in the Saeger case C-76/90 [1991] ECR I 4221 par.15, Commission survey, op. cit. p. 119, etc.*

are identified (permanent, and temporary and highly specific ones, in the articles immediately following art. 16) which are typically 'regulatory'. They express the preferences of the legislature when protecting the regulatory autonomy of the Member States against the working of the origin principle. It is here that one serious weakness of the Bolkestein draft can be found: once the E.P. became the central body for the drafting of the revised version, a long queue of lobbies emerged, all pleading for 'their' derogation.

A fourth type of derogations are the so-called mandatory requirements, based on the 'rule of reason' applied by the ECJ. This group prompted major controversies about the services draft. It one takes the view (with the Commission at that point) that the origin principle can only be derogated by

Figure 2
The regulatory logic of services liberalisation



Note that, if structural assistance between Member States and some further harmonisation is dealt with, the ECJ is likely to significantly reduce the number and scope of derogations, regarded as 'mandatory requirements'.
SHEC = safety, health, environment & consumer protection
IPRs= intellectual property rights

the treaty itself (and not by case-law under the rule-of-reason) and by explicit derogations in the directive, this group of derogations would no longer apply or only in so far as there is a direct treaty basis. The argument behind this radical stance is probably that several such derogations are very generally formulated, as noted before, and have provided excessive discretion to Member States to protect their services sectors. The responses are predictable: one induces an understandable groundswell of opposition, or, an explicit re-insertion into the directive. In addition, by assuming a complicated position on network industries (some excluded, other not but possibly derogated) and insisting on the health sector (with all the new case-law and other complexity) the debate about derogations went out of control.

Once free movement, based on the origin principle, is not reduced or blocked by the derogations, general liberalisation applies (left, bottom). However, since service provision is labour intensive and, in some sectors like construction and construction-related professions (painters, plumbers, electricians) and simple 'horeca' labour services, heavily dependent on labour costs, the posted workers directive 96/71 governs any contracts under this general liberalisation. The consternation around the posted-workers directive in the services debate is almost certainly due to adverse 'political framing'. The Bolkestein draft is not ambiguous about it. The reasons for the nervousness and emotional debates probably lie elsewhere (see section 6). It is also crucial to realize that the 'Polish plumber' is a highly misleading slogan, since the draft directive was either applying the posted workers directive or irrelevant to the accusations (cf. section 6).

5. Economic impact, with and without the origin principle

Since 2003 new EU proposals for legislation have to be subject to Regulatory Impact Assessment (=RIA).[17] One would expect the RIA of the Bolkestein draft to comprise a survey of the relevant economic impact studies available and/or the results of a targeted impact study commissioned for RIA purposes. Even though the RIA of 'Bolkestein' serves the purpose of analytical clarification and also helps the reader to appreciate the choice between several options for the EU services market, it fails to provide a survey of genuine impact studies and does not provide even proxy quantifications of the economic impact. It is of critical importance to understand, why. By the end of 2003 (when the RIA was concluded), quantitative studies were simply not available. In analytical economics, services had long been stepmotherly treated [18] and in international economics the absence of modeling work was conspicuous. One amongst several reasons consisted in the tremendous complexity of barriers to entry and to market access; a related reason was that regulatory barriers (not, tariffs) had to be assessed as to their price and non-price effects, which is extremely difficult; yet another reason consisted in the lack of reliable data for all the barriers to services trade and FDI for all the Member States, the result of decades of neglect by the EU of the internal market of

[17] *Commission Staff Paper, Extended Impact assessment of the proposal for a directive on services in the internal market, SEC (2004) 21 of 13 Jan. 2004*

[18] *It is not exaggerated to consider services as the cinderella of the EU internal market, also in economic analysis. In textbooks on EU economic integration, matters are hardly any better as even a cursory look at Balassa (1961), Hansen & Nielsen (1997), El-Agraa (2001), Hitiris (2003), and Baldwin & Wyplosz (2005) will confirm.*

services! Given all those reasons, the Commission was simply not in the position to 'guesstimate' the economic impact. The lack of quantified 'guesstimates' in the RIA did not help, of course, to facilitate a smooth passage of the draft through the EU legislator, that is, the EP and the Council.

During the policy debate in the EU legislator two studies became available which, in different methodological ways, produced some rough estimates. Economists from the CPB (Kox, Lejour & Montizaan, 2004) found an ingenious method to arrive at rough (minimum) estimates by utilizing the extremely detailed OECD data base of regulation and studying the differences in legislation in every bilateral relation between two EU countries as cost-increasing barriers to cross-border service providers. The underlying idea is that regulatory heterogeneity in such bilateral relations is costly in and by itself, but these costs quickly multiply once more bilateral relations are exploited by service providers interested in trade in the internal market. This is so because for every new country market, the exporter incurs fixed costs of entry and information, which can only be absorbed with a considerable export volume. The authors used a gravity model to show the empirical effects of heterogeneity in services rules in the internal market and subsequently attempted to assess the economic impact of lowering that heterogeneity because of the Bolkestein draft. They estimate an increase of intra-EU services trade of 15 % - 30 %, but in a later refinement a range up to 60 %. In a slightly different fashion, they also estimated the impact of freer establishment due to the draft proposal, expecting an increase of 20 % - 35 %. Also, the EU GDP would increase between 0.3 % and 0.6 %, assuming a faithful implementation.

The other team studying the economic impact was Copenhagen Economics (2005), on request of the Commission. Their approach is closer to what conventional economics would suggest: an attempt to identify the barriers which distort or prevent services trade in the internal market, convert them into so-called 'tariff-equivalents', amalgamate them in a barrier index and see how the index would change with the Bolkestein draft. The index change is related to efficiency improvements and cost reductions of services companies. The empirical effects are then found by applying this on a data base of 275 000 firms of all possible services sectors. The macro-economic impact is derived from the Copenhagen CGE model for trade and investment. The overall effect on economic welfare in the EU amounts to EUR 37 billion, besides a growth in jobs of 600 000.

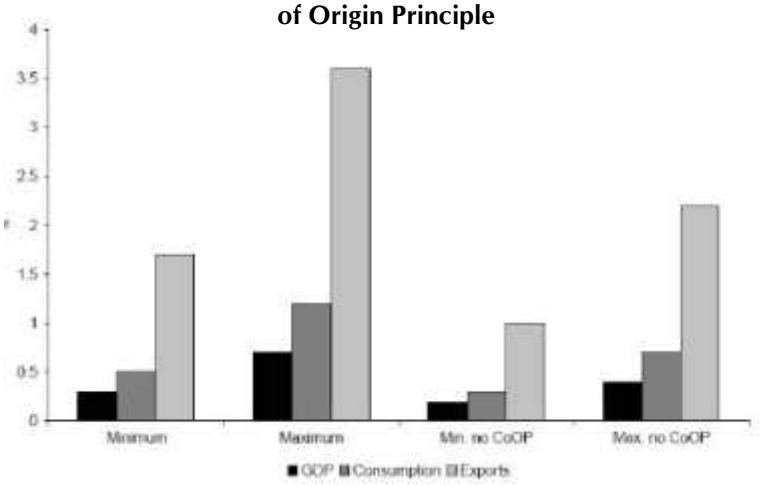
This short contribution is not the place to discuss the merits and technicalities of the two studies. For such a sweeping horizontal directive, all one can say is that the two estimates are not that far apart and distinctly positive. It is interesting to note that most of the gains result from the 'free establishment' part of the directive which is consistent with the general notion that services delivery is more naturally done via direct presence in the local market. One should also not forget, when reading these estimates, that a number of leading services sectors do not fall under horizontal liberalisation and hence are not part of these numbers. Furthermore, the sectors derogated in the draft directive have been left out. In follow-up studies, both centres have attempted to isolate the effect of the origin principle (i.e. trade alone) because it was so controversial in the debate. In de Bruijn, Kox & Lejour, 2006, the origin

principle is found to generate one-third of the welfare gains - the overall results with and without the origin principle are depicted in Figure 2. Copenhagen Economics come to a mere 10 %. These findings confirm that much of the political heat on the origin principle completely disregarded that the *establishment* part of the directive (which has largely survived the radical amendments in the EP) is the true source of benefits. The removal of the origin principle in the adopted services directive 2006/ 123/EC[19] is almost certainly detrimental to the erstwhile expected impact on intra-EU trade, but this does not mean that the adopted directive would not signify considerable progress in economic terms.

Few other impact studies would seem to have been made. But perhaps it is interesting to mention the PriceWaterhouse Coopers (2005) collection of 38 business case studies of companies anticipating the services directive because its approach is so different from that of economic modelling. The larger services companies typically regard all Member States as separate markets for many reasons, only some of which result from policies or laws affected by the Bolkestein draft. When seeking establishment, companies know beforehand that this is an expensive route and policy-related barrier removal (as in the services directive) would not so easily affect, in a decisive way, the economics of establishing an office or new company.

The study suggests that up to 40 % of the barriers to establishment would be addressed by the directive. As to services trade, the low costs of this mode of delivery and the absence of almost any fixed or sunk costs make it ideal for SMEs.[20] Again, there is not so much support in their cases that the directive (then still the draft with the origin principle) would make a major difference as many other barriers, including culture, language, etc., would be more important in the final analysis.

Figure 3: Macroeconomic effects of Services Directive with and without the Country of Origin Principle



Source: de Bruyn,. Kox & Lejour, 2006

[19] *Dir. 2006/123/EC of 12 Dec. 2006, on services in the internal market, in OJ EU L 376/36 of 27 Dec. 2006*

[20] *Note that this assertion contradicts the empirical approach of the work of Kox & Lejour (op. cit.) and co-authors, unless one applies an extremely sweeping version of the origin principle (without derogations, etc.).*

6. Understanding a tumultuous politicisation

The political economy of the process of amending and adopting the services directive 2006/123 is as fascinating as it is complex. Politicisation was more wide-spread and intense than in the case of almost any directive ever before. But that had not been foreseen by most political actors. In 2000 a strategy for a deeper and wider internal market for services was unanimously accepted by all Member States as a crucial element of the Lisbon strategy. In 2002 the Commission showed in great detail how numerous, costly and, at times, prohibitive, barriers and red tape had prevailed in the badly functioning internal market for services and the Council urged the Commission to come up with a horizontal proposal to tackle them. It was only in the course of 2004 and more vigorously during 2005 that an unusually hectic process of politicization unfolded.

In trying to shed some light on the politicisation, at times derailing into polarization, one has to begin by recognizing the somewhat unfortunate socio-economic context of the process. In addition, a host of other factors can be discussed including a range of distinct vested interests (a result of the great diversity among Member States in regulating and/or protecting services or practices of actors in certain services sectors), the complexity of the draft directive and the resulting stream of misunderstandings and false alarms, the potentially radical nature of the origin principle (easy to turn into a caricature, given the complexity of the directive and the subtleties of the ECJ case law), the dominant role of the European Parliament (given the paralysis in the Council for more than a year) and the opportunism of leading politicians including prime ministers in the light of domestic pressures at home. Considering all these factors, and the fierce debates in public opinion in many countries, sometimes linked to the presumed (de) merits of the 2003 draft Constitutional treaty, one might find it amazing that the EP did succeed in passing a text at all which has largely survived the second reading for Commission and Council.

The superficial explanation is the political deal between the Christian Democrats and the Social Democrats in the EP, under heavy German pressure, and the subsequent deal between France, Germany and (after a kind of U-turn) the UK in the Council. But this begs the questions why these risky deals were made. This would require a detailed political analysis which this contribution cannot possibly provide. Nevertheless, it is good to remember a few reasons which have helped to bolster the determination of the EU legislature to tackle the services liberalization and not back out. Such reasons include, inter alia, the firmness in the EP not to budge again for excessive pressures from aggressive social interests [following the retreat by the EP on the draft harbour directive, in the presence of shocking violence in Strassbourg by radical elements in the labour unions], the importance of acting in the preponderant area of services in the internal market which was recognized throughout the debates, the strong sentiment that Central European workers and SMEs perceived a great opportunity in the internal market for the first time since their countries had become EU members (and many MEPs feared to be seen as blocking such an initiative) and the low credibility of the Lisbon process with its lack of domestic 'political ownership' in most Member States[21] compared to the hard law of the internal market which had to be

shown to be effective in giving much greater scope for dynamism, trade and establisment.

The socio-economic context in the beginning of 2004 (when the Commission tabled the draft) was unfortunate in several aspects. The EU was divided in a number of countries with healthy economic growth (8 candidate countries, about to enter by May of 2004, and Ireland), a group with reasonable economic performance but modest or lacklustre growth (a number of smaller countries and the UK) and three large countries with relatively high unemployment for a long time already and little to no growth : Italy, France and Germany. Anxieties in the latter three countries and some other ones about the Eastern enlargement, globalisation (and the feared relocation of companies as a consequence of both, exacerbated by low corporate tax rates in the candidate countries), inflows of illegal low-wage workers, the reform on pensions and in labour markets, outsourcing by multinationals and the alleged constraints or pro-cyclical effects imposed by the Stability & Growth Pact on national budgets created a climate of suspicion and deep resistance against initiatives driven by "more market". Against the backdrop of pressure to allow greater flexibility in European labour markets, to pursue other reforms, to further liberalize network industries and to do significant trade concessions in the WTO Doha Round which could only mean 'more globalisation' - and suspected job losses to China and India - , while EU leaders began to stress the goal of competitiveness (seemingly without much interest in the social dimension), labour unions and certain political parties began to accuse "Brussels" of following a 'neo-liberal agenda'. When, in this setting, the Bolkestein draft was published, some hardliners would seem to have opted for a 'nuclear strategy' against a perceived radicalisation of the already objectionable 'neo-liberal agenda'. Whereas in ordinary circumstances such hardliners would have remained isolated and without much influence, the socio-economic context in these three countries (and perhaps Belgium as well) rendered a favourable resonance in other circles much easier. The negative political framing of the 'Frankenstein directive' was ideological but anxieties could be exemplified by selected illustrations of possible consequences which raised serious concerns in many very different groupings in a great many countries. To a considerable degree, the socio-economic context in which the Bolkestein draft was discussed began to substitute the actual substance of the text.

Moreover, the timing was unfortunate, too. 2004 was the year of the first Eastern enlargement and a permanent debate was raging in the EU-15 about the impact of the free movement of workers and the wisdom of having or foregoing temporary restrictions of the inflows of workers from the new Member States. Now that push was coming to shove, most Member States opted for restrictions, thereby confirming the fears of many workers in the Western part of the Union. It does not take much fantasy to appreciate that such a climate was not conducive for a good landing of the draft services directive in which the 'free movement of services' section attempted to facilitate the temporary provision of services by workers from Central Europe ! The ill-understood origin principle was read, more often than not, as

[21] *See Kok et al., 2004. One should add that the EP also plays no role in the Lisbon process. Here was a major chance to show that its role as a legislature did matter.*

meaning that the wages and non-wage conditions from Central Europe would then apply to these 'posted workers', even if this was flatly wrong in 22 out of 25 countries. No matter how emphatic Commissioner Bolkestein repeated that the posted workers directive 96/71 imposes host country control (for minimum wages and several other conditions), a widespread disbelief lingered. This disbelief was partly due to the strong objections from Germany, Sweden and Denmark where collective agreements rather than minimum wage legislation prevailed, circumstances which were regarded as an open invitation to set up circumventive (but legal) constructions to avoid paying such local wages. In other countries, the lingering disbelief was fed by the observation of other evasive constructions or plain illegality which rendered host country control a paper tiger without much practical effect. Inside labour unions prospective losers such as low-skilled workers or semi-skilled workers in a few sectors bound to be hit (e.g. construction, repairs, hotels, restaurants, horticulture) began to receive the benefit of the doubt and a groundswell of protest emerged against the draft directive on account of labour issues. Thus, in addition to the context dominating the substance, the labour issues began to overwhelm the hard core of issues for which the directive had been drafted: the liberalisation of cross-border services.

Thus, to say that rent seekers were the main reason for opposition to the draft directive is too simple, even if there is clear evidence that rent seeking manifested itself in the many requests for derogations (from the liberal professions to taxies !) and, possibly, in the fierce resistance against the combination of the draft services directive and the posted Workers directive in the countries not having general minimum wage legislation (first of all, Sweden and Denmark, and in a less general way, Germany). The latter issue turns around the practical impact of service providers from (say) new Member States, which could be daughters of German or Swedish companies, offering temporary services at wages far below the collective agreements in these three countries and not hindered by wage floors in the law.[22] The obvious remedy to enact a minimum wage legislation is fiercely resisted by the labour unions in these countries for reasons that look like a combination of local ideology ('the government or politics should stay out of industrial relations') and all-too-cosy closed shop practices. Respecting diversity among Member States would imply here that the internal market for (temporary) services would not be under the conditional and moderate host-country control of the Posted Workers directive 96/71 but under absolute host country control entirely dictated by the social partners in such countries. Such an extreme view would be defended as a 'right of social partners to make collective agreements', but would fragment the internal market for temporary services as any advantages of workers from the new Member States are totally removed. Incidentally, it would also apply to the 'free' movement of workers: the 'free' movement would be throttled as host country control reduces the demand for workers from the new Member States to a trickle (see Pelkmans, 2006, p. 198 for a graphical economic analysis).

[22] *See for the case of Germany, the examples and analysis in Nicolaidis & Schmidt (2007). For Sweden, the issue became acute just before the Bolkestein draft was tabled in the Laval case (case C-341/05). See http://curia.europa.eu and Press release no. 36/07 and the links to Advocate General Mengozzi's view, on 23rd May 2007. See also Pelkmans, 2007 b.*

The labour issues, however, also played a role in many countries which do have minimum wage legislation. By way of illustration, it is insightful to zoom in on the completely misconstrued debate in e.g. France on the 'Polish plumber'. In sharp contrast to the framing in French politics, this Polish plumber (if working as an employee in temporary services under the draft text) would have been obliged to be paid the French minimum wage plus adherence to several other non-wage conditions like health & safety and vacation days, for example (this follows from the Posted Workers directive). If the Polish plumber would provide temporary services as an independent, he does not need the draft directive because there is no change from a long tradition of concluding a service contract, the implicit hourly wage of which is 'free'. In other words, the situation from before Bolkestein in this respect remains unchanged. If the Polish plumber comes to France or any Member State (other than the three mentioned above) as a worker contracted by a French building firm, again host country control applies. If he comes illegally, obviously, the directive is of no use, it is up to the national authorities to enforce the law. These four options for the Polish plumber are exhaustive, there is no other option Nothing in these four options constitutes a new threat to French workers ! But this inference is the exact opposite of an avalanche of assertions in the French media at the time. A detached analytical approach of the draft directive is of little use if politicization takes on such ominous forms[23].

One may also study the positioning of individual countries. Nearly a dozen governments, sometimes the Prime Ministers personally, shifted from a generally favourable view to staunch opposition or 'Bolkestein bashing' without details. This was prompted by complex and varying drifts in domestic politics. However, in Western Europe it is too easily forgotten that the new Member States as well as countries such as the UK, the Netherlands and Spain remained in favour of an only marginally amended version of the directive until the French/German/British compromise was hammered out in May 2006. It should also be telling to many readers that in the Netherlands the social partners in the Socio-Economic Council (SER, 2005 ; see also Pelkmans & van Kessel, 2007) *unanimously* agreed to an amended version of the directive (with an analytical report going into almost every conceivable detail and dismissing a lot of the framing) with the origin principle being upheld! Nobody can seriously argue that the Dutch SER would not wish to balance carefully the social dimension with the desirable and long overdue services liberalisation in the internal market. Had the EP adopted this version, all the serious objections would have been dealt with appropriately and the internal market for services would nevertheless have been pushed forward much more than today. Finally, in several countries the services directive became mixed up with the domestic political campaigns about the constitutional treaty. In France, this went so far that numerous French voters came to

[23] *It is not the purpose of this contribution to survey the entire debate of the directive. Thus, the sensitivities about a sectoral approach for health (see infra), the more precise demarcations of services of general economic from non-economic interests, the idea of a separate directive on the former (an older idea which resurfaced in the services debate) and the turbulence about the origin principle, the option of mutual recognition and the final 'solution' for art. 16 as well as other questions are not treated here. For art. 16, see section 7 (supra).*

believe that the constitutional treaty was another example of being too liberal (whereas, in fact, the status quo was purposely kept in socio-economic affairs, already in the Convention, and a few marginal amendments are best regarded as going the other way e.g. art. III-122).

7. The services directive in force

In December 2006 the EU legislator passed the new services directive[24] in second reading, a text which differed rather drastically from the initial draft text. Indeed, the new version had been amended in such a far-reaching way that the text should have been subjected to a second regulatory impact assessment (=RIA), as the 'better regulation' rules and the inter-institutional agreement prescribe. There was every reason to do so, after the polarization and incredible confusion, which characterized the debate for almost two years, had clearly caused serious problems of drafting and coherence whilst raising pertinent queries about impact and effectiveness. However, none of the three EU institutions involved dared to propose a new regulatory impact assessment. The reasons are purely political. The leading arguments (which were, of course, never formally expressed) can be paraphrased as "better pass a truncated directive first" and " in the present political climate, a new regulatory impact assessment could be regarded as a political postponement rather than an analytical exercise, hence, the RIA could become tainted". The upshot is that a piece of bad regulation was adopted, even if the directive represents welcome progress in some respects.

Two properties of directive 2006/123 on Services in the Internal Market immediately catch the eye: it is a directive of "Angst" and the value-added of the free movement section has been truncated significantly. Before relating the directive now in force[25] to Figure 2, it is worth illustrating how the "Angst" has overwhelmed the (re)drafters of the directive. There are no less than 118 considerations in the preamble (!) which is already most unusual[26] but a long series of them is about what does not fall within the scope or is derogated. Fortunately, consideration no. 33 has survived the hectic process of amending texts because it is the only concrete indication of what services do fall under the directive. It is perhaps good to mention this list explicitly : business services such as management consultancy, certification and testing, facilities management, advertising, recruitment services and those of commercial agents ; mixed B2B and B2C services such as legal or fiscal advice, real estate services, construction, architect services, distributive trades, organizing trade fairs, car rental and travel agencies ; consumer services such as tourism, leisure services, sports centres, amusement parks and certain services for the elderly (except when derogated). A comparison with Figure 1 shows that this coverage is still interesting.

Also at the outset of the directive's text, "Angst" dominates. It is peculiar to find that lengthy articles 1 and 2 as well as art. 3 are entirely devoted to the specification of what does not fall within the scope of the directive, what the directive is not about and what other EC law overrides the provisions of the directive (e.g. the posted workers

[24] *Directive 2006/123 in OJ EC L 376 of 27 Dec. 2006 on Services in the internal market.*
[25] *Although the directive is formally in force since 28 Dec. 2006, the Member States have until 28 Dec. 2009 for bringing into force the laws, regulations and administrative provisions necessary to comply (art. 41 / 1).*
[26] *See Hatzopoulos (2007) for similar observations.*

directive and the TV without frontiers directive). Art. 1 reiterates that the directive is not about the liberalisation of 'services of general economic interest' (art. 86, EC) nor about privatization (which is a curious and totally superfluous remark because the EU has no competence whatsoever with respect to such matters of ownership [art. 295, EC]). Other curious specifications include that it is not about state aids which fall under competition rules (why this remark?), not about media pluralism and related matters, nor about criminal law, nor about labour law or social security. Art. 1.7 does matter : the directive does not 'affect the right to negotiate, conclude and enforce collective agreements and take industrial action ', a direct reference to the Laval case in the ECJ and more generally to the three countries relying on collective agreements only. Art. 2 narrows the scope and lists 12 areas not falling within the scope. Some are sectoral acquis and hence not surprising (e.g. transport [where consideration no. 21 specifies that taxis and ambulances are defined as transport], financial services, electronic communications), one is sectoral but with an unclear acquis, hence understandable (healthcare), some are obvious because not economic (services of general interest and social services) whereas the rest consists of the outcome of strong lobbying for derogations (temporary work agencies [with a few Member States long favouring extremely restrictive provisions], audiovisual services, gambling, private security services and notary services). One might hope that, except for gambling, sectoral liberalisation is given priority by the Commission for these latter derogations.

The broader functional provisions of the directive (simplification obligations for Member states, single windows, right to information, and facilitation by electronic means) have survived, with finer amendments which are too detailed for present purposes. Clearly, these are useful if well implemented. In terms of Figure 2, the section on the freedom of establishment has largely remained the same. What is important is the disciplining of licenses and other authorisations (a true curse in some countries) in art.s 9 13 as well as the list of prohibited requirements in art. 14 (or those subject to evaluation, in art. 15), including the infamous 'economic needs test'. There can be little doubt that, on this count alone, the directive was worth passing. Different simulations (see section 5, infra) show that the larger part of the economic gains can be expected to come from the freedom of establishment, not least because that is the natural route to deliver many services, as noted before. In this perspective, much of the polarization on the origin principle was more symbolic than crucial for a boost to EU economic growth, except for selected sectors.

Figure 2 shows that the free movement section in the draft is far more complicated, not to speak of its proper reading (against the backdrop of sizeable ECJ case law). Even if these complications would seem to be for a lesser economic gain (than establishment), the debates were ferocious and accompanied by several demonstrations. The directive now in force has removed the rigorous (though intricate) logic of Figure 2. The regulatory logic of Bolkestein was centred on the origin principle, decorated with all kinds of disciplines and derogations. Directive 2006/123 does not comprise the origin principle anymore, even if much of the rest of the edifice has remained more or less in place. Instead, art. 16 now reiterates the existing free movement of services provisions in two complementary sentences

as follows: "Member States shall respect the right of providers to provide services in a Member State other than in which they are established. The Member State in which the service is provided shall ensure free access to and free exercise of a service activity within its territory". These sentences add nothing to a treaty text which is 50 years old by now. They are followed by the explicit listing of three elementary principles of EC law : non-discrimination, necessity and proportionality, which, again, seem superfluous (quite apart from lengthy texts in the Pre-amble on these very principles). Art. 16/2 is interesting as it comprises a 'black list' of 7 practices which are henceforth forbidden[27] and will be a relief to many SMEs crossing borders to provide temporary services. Collective agreements are protected in art. 16/3 'in accordance with Community law', which renders the (forthcoming) ruling on the Laval case even more crucial than before. Art. 17 adds a list of extra derogations (on top of art. 2) including network industries (postal, electricity, gas, water and waste) and a series of more special cases (including e.g. mandatory notary services, certain intellectual property rights and, once again, the posted workers directive 96/71, etc.). One can raise serious questions about these derogations, now that the origin principle has disappeared. Given that art. 16 is merely restating free movement of services, the derogations imposed by the EU legislature cannot alter the authoritative interpretation of EC law by the ECJ. As Hatzopoulos (2007, p. 34) puts it "Toutes ces 'exceptions' portant sur les principes etablis par la jurisprudence de la Cour sont source d' insecurite juridique et risquent de créer des tensions entre le legislateur et le juge communautaire..". Former ECJ judge Edwards (2006) goes further and laments "[I]f political institutions no longer feel bound by the case law on the Four Freedoms, for how long will there be 'common market law' for us to review ?". His conclusion is for the "... Parliament to work within the bounds of that interpretation, unless and until the Treaty itself is amended by those who have the power to amend it".

On a positive note, these central articles are followed by a range of provisions which are to be applauded. Art.s 19 23 are protecting the recipients of services in various ways by outlawing special licenses, by assistance, by information obligations and other aspects of services quality. Art.s 28 and following stipulate details about far-reaching administrative cooperation. Although some such administrative cooperation is already specified in the treaty (!), it is the organisation and detail, helped by dedicated networks and electronic means, and actively stimulated by direct Commission involvement that raises hope for effectiveness. Finally, since this horizontal directive is mainly about liberalisation, it is good to mention that two other types of provisions might augment the value of the directive over time. First, Member States will enter an extensive screening exercise and will have to report on it (art. 39/ 1), so that joint evaluation will be possible on the harder cases. A standstill provision is included, too (art. 15/6). Second, there are several options to harmonize. One is that the Commission is held to report by the end of 2010, with additional initiatives 'where appropriate'. Another is given by the so-called "rendez-vous" clause of art. 41 which is to review the

[27] *E.g. a Member State cannot require establishment when only free movement is at stake, cannot impose a license or registration requirements unless covered by the directive, cannot impose bans on activity or special contracts, cannot ask for service-specific rather than general identity documents, etc.*

working of art. 16 ; it might also lead to amendments. Third, now that so much has been pushed outside the directive, one should not neglect what happens in sectoral initiatives, the principal one in the short run being healthcare.

8. Conclusions

Decades after the absence of detail in the (horizontal) services provisions in the treaty needed to be addressed, the EU has finally enacted a directive, be it after exhausting debates and much talking at cross-purposes. The economic case for going this route is firm and will only become more important over time. The outcome of the legislative process in the form of directive 2006/ 123 can be assessed, in short, as follows. In terms of 'better regulation', the directive is something like a regulatory failure : its coherence has suffered a blow compared to the draft, the dominance of 'Angst' has prompted a text full of negatives and curious, superfluous statements and the status of the derogations is unclear at best (and, possibly, go against case law !) now that art. 16 is no longer about the origin principle. But the harvest in terms of concrete provisions which do matter, is fortunately a lot more positive than the often hectic debates in the EP would seem to have suggested. The most important gain is that the freedom of establishment has effectively been liberalized and relieved (e.g. by the black list) from a range of national practices going against letter and/or spirit of the internal market. Other provisons about establishment are also to be applauded as they should help hesitant and uninformed SMEs. The economic gains from establishment in services are bigger than those from free movement, even with the origin principle, let alone 'without'.

The free movement of services as formulated in art. 16 represents nothing else than the status quo. However, even when accepting the derogations and exclusions on face value, useful additional features nevertheless do add value. One may refer to a black list also here (art 16/2), more credible structures for administrative cooperation and extensive protection for the recipients of services. Furthermore, Member States go into a screening exercise and a possible route for future harmonisation has been indicated.

In the medium-run, one should expect several draft directives of a sectoral nature e.g. on healthcare. Also, the repetitive derogations and exclusions of network industries in the text, of course, do not mean that the combined liberalization and regulation of the network sectors will be stopped or weakened. They will simply remain sectoral as has been the case for almost two decades now. It is true, the absolute form of host-country control, driven by collective agreements, is likely to prevail, but with the rapid convergence of wages between East and West in the EU, its impact will soon become less important. With the 'rendez vous' clause, the services debate will come back on the table in 2011. One cardinal difference will be that the EU and many services players will have become better accustomed to the language, case law, harmonisation and implications of the internal market of services. Also, Member States (and regional governments) will at long last have undertaken a systematic screening of their own laws and decrees and presumably - cleansed them from all kinds of cosy specifications protecting vested interests rather than the broader public interest in an EU context. Economically, the crucial position of services will be better understood and, one

suspects, analyzed. The EU should therefore expect another decade of gradual further liberalisation and modest harmonisation in the internal market of services after the 'rendez-vous' which will further reduce the costs of lost opportunities caused by the "Angst" in the EU institutions in 2005 and 2006.

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