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Policy Note

The EU Services Directive: Untapped Potentials of Trade in Services

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The biggest reform step to date in the liberalisation and deepening of the EU internal market for services was taken with the EU Services Directive. Its implementation intended to provide a clear impetus for the removal of existing obstacles to the free movement of services, the freedom of establishment of services providers and for administrative simplification. The project quantifies the Directive's effects on Austrian and EU services trade and welfare but also highlights untapped potentials due to remaining administrative barriers and existing weaknesses in the implementation and enforcement of the Single Market rules. The estimation relies on a structural gravity model estimated on a disaggregated industry level.

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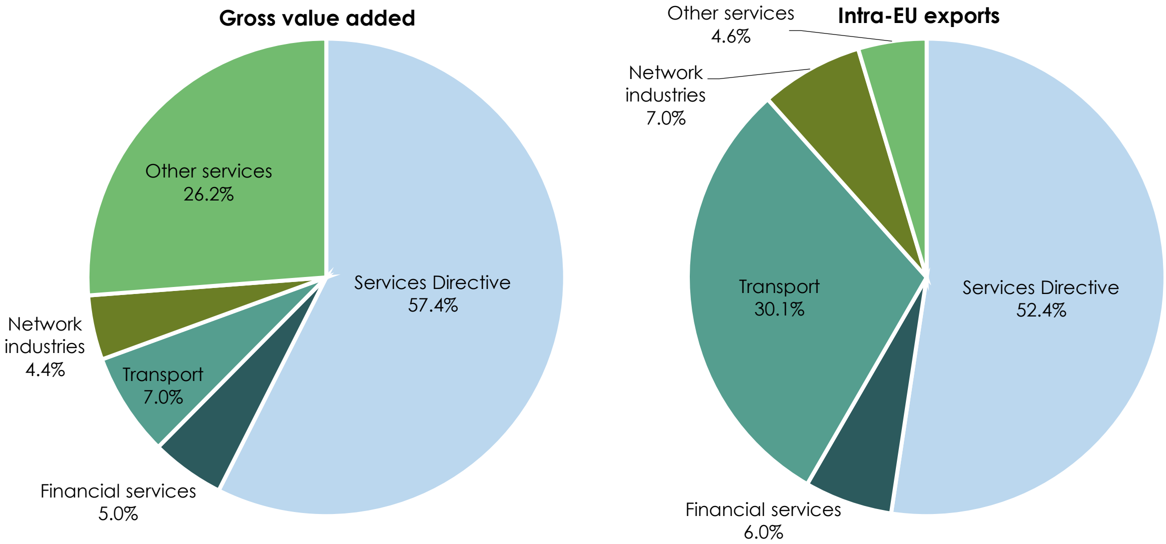
Policy Note

The EU Services Directive: Untapped Potentials of Trade in Services

Yvonne Wolfmayr, Michael Pfaffermayr

European services sector integration and liberalisation have proven to be difficult due to the multitude of administrative barriers, access restrictions and different regulatory approaches in the Member States. The most important reform step to date towards deepening the internal market for services was taken with the Services Directive (SD). It entered into force in June 2006 and was implemented – in legal terms – in most countries by 2010. Its goal was to advance the removal of existing obstacles to the free movement of services, the freedom of establishment of services providers (FDI) as well as to spur administrative simplification. While its scope is broad, the SD excludes some sensitive sectors as well as sectors for which there are separate Community actions or EU legislative acts. The sectors covered include business and professional services, business support and administrative services, information services, construction, retail and wholesale trade, real estate, tourist accommodation, hotels and restaurants as well as private education and health care. These sectors accounted for 62% of total intra-EU services exports, well over half of Austrian exports to other EU members and almost 60% of Austrian total services value added (Figure 1).

Figure 1: Austrian nominal gross value added and intra-EU services exports by services sectors, 2018



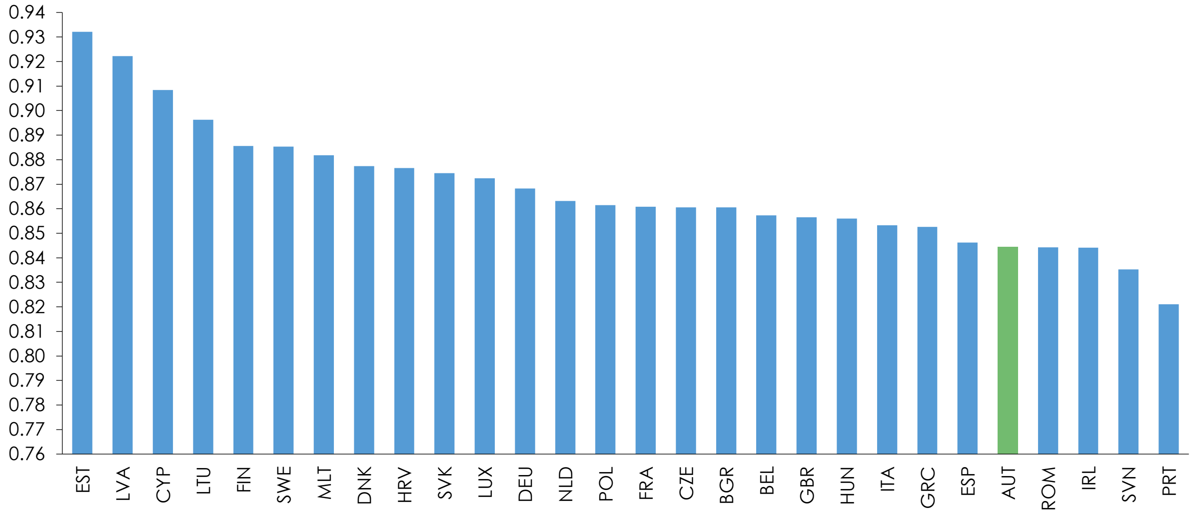
Note: The export data presented only cover cross-border services provision. Other forms, such as consumption abroad (as in tourism), supply through establishments ("commercial presence") or posting of natural persons are not captured in these data. Travel is mainly supplied through "consumption abroad" and is therefore not part of the reported OECD TiVA data for "accommodation, food services".
Source: OECD TiVA (2021 release), WIFO calculations.

The SD's 15th anniversary in 2021, motivates to take stock of the progress of reforms as well as the trade and welfare gains so far achieved and to quantify unexploited potential gains due to implementation deficits. The results add to still sparce empirical evidence based on ex-post analyses of the SD. Estimation results are based on a theory-consistent specification of the gravity model at the industry and country level over the period 1995 to 2018. The analysis applies a novel country-specific indicator derived from business complaints with respect to cross-border trade issues reported to the SOLVIT mechanism[1]). In this way all estimated effects take account of heterogeneous degrees and qualities of SD implementation across Member States.

Key findings

Highly uneven implementation and reform efforts across countries and sectors: According to an indicator based on SOLVIT complaints as well as earlier findings in the literature, implementation of the SD and progress in reforms have been limited, slow and highly uneven across countries and sectors (Eurochambres, 2010; Monteagudo et al., 2012; European Commission, 2015; European Commission, 2021). Austria finds itself among the group of EU countries with moderate implementation of the SD. At the same time Austrian exports are rather strongly concentrated on EU trading partners belonging to the group of weak reformers (Figure 2).

Figure 2: Reform progress in EU trading partners by Member States as signalled by the SOLVIT indicator (2010-2018)

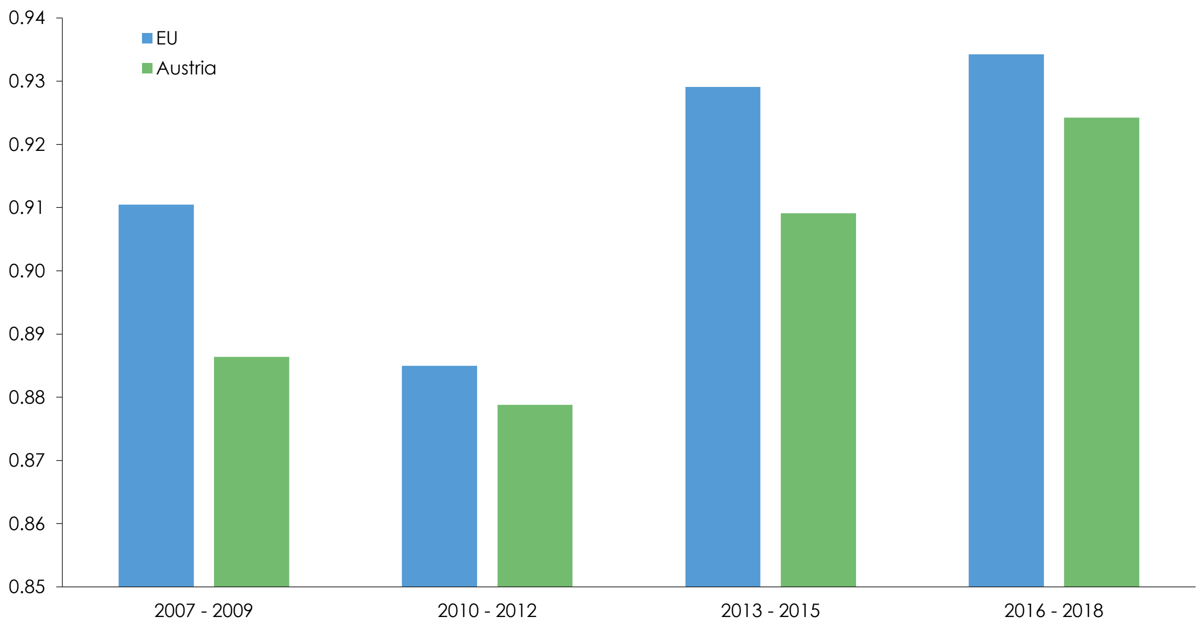


Note: A higher value of the indicator signals a lower frequency of problem cases in SOLVIT.
Source: Single Market Scoreboard, SOLVIT business cases, WIFO calculation.

[1]) The SOLVIT network was introduced in 2002 to solve cross-border problems related to misapplications of internal market rules by public authorities. SOLVIT handles complaints by citizens and businesses concerning infringements in the EU internal market due to national rules that conflict with EU law or due to a lack/inadequate transposition of EU law, etc. It is one of the EU's most important internal market institutional instrument and mechanism.

SD implementation improves over time: According to the literature reviewed most reform steps were taken during the "official" SD implementation phase between 2006 and 2010, but reform efforts slowed down considerably and remained heterogeneous across countries thereafter. This conclusion in the literature relied solely on assessments of the changing number of trade-impeding services regulations in place not taking into account for the stringency and the trade-impeding impact of restrictions. The SOLVIT indicator on barriers to services trade applied in this study more directly relates to more relevant obstacles and impediments to cross-border business in the EU as services providers are likely to report only problem cases of high importance to the SOLVIT system. The development of the SOLVIT indicator confirms the pattern stated in the literature until 2012 but indicates improving compliance with SD rules by most Member States and Austria beyond that date.

Figure 3: Development of the SOLVIT indicator in the EU and Austria



Note: A higher value of the indicator signals a lower frequency of problem cases in SOLVIT.
Source: Single Market Scoreboard, SOLVIT business cases, WIFO calculation.

The SD raised Austrian exports to and imports from other EU countries by 6.2% and 6.7%, respectively. Real income was lifted by 0.3% on average: The study finds that the SD has delivered benefits in terms of increased trade and real income gains in Austria and at the EU level. The estimates indicate positive trade and welfare effects for all services industries covered by the SD. The IT and information sector, as well as the sectors "professional, scientific and technical activities" and "wholesale and retail trade" contributed most to overall trade gains realised up to the year 2018. General equilibrium trade results indicate that the SD raised Austrian exports to other EU countries by 6.2% and Austrian intra-EU imports by 6.7% on average in the period 2010 to 2018 inducing an average real income effect of 0.3% compared to a counterfactual situation of "no policy change". With these results Austria ranks well in the middle among the EU countries. SD-induced trade effects for Austria as well as for the total EU accelerated over time. This reflects the delayed reform process, but also that SD-induced reforms needed time to become fully effective.

Table 1: Realised and potential trade and real income effects of the Services Directive in Austria

	Realised effects 2010-2018	Potentials
	Percentage changes	
Intra-EU exports	6.2	9.5
Total exports	4.5	6.4
Intra-EU imports	6.7	7.5
Total imports	4.3	5.6
Domestic trade	-1.1	-0.5
Real Income	0.3	0.2 to 0.4

Source: WIFO calculations.

Potential further impacts of 9.5% for Austrian intra-EU exports and of 7.5% for Austrian intra-EU imports. Real income potentials range between 0.2% and 0.4%: The findings in this study also indicate that strong improvements in the compliance with and the implementation of SD rules could be an important source for additional trade increases and associated real income gains for Austria and the EU. In a counterfactual scenario of "best SD implementation" which assumes that all EU Member States increase reform efforts to the level of the group of best reforming countries in the sample, the analysis finds an intra-EU export potential of 9.5% and potential real income effects in the range of 0.2% to 0.4%. Real income effects are driven by a shift in relative prices of traded goods and arise not only from an increase in exports to countries of improved SD implementation but also by substituting cheaper imports for more expensive domestic services provision.

The resulting trade potentials are similar across the services sectors covered by the SD. Throughout, the calculated potentials are higher than the impacts so far realised. Real income potentials range from 0.1% in the sector of "business support and administrative services" to 0.7% in the sector "publishing, audio-visual and broadcasting". Austria ranks among the EU countries which have the most to gain from deeper reforms and better compliance with SD rules. At the sector level, the revealed trade and income effects from SD implementation in the IT and information sector as well as the group of professional, scientific and technical activities are most promising since these activities are essential inputs to many other sectors and key drivers of competitiveness and productivity. Last not least, the analysis provides evidence on the importance and positive impacts of informal and faster solution mechanisms such as the SOLVIT mechanism to tackle possible cross-border services trade problems.

Small trade diversion effects with non-EU countries in the rest of the world (ROW): Trade diversion effects were found to be quite moderate and non-existent in some bilateral relations with the ROW. Deeper and stronger services sector reforms in the EU are therefore not likely to be associated with high costs for the ROW and might even contribute to an overall liberalisation of services trade.

Policy conclusions

The counterfactual scenario of "best implementation" considered in the analysis implies an almost perfect world of full compliance and enforcement of SD rules in all Member States. Thus, for the potential effects to be realised policy coordination among members must ensure joint efforts and must prevent uncooperative behaviour of individual countries, which could be born out of the incentive to capture gains for its own export industries but at the same time to protect its own industries from increased import competition. Indeed, the resulting welfare gains stem from an increase in exports but also from an increase in imports that substitute for less efficient, more expensive domestic provision of services. In that sense, further income gains from the SD in Austria will only materialise if all its EU trading partners improve implementation of the SD and push ahead with services sector reforms and, if Austria itself does not deviate from this behaviour to shelter its own services industries. This is also true for all other EU countries.

Hence, the strengthening of mechanisms to improve compliance with internal market rules is of utmost importance. This is a big challenge from a political economy view and might to some extent explain the slow progress of services sector reforms so far. Therefore, better implementation and enforcement of SD rules crucially depend on Member States' commitment and involvement and better cooperation between all European actors.

In this context the coordination and cooperation mechanisms already in place are important and promising. These include the mutual evaluation exercises, the periodic European Commission assessments on the progress of SD implementation, compilation of administrative and legal barriers in services, the establishment of "Points of Single Contact" as well as initiatives set with the 2017 Services Package. In addition, mechanisms not directly related to the SD but also promoting the enforcement of its rules include the Internal Market Information System (IMI), the Single Market Scoreboard or the SOLVIT mechanism. The IMI is an important online tool to support authorities in cross-border exchanges of information and administrative cooperation in the implementation of internal market legislation. The Single Market Scoreboard has proven to be useful in providing insights into legal enforcement and transposition deficits as well misapplications in the practical execution of the law. This has the potential to increases awareness of problems. In addition, inter-Member-State comparisons create some peer pressure and could help to improve Member State's commitment. Finally, the SOLVIT mechanism challenges breaches of internal market rules and simplifies the procedures for business (and consumers) to complain about problems encountered in cross-border intra-EU trade.

While all these mechanisms are in place and are important to an effective monitoring and evaluation at the national and the EU level, they still face the challenge of lax reporting by individual Member States, diverse reporting standards across countries as well as insufficient awareness of the tools and mechanisms in place. Assessments of barriers to services trade are valuable, but so far not readily accessible. In addition, they are focused on the presence of restrictions and the number of restrictions in place. The pure number of regulations does not reveal the stringency and trade-impeding impact of the regulations. Likewise, the purely legal transposition does not ensure full compliance with SD rules in practice. To tackle these challenges, it seems most important to provide clearer and more precise guidelines as well as further trainings of officials to increase and harmonise reporting standards across EU countries as well as to lift awareness of the Single Market tools at hand.

A focus on developing better indicators that reflect internal market barriers in all sectors, but particularly in services sectors, could promote a common understanding of the challenges and improve the assessment of the economic impact of policy initiatives such as the SD. These in turn could raise awareness and commitment. Such indicators could be formed along the lines of the OECD's Product Market Regulation (PMR) or the World Bank Doing Business Indicators but would have to be adapted for the purpose of assessments of the state of the Single Market for services. It would be important to provide more such indicators at the sector or service activity level. This research study was a first step towards disaggregated analysis at the service sector level and found that improved application of the SD could result in additional trade and real income gains in all sectors analysed. Exploitation of these potentials requires continued identification and monitoring of barriers at the disaggregated level of countries and individual services sectors.

Last not least, it is important to see the SD as an important part of an overall framework for the EU internal market of services. The report has highlighted the most important cross-linkages to the relevant EU legislative acts and directives. These complementary policies are essential for the SD to be fully effective. The most important of these cover the EU competition policy framework, regulations concerning public procurement, infrastructures for network industries, including electronic communications, but also sector-specific EU regulations for services that are excluded from the SD (financial services, transport and network sectors) or the European Retail Action Plan (ERAP) as well as the Recognition of Professional Qualifications Directive or the Posting of Workers Directive. Since online transactions represent an important mode of delivery for many services the Digital Single Market is also of great importance.

Literature

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