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MARKET INTEGRATION FOR SERVICES: MESSAGES FROM THE WORKSHOPS ORGANISED BY THE BUREAU OF EUROPEAN POLICY ADVISERS

1. Introduction

The Commission's Spring 2007 Communication 'A single market for citizens' stated that:

> *The Single Market is one of the European Union's concrete successes. For individuals, it means the right to live, work, study or retire in another EU country. For consumers, it means a wider choice of quality products and services at lower prices. For business, it means operating on a common set of rules and enjoying access to a domestic market of 500 million consumers. For Europe as a whole, it means a more open society and a more competitive economy in which social rights are respected and high standards of health, safety and the environment prevail.*

While these achievements are by now widely acknowledged, it is equally widely felt that the Single Market has substantial untapped potential and needs to be adapted so to meet new challenges. The economy has changed from a mass manufacturing to a knowledge and service base. Enlargement has changed the nature of the Single Market. The market itself will not be single but diverse, culturally, linguistically, in levels of development and administrative capacity. The scope of the game has changed from national to European to global.

The question then becomes *how* the Single Market has to be adapted to meet new challenges. Today's complex and diverse world precludes one-size-fits-all solutions. The legal rights to establish a business and to move freely within Europe exist. But that alone is not sufficient to let markets function properly. In order for the Single Market to deliver further concrete benefits to citizens, one first needs to verify where the biggest potential for benefits lies and what is preventing these benefits from being realised. For this a results based approach taking a user perspective is needed. This implies analysing specific markets through a bottom up approach involving users, innovators and new entrants, market participants, public authorities and market experts.

As a first step in exploring this results-oriented approach to the Single Market, BEPA, with the cooperation of McKinsey and Company, organised four workshops. The markets covered include pharmacies, legal services, construction, health services, retail distribution and e-commerce. They were selected on the basis of their economic significance (they accounted for 21% of EU25 value added and 29% of employment in 2005) and their untapped potential. The set of services markets chosen provided opportunities to examine more closely the nature of remaining barriers and the way in which different barriers interact to limit the potential development of service markets and integration between Member States. They also provided an opportunity to identify

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common elements despite the differences. The workshops were set up as a limited test of the results based approach. The results that emerged were sufficiently encouraging to justify further testing and extending by in-depth market monitoring of these and other sectors. The workshops brought out in a strong fashion several common elements across sectors and across countries. The conclusions drawn for the Single Market Review are based on these common elements which are developed further in section 3.

From the workshops, BEPA derived three main findings:

1. A results based approach reveals that barriers both regulatory and non regulatory still exist in abundance and in large variety. These barriers prevent service markets to reach their full potential in terms of growth and employment, and obstruct market integration;
2. The Single Market is most effective through its impact on national markets;
3. The Single Market is most effective when acting in conjunction with other policy instruments at EU level and with national, regional and local regulations.

1.1 A results based approach

A top-down approach with EU directives implemented by national governments has contributed to eliminating legal barriers for the four freedoms. This was an essential first step in the Single Market process. Now that this step has been taken, the next step has to move down one level of aggregation. For the Single Market to deliver results for citizens in a European economy above all markets need to function well. To assess the appropriate role for the Single Market in each market and in each Member State, we first need to identify which barriers remain and which new barriers emerge. Since the nature of these barriers will be different between countries and different between services markets, one has to start from the bottom and then move up to identify common elements.

The workshops have shown that such a bottom-up approach works. A variety of barriers were revealed, some of them confirming what one could expect reading the literature but more often than not revealing information that cannot be easily acquired from other sources. The workshops confirmed the general line that has been taken in the Spring vision document, but also moves beyond that by revealing the direction in which the Single Market needs to be adapted in a more concrete way.

Barriers were often not directly Single Market related. Sometimes relatively straightforward mismatches between national regulations caused barriers to entry. At other times lack of technological standards blocked progress, sometimes lack of transparency for users or cultural differences made the difference.

Despite the variety of barriers, common elements could be identified. Three of such common elements are:

(i) protection of national vested interests is still widespread, at the expense of users and linked to this and (ii) national regulation is still often based on historical grounds, but does not always serve the public goals it used to do. For instance, the workshops revealed that in the market for pharmacies and legal services there were restrictions on ownership, advertising and economic needs tests in many Member States. Some of these requirements are effectively protecting vested interests; others are relics from the past. Either way, it is not clear that these regulations or requirements always serve the best interest of the users.

(iii) administrative requirements and labour market regulation constitute a barrier to growth for successful SME's. For instance, in construction the inability for small and successful SME's to grow is blocking progress.

1.2 The Single Market is most effective through its impact on national markets

There could be a temptation to associate 'the Single Market' with one integrated and homogeneous European market for goods and services. However, and particular in the case of services, the markets are national (sometimes even regional or local) and are likely to remain so. The reasons for this have to do with language, differences in legal systems, the importance of distance, trust or cultural differences. Health patients do not like to travel to get an operation. Legal services requires providers with knowledge of national legal systems. Residential construction markets are regional. Lack of trust makes cross-border e-commerce very limited in scale. These differences are not likely to change rapidly.

The national character of markets does not make the Single Market irrelevant. Despite its limited scale, cross-border trade exists, there is eagerness by enterprises to penetrate other markets than their domestic one and labour and capital mobility is there as well. Certainly if there are impediments to cross-border activities there is a need for action at the European level. However the *main* contribution of the Single Market is not necessarily through the growth of these activities.

To the extent to which the national nature of markets is based on features that are likely to persist, the impact of the Single Market is channelled exactly through those national markets. Even if they remain limited in scale, the fact that there exist new entrants, labour mobility and local cross-border activities, implies that Single Market legislation becomes relevant. National markets at present do not function well as a result of obsolete historical regulations or the protection of vested interests. Such a situation of stalemate requires an external shock in order for it to dissolve. Local cross-border activities and new entrants can provide such a shock. The fact that regulations have to be coordinated between neighbouring countries or regions, or the fact that national regulation has to be adapted to accommodate foreign entry often implies the shake up of a market.

The workshops illustrated these points. For instance the pharmacy market in Germany has been shaken up by a new entrant using Single Market legislation to try a new business model. Irish health markets function more smoothly because of labour mobility from new Member States. Construction markets in Belgium and the Netherlands cannot meet demand without the influx of Polish workers. E-commerce markets will only develop if trust is enhanced and technological standards developed. For the Single Market to be effective it cannot rely on the emergence of a homogeneous European market for services that can be managed or regulated by centralised top-down solutions. It may be possible for such a Single European market to emerge for some specific services and in such cases there is every reason to encourage that development. But many markets remain local or national. In these cases the Single Market can effectively use free movement of labour, right of establishment and cross-border activities to improve the functioning of national markets to the benefit of end-users and European citizens.

1.3 Coherence between policies at EU level and those of Member States

A single policy instrument is unlikely to meet the challenges posed by the changing environment. For end users it does not matter where regulation comes from, as long as it benefits them. Making markets function better implies better co-ordination both between EU policies and between the EU and Member States. This is not just an issue of getting Member States to take ownership of the Single Market. National markets for services are the product of regulation adopted at EU, national and often regional and local levels. As a result, consistency of approach and compatibility between the different types of regulation becomes a major issue for the efficient functioning of markets. There are limits to what both harmonisation and mutual recognition can achieve. The huge number and disparate nature of services makes full harmonisation in most cases illusory. Mutual recognition has benefits but when there is incompatibility between different levels of regulation or between those of different countries, there are limits to what mutual recognition can do. Regulatory convergence around commonly agreed sets of principles and best practices between and among the EU and Member States would appear to be required in addition to minimal harmonisation and mutual recognition to make the Single Market for services function better.

Policy coherence is also needed across policy areas. In particular, coherence between labour and product markets is required to make sure that the opportunities that product market reform opens up are exploited and that adjustment takes place as smoothly as possible with minimum disruption to careers and individuals. The workshops revealed this as being particularly relevant in the construction market. At EU level, the three big market oriented policies of the Single Market, trade and competition policy are already mutually supportive. In the case of services, greater transparency up-stream is required for these policies to become more effective. A number of so-called "soft" initiatives could be taken in addition to the "hard" regulatory ones to make the markets for services function better. Outcomes are hard to measure, quality is a big issue and the consumer is often not in a position to judge a supplier before the damage is done. This proved to be the case for all the workshops. Work on developing product and process standards for services, on benchmarking best practice and innovation, such as applying information technology to services, are all important for improving transparency and encouraging diffusion of innovation. In addition, physical infrastructure and the interconnectedness of those sectors on which services depend such as telecommunications and logistics such as e-commerce are very important for the efficient functioning of the Single Market for services.

2. A results based approach to services

The interim report identified the need for the Single Market to move from a legal and regulatory approach to one based on results for users. The workshops provided an opportunity to dig deeper into the functioning of individual markets for services but obviously without being able to undertake fully fledged market monitoring. Rather they demonstrated the potential that future in-depth market monitoring exercises could bring to the identification of problems and the range of possible solutions. Examples of successful user based approaches to market monitoring exist. It was fortunate that the final workshop was able to benefit from the presentation of such a market monitoring exercise on internet shopping by the UK's Office of Fair Trading.[1]

Markets for services are highly diverse across services, within services and between countries so that making generalisations about them can be hazardous. Nevertheless, similar features across many services could be established. These features are of great importance for the functioning of different services. A great many barriers both of a regulatory and non-regulatory nature still hold back the development of services. The specific characteristics of many of these services combined with the remaining barriers determine to a large extent the economic performance of services. In addition, the weight of services in the economy and their strong interlinkages with the rest of the economy, both goods and services, mean that service sectors and markets also determine to a large extent overall economic performance. This section will begin therefore with the key characteristics of services for the functioning of the Single Market as they emerged from the workshops before examining some of the remaining barriers and their impact on economic performance.

2.1 Characteristics

One important characteristic of services that is commonly but not universally found is the <u>bespoke</u> nature of the activity. When each service needs to be tailored to an individual case, the capacity for standardising responses and making productivity gains in this way is low. Services as diverse as construction, professional services and health usually require a great deal of customisation for individual clients or patients. Even for retail, the service component often implies face to face contact that requires the reaction to be adjusted in the function of the client.

Issues of <u>asymmetric information</u> are rife. The supplier of the service has greater knowledge than the customer both about what service is required and the ability of the provider to supply the service. As a result, the customer has to rely on the regulator, for instance through the requirement that the provider be in possession of a recognised qualification, on word of mouth or on experience in the past with the same or other providers. In any case he or she is in a position of relative weakness. The often technical nature of the information means that consumer of the service may have limited ability to assimilate important aspects of the transaction. In the most extreme case, that of construction, inability to judge quality ex ante may lead to competition on the basis of price alone, even though for the customer quality may be a more important purchase criterion.

Many services have potentially long-lasting consequences or deficiencies that will only show up after the service has been provided. <u>Quality is an overriding consideration</u> but one that is difficult to measure or to monitor. Does it mean that the patient survives, that the building does not fall down, that the enterprise does not go bankrupt? Or does it mean something much more complex and nuanced?

With quality difficult to measure, particularly ex ante, the traditional way that regulators have strived to assure quality for many services is through limiting entry by the requirement that the provider be in possession of a recognised relevant <u>qualification</u>. In the course of a working life, knowledge acquired for an initial qualification will become out of date in the absence of a system to continuously upgrade skills. Qualifications are in any case an imperfect measure of the competence

[1] See http://www.oft.gov.uk/shared_oft/reports/consumer_protection/oft921.pdf

of a supplier to provide a certain service, which begs the question of who is to define and monitor competence? Even competence is not necessarily a good predicator of outcomes, although it is obviously a necessary condition for good quality provision.

Because it is easier to assess the provider than the service itself, most systems of accreditation are based on the procedures which a supplier applies rather than on judging outcomes. However, when assessing the quality of information provided on-line on health, the Picker Institute found that for the medical information sources they examined there was only a weak, non-significant correlation between providers who scored high on the content of their materials and those who scored high on their development process. The more sophisticated the service the greater the likelihood of such a divorce between process oriented controls and outcomes.

Where it has proved possible to measure outcomes, potential for considerable improvements in both quality of service and productivity have been revealed. One example concerns diagnosis related groups (DRGs) for the provision of health services. Such groups identify a specific illness and therapy and relate the success with which a treatment has met with the way in which the health system has organised and delivered the treatment. The introduction of DRGs has typically reduced the length of stay in hospitals by two days.

All of these problems of how to assess quality appear more difficult when dealing with cross-border provision of services, where information available is weaker and systems of national regulation and organisation of services unfamiliar. Without adequate systems of assessing quality, it will however be extremely difficult to make progress on either productivity improvements or stimulating cross-border purchases.

Both the bespoke nature of services and issues with measuring quality make measuring service output difficult. When each service is tailored to an individual user, it is difficult to distinguish between what is a new and an existing service. New product introductions then go un-noticed. Quality improvements constitute a big part of raising service output and when they are not measured they are ignored. As a result, much official data for services is unreliable and can give rise to mistaken interpretations on how services are driving the economy.

The specific characteristics of services make issues of trust between the service provider and the user important. This can take different forms. For electronic commerce issues of trust relate to the security of the payment system used to make a financial transaction, on the use of personal data, that the product (good or service) will be as specified and arrive in good condition, that warranties will be honoured and so forth. For professional and health services trust concerns the degree to which the recipient believes that the provider has his or hers best interest at stake, that the provider is independent of outside influences and is working to the highest ethical and professional standards.

Allied to issues of quality and trust were those of redress. Consumers and patients wanted to be sure that if something went wrong that they would have access to redress. Neither consumers nor SMEs wanted to engage in long and expensive litigation whose outcome was uncertain. They desired that procedures for dispute resolution should be simple, rapid and effective. For professional services and health, in addition, users wanted to be sure that their case would mean that errors would not be repeated on others. For electronic commerce, getting the money back and ability to return defective products without hassle figured heavily. For retail construction an effective system of guarantees over a sufficiently long period of time – usually five years but sometimes longer – was available so that defects could show up.

Many services are characterised by a strong interaction between labour and product markets. Self employment is high and a worker may move between employed and self-employment status with relative ease so that it is not always possible to distinguish clearly aspects that relate to product and labour markets. Such movement is particularly prevalent in construction. Another form of interaction is between working hours and shop opening hours where the different forms of regulation may in practice be incompatible. High skills are an important characteristic of professional services, health services and also construction. Attracting and retaining skilled staff is particularly important and the key to improving productivity but the prevalence of underground or black markets for labour undermines the incentive to train and to maintain skills in several service sectors. In the case of construction this can lead to a low productivity/low price equilibrium. Elsewhere, skills constitute a significant bottleneck on growth.

2.2 Barriers to growth of services

Market fragmentation for services is significant. Market fragmentation can be the result of regulation. Restrictions on the location of sales of over the counter medicines, ownership restrictions on pharmacies or the provision of legal services, zoning laws prohibiting out-of-town shopping are examples. Fragmentation can also result from market conditions. The residential construction market suffers from the large number of small jobs that are required to repair and maintain buildings; in retail consumers may prefer to shop for certain items in small scale, 'boutique' type establishments. Issues of confidence and trust also act as a barrier to take up of services. Again, the barrier created is much greater for cross-border purchases where previous experience with the provider, word of mouth and knowledge of local regulation and ways of doing business will be much less than for the local domestic market.

Barriers to entry for services are significant but vary in nature widely from one sector to another. Construction represents an exception with relative ease of entry and the ability to work as a sub-contractor for larger firms. For pharmacies the most significant barrier to entry is the limitation on the number or location of pharmacies allowed followed by ownership restrictions. Prescription methods may in practice preclude the provision by the pharmacist of generic medicines when the brand rather than the active substance is prescribed. For legal services, ownership restrictions and restrictions on advertising represent significant barriers to entry. Where certain services are reserved for public notaries who may have considerable pricing power, this also restricts the degree to which competition can take place. For retail distribution, shop opening hours and restrictions on the opening of hypermarkets constitute significant entry barriers that weaken competition in this sector. For health services, entry is restricted through for example numerus clausus restrictions on the number of health professionals that can enter training in any year.

Market fragmentation and high entry barriers often lead to low competition. Competition in services takes place on different dimensions and in different forms of which price is only one. For health services, the crucial dimension is that of choice by the patient rather than that of cost, a large part of which is usually reimbursed by the health system or free at point of use. Quality of information and advice is paramount for the relationship with the pharmacist or the lawyer. For retail distribution, price is a more significant factor but competition takes place also along different formats, hypermarkets versus low cost in-town outlets (discount stores) or general clothing chains versus franchises for individual brands.

2.3 Impact of services on growth and employment

Since most of the growth potential of the economy resides in services and the sectors selected have performed quite differently, the workshops provided an opportunity to examine in more detail the remaining barriers of both an economic and regulatory nature to a better growth performance in Europe. The barriers act directly to depress performance in individual sectors and through linkages also indirectly on other sectors of the economy.

Services are highly integrated with the rest of the economy and play a significant role in determining the growth performance of other sectors. Most professional services are sold to other businesses and provide key inputs to the corporate sector, including those relating to the internationalisation of business activities. Construction accounts for 52% of gross fixed capital formation and through its effect on investment has an important multiplier effect on the economy. The interaction between health services and social protection is quite strong. When people are not working they are usually in receipt of benefits. The health sector is also a highly technology intensive sector with a great deal of innovation stemming from the medical equipment sector. Likewise, retail distribution is a leading user of information technologies. The distribution system plays a key role in matching producer and consumer requirements and ensuring that the Single Market for goods and increasingly services can function effectively.

Cross-border purchases of services within the EU are rare, varying from 1-2% in the case of legal services, health care and construction to 15% of turnover for e-commerce (but only half that for sales to consumers). Markets are organised on a national basis and consumers in particular are reluctant to venture beyond national borders, even when there are relatively few restrictions and some advantages for them to do so – as with e-commerce. Local cross border markets are the areas where cross-border provision appears to have most potential as well as being most developed. The total population of local cross-border regions is 172.5 million inhabitants (or 35.2 of EU-27) with a combined GDP of €3.4 billion (or 31.9% of EU-27). In their own right, such regions represent a huge potential for cross-border provision of services.

The workshops confirmed the findings of the McKinsey Global Institute and other sectoral studies that there are very large differences in outcomes within the same sectors and that poor productivity is not inevitable. For example, in health, for each station on the London underground travelling east from Westminster life expectancy declines by almost a full year. Devising appropriate incentive structures in many cases can lead to major improvements in performance. However, such structures need to be careful to avoid perverse results. Targeting hospital waiting times for patients can lead to neglect of other important dimensions of health such as infections within the establishment.

All of the four sectors for which workshops were organised are major economic sectors in their own right each contributing a minimum of 4% to value added and employment. By nature of comparison, no manufacturing sector exceeds 3% of value added or employment. Labour productivity for the professional services grouped under "legal, technical and advertising" is above average for the economy while that for construction, retail distribution and health and social work is below (Table 1). Low productivity in such significant sectors will depress also the overall level and thereby income levels.

Difficulties with the measurement in particular for non-market services impose caution on the interpretation of data. For example, it is not obvious that health care, with a skill composition similar to that of professional services sold to businesses, a high user of sophisticated technology and with best practice management skills in areas such as hospital operation theatres should be a low productivity activity.

In terms of their contribution to growth and employment, construction and retail trade have both seen declining shares in value added while the professional services and health and social work both saw large increases. Employment growth for construction has been below average but above average for retail trade and well above average for professional and health services. Most worrying, according to the data growth in labour productivity was sluggish for all four sectors. Although considerable growth potential exists for all these services, therefore, the degree to which this potential has been realised varies and the productivity outlook does not look good – at least on the basis of the official figures. These must be treated with extreme caution. However, other indicators can also demonstrate the existence of a productivity problem such as the decline compared to the average of levels of labour productivity, higher increases than average for producer prices and the concentration of output in micro-enterprises for which productivity is lower than for large enterprises.

As is by now quite well known, Europe suffers from the low growth of new entrants rather than from a dearth of start ups (Fig.1)[2]. When dealing with market services, low growth is reflected in the "missing middle" (Table 2). Micro-enterprises of less than ten persons represent more than three-quarters of the total for all sectors and for more than 90% of the total for all the market service sectors. However, for manufacturing, public utilities and transport and communication the share in turnover, value added and to a lesser extent employment tend to rise with firm size. For other market services however the size category of firms with 50 to 249 persons employed is much weaker. In other words, a dualistic structure with a number of large firms and many small firms but few medium sized ones appears to dominate.

Threshold effects such as regulation on employment that make it much more burdensome to take on additional labour, or the need to take on professional managers once a firm reaches a certain size seem to hold back firms from expanding. In turn this would seem to indicate that the incentive for firms to grow beyond a certain size is insufficient to overcome the additional expense and problems that such growth would entail. Thus between the established large firms, often international in outlook and practice, and the small firms that have no desire to grow there is a category of potentially high growth firms that at present is not performing well. It is this category of firms that the Single Market could have been expected to impact most positively by removing barriers to their expansion.

[2] The OECD data would appear to overstate the growth of US firms relative to European ones since American start ups employ less people than those in Europe.

3. Impact of the Single Market on services

The previous section indicated that many barriers of both a regulatory and non-regulatory nature still exist to the integration of markets for services within Europe. Many of these barriers stem from national and local conditions that are holding back the development of services domestically as well as internationally. In this sense, the Single Market reveals problems with the functioning of existing markets for services.

Because the markets for services remain overwhelmingly national and even local, the effect of the Single Market on services is most profound through its impact on the functioning of national markets. For example the distance selling directive and e-commerce directives as well as general consumer protection measures that also apply to this area act within national markets as well as for sales cross-border. Measures to open telecommunications, rail freight and postal services all have a profound effect on the development of e-commerce providers, irrespective of whether their customers are located in the same country or in another Member State. In other sectors, where European regulation has addressed primarily issues relating to the cross-border provision of services, the impact of the Single Market has undoubtedly been less than expected. For example, standardisation has affected construction products rather than the service itself. Legal services and pharmacies remain essentially regulated or self-regulated on a national basis with for example the directive on recognition of qualifications playing a supporting role. So far the impact of EU regulation on national systems of health has been minimal, reflecting national responsibility for this area.

It is clear that the different modes of opening up markets for services have had quite different effects on national markets. Free movement of labour, both skilled and unskilled, has undoubtedly contributed to the development of service markets in Europe. Right of establishment is the most common way to penetrate markets for services and is also the preferred mode of both enterprises and public authorities. The small share of cross-border provision means that its direct impact is limited but indirectly it can affect the functioning of national markets. These issues are developed in the following sections.

3.1 Free movement of labour

The main area where the Single Market has had an impact on services is through labour mobility between Member States, facilitated by EU legislation on freedom to move and to establish and on the mutual recognition of qualifications. Although overall labour mobility in Europe is low, quite significant movement has taken place in a number of sectors, above all for health services and construction although also for retail distribution and professional services. Labour migration has been especially significant from the new Member States to those of the EU-15 that opened up their labour markets to migrants.

Overall, the impact of mobility has been positive, overwhelmingly so for the recipient countries. For those countries sending labour the situation is more nuanced. Where there is an excess of labour out-migration helps to re-establish equilibrium on the labour market and remittances can provide a significant source of income. For the construction industry, shortages in the sending countries emerged which were met in turn by in-migration from countries further east. For health services, mobility may have a negative impact on countries sending professionals when this generates or exacerbates shortages in the health systems of the country of origin. This is currently perceived as a problem for new Member States. These flows of professionals have only very imperfectly been compensated by flows of patients seeking elective treatment of a non-reimbursable kind – for instance Finnish patients seeking cosmetic surgery, dentistry or 'wellness' treatments in Estonia. General experience with labour mobility has been that when conditions improve after accession, mobility declines and this is already taking place for seasonal unskilled workers from new Member States. Ultimately, convergence in overall economic conditions will be decisive in ensuring that mobility meets genuine shortfalls and surpluses within the Union to the benefit of all.

The effect of the posted workers directive, which deals with workers present on a temporary basis while they are working on a project in another Member State, appears to have been less than that of EU regulations on the free movement of labour. Even though it covers the basic needs of the market in terms of permitting cross-border provision of services its effectiveness suffers from problems of compliance and enforcement of the directive by Member States in particular through the imposition of excessive administrative requirements. However, the main obstacle with posted workers is that they are dependent on the ability of firms to provide services cross-border which at present remains very circumscribed.

There can be strong substitutability in services between labour migration and provision of services. Working in a salaried position to get to know a country and its language can be a prelude to setting up there. In this sense, labour mobility and right of establishment are complements rather than substitutes.

3.2 Right of establishment

Because most services remain national and even local in character, establishment represents an obvious way in which to penetrate a market. Where a local presence is required on a continuous basis, it may be the only way. In the course of the workshops, few obstacles to establishment were encountered. Public authorities appear particularly at ease with this form of integration since it enables them to maintain control of the activity through their national regulatory regimes. The effects on national and local employment are also likely to be reduced since national rules continue to apply. The workshops revealed examples whereby new entry for firms elsewhere have had an appreciable effect on the functioning of national or local markets. Entry by DocMorris in the German pharmaceuticals market is beginning to have an effect there; construction markets have been shaken up by self-employed workers and by construction firms set up by migrants. Single Market rules have facilitated such entry on national markets of other Member States.

Nevertheless, entry through establishment should not be seen as a panacea for opening up the markets for services. It could even happen that market integration through establishment reinforces the dual nature of service market and limits the potential of high growth firms. This would come about if right of establishment was used essentially by very small and very large firms to the detriment of the most dynamic firms in the middle. Small firms are likely to be set up by new entrants that initially come as labour migrants. Large firms establish to cover a domestic market more conveniently than from their home base and have the means to cope with multiple administrative and legal systems. The companies that are likely to lose most by being forced to establish are the smaller and middle sized companies that cannot justify the overheads that such establishment would entail and whose main selling point is the flexibility with which they can undertake a task.

Construction companies specialising in public works will usually find it advantageous to set up a local subsidiary to deal with labour law, tax and other issues in the host country where it is executing large projects. Backwards integration into construction materials is also common for such companies which may imply a further degree of internationalisation. Because most retail distribution still requires a physical presence close to the customer, it is inevitable that establishment dominates market integration for this sector. Electronic commerce has the capacity to change this situation but remains for the moment very oriented towards national markets, with the exception of electronic auction sites which appear much more oriented to cross-border purchases.

3.3 Cross-border provision of services

Cross-border provision is currently very much a minor characteristic of service provision and does not appear likely to grow very fast in the foreseeable future. There are both structural and regulatory barriers that reinforce each other. Nevertheless, by providing an alternative to existing channels, by promoting price transparency and through the possibilities opened up to compare how countries differ in the type and quality of service provided, cross-border provision may still have an impact on national systems of service out of all proportion to its relative importance in terms of sales.

Cross-border provision covers the situation in which neither the service provider nor the client move (comparable to trade in goods), where the client moves to the provider on a temporary basis and where the provider moves to the client also on a temporary basis (otherwise entry takes place by establishment). All three modes are practised although not to the same degree. Direct cross-border provision is the least frequently encountered.

Technological developments are making it possible to supply a certain number of services across border in this way. Electronic prescribing makes the cross-border supply of medicines a possibility, held up by issues of security and of the possibility to obtain reimbursement from national systems of health. Radiology is a health service that is beginning to be supplied cross-border but still faces several regulatory and information barriers. Electronic commerce represents by far the most widely traded service directly across borders. Availability of access to the internet at sufficient speed, issues of trust and confidence, the unreliability and high cost of international deliveries as well of those of financial transfers cross-borders and from the suppliers point of view the complication arising from different national regulatory regimes all limit the take up of e-commerce. At the other extreme to e-commerce, potential for direct cross-border provision of legal services is very limited. Legal systems differ markedly and expertise in the law of the country in which a transaction took place is required. Instead there is a need for “translators” or intermediaries who can explain the meaning of different traditions and ways of working of the legal profession to clients in another Member State.

Temporary movement of the client to the provider of the service is perhaps the most common form of cross-border provision of service. Cross-border shopping has a long history both in border regions and by tourists further afield. With the removal of border restrictions within the EU, there are few obstacles to cross-border retail activity. Health services are a second area for which a certain potential exists for patients to seek treatment in other Member States, facilitated by jurisprudence of the European Court of Justice. However, there is a strong preference for treatment in the country and even the locality of origin and within a national health and local health system that is known and respected. In general, patients do not seek out treatment abroad except in cases of particularly acute diseases or where domestic treatment is unavailable (the case for certain specialisms in small Member States). Language barriers, and therefore the ability to communicate with physicians, as well as a desire to be near a domestic social support systems also militate against leaving home for treatment. As a result, with the exception of tourists seeking treatment while abroad, most cross-border treatment of patients has occurred on a local basis in border areas. Here shared traditions and language are most often felt and the need to share infrastructure and capacity on a local basis best understood.

Construction requires that it be the supplier that moves to the clients premises in order to execute the necessary work. For large infrastructure work, there already exists a high degree of internationalisation with a few large companies dominating the sector. European based companies are indeed among the world leaders in this segment of construction. Residential construction is the least internationalised with commercial property in between. Even for residential construction, there exists potential for local cross-border provision.

When providers of construction services attempt to cross an internal border even on a local basis they face numerous practical difficulties that make such provision difficult if not impossible or prohibitively expensive. Examples of such difficulties in one border region are the ‘garantie décennale’ in France that requires that insurance be taken out to cover this guarantee, which is almost impossible for a foreign company to obtain. Similarly French companies operating in Germany face problems relating to taxation on a pay-as-you basis in that countries. Companies from Luxembourg, but not in France, need to make contributions to the German Urlaubskasse. Companies wishing to operate in the Belgian border region run up against problems of multiple levels of authority required to provide the necessary authorisations. The services directive has yet to be transposed so that its effects will only be seen over the coming years. Already it is apparent that though certain provisions such as the point of single contact for providers and administrative cooperation will help, it will not be sufficient to remove all remaining barriers such as those stemming from different national systems of taxation. Indeed domestic barriers to growth and the limitations to cross-border transactions posed by incompatibilities between national regulatory systems are most evident in construction. Barriers have to be removed over a very wide field and not just in one area for integration to progress in service markets.

Summarizing, the Single Market has had a significant impact on the functioning of national markets for services but not always in the way that was expected. Potential undoubtedly exists for the Single Market to act as a catalyst for change in services that would benefit both users and producers of services and contribute to improving the overall performance of the European economy in terms of growth and jobs. However, progress is likely to be slower than expected and requires very many changes to the way in which individual markets function for the effect to be cumulative.

4. Implications of the workshops for the Single Market Review

Since the workshops were organised to provide input for the Single Market Review, the implications for that review of key findings from the different sectors covered need to be presented as conclusions for the exercise. Experience from the workshops appears particularly relevant for three areas in the review, future market monitoring exercises, the set of EU policies that affect services and the relationship between EU and national policies for services.

4.1 Market monitoring

The bottom-up approach tested in the workshops revealed the importance of monitoring markets. The workshops provided several complementary suggestions that could provide input to the exercise currently undertaken by DG Ecfin.

Problems with the availability and quality of official statistics on service sectors are both substantial and well-known. Official Statistical Institutes are working to improve the situation but the rate at which changes are made differs from country to country. While improvements are being made, comparisons with previous periods lose much of their validity. At the present time, it is still not possible to establish a comprehensive and accurate picture of the state of development of service activities at a sufficiently detailed level. The situation is compounded with regard to developments over time.

Macro and meso-economic data relies on data collection at the micro-level. For services, annual enterprise based surveys for market services are necessary to provide the necessary micro-based information. The predominance of very small firms in service activity requires that also firms with twenty persons employed or less also be surveyed on a regular basis. Recourse to surveys rather than censuses and limitations on the number of variables collected can reduce the administrative burden of response for this category of enterprises. Enterprise surveys can also provide a wealth of information, for instance the breakdown of turnover by segment that is of particular importance for market monitoring. Such comprehensive survey based data should become the initial source for market monitoring exercises in the place of the national accounts.

Lack of adequate data means that considerable caution needs to be exercised by users when interpreting results. This applies particularly to data from the national accounts, the only source for comparable cross-sector analysis and within the national accounts to that on productivity. Data for two thirds of the economy is either unreliable or unsuitable for productivity analysis in its current state. Market monitoring should begin with productivity levels since these with employment levels determine living standards. In a period of catch up very fast growth in productivity can occur from a low base. In any case, analysis of developments over time for most services for value added or productivity is usually not feasible with any degree of confidence. Although the data for manufacturing is better, there are still problems with data for some sectors. In particular, quality adjusted data using hedonic price indicators is not always available. The estimate of a two thirds share of unreliable data is therefore more an under-estimate than an over-estimate.

Although improvements to the quality of official data should be a priority, such data will not be sufficient. Data on markets and their development will need to be collected from private and other sources in order to complement the official data. Information on the use of services and the satisfaction of users, both SMEs and consumers is also important. Such data is already collected for several infrastructure services of general interest and constitutes a precious complement to other types of data for the Single Market. Commission services need to be able to analyse on an on-going base the development of the major market segments for each sector and to be able to identify the major players. It should be mentioned that market analysis is required for several policies, including competition, trade and consumer protection policies in addition to the Single Market. Market monitoring should be able to respond to needs also for these other policy areas. The recent market monitoring exercise by the Office for Fair Trading on internet shopping indeed demonstrates the importance of linking different policies and integrating different levels of regulation to obtain the most favourable outcome for consumers.

There are different ways to acquire such data. In many cases, it will be necessary to use commercial sources. These can be on-going commercial data bases such as the PIMS data base from the Strategic Planning Institute or regular or ad hoc market reports and surveys, as well as in-depth sectoral monographs by for instance McKinsey and Company. In practice, it will prove necessary to use a variety of sources in addition to the traditional ones such as the European level trade associations as a source of sectoral information. There are a number of drawbacks to over-reliance on associations as a dominant source of information. They are necessary partners for the Commission but their role is primarily a reactive one to Commission proposals affecting their sector; they may not be well equipped to gather the type of information required for market monitoring. In addition, by definition such associations represent the interests of enterprises that are already active in a sector and do not therefore take into account the needs of new entrants.

Available information on market developments with the Commission is at present very variable. One department that has invested heavily in information and in tracking market developments is DG Information Society (Infso). The fact that these markets are extremely fast moving demonstrates that achieving a satisfactory level of initial information to undertake market monitoring should be possible, at least for market services.

Market monitoring begins with an in-depth analysis of the available statistical data. It then needs to be complemented with specialised knowledge of a sector, for instance on the nature of specific entry barriers and the type of regulation applied. Such knowledge is required to interpret the results of data analysis and to point up relevant factors that would otherwise be missed. Market monitoring, therefore, implies a combination of rigorous statistical analysis with more qualitative appreciation. The better the initial appreciation the easier will it be to proceed later with in-depth market monitoring.

4.2 EU policies

The Single Market reveals problems with the operation of national markets for services by allowing for comparisons between the different systems and by promoting to a limited degree competition between providers of services. The role that the EU could play in terms of establishing and disseminating comparable information on outcomes, on establishing quality control mechanisms and procedures for accreditation of suppliers along with benchmarking of best or good practice are some of the most beneficial and least contentious areas for EU action.

Because of the overriding importance of quality and the difficulty of measuring this dimension, work on defining, measuring and assessing quality of services should receive high priority. Such work would of itself improve transparency of the markets of services. It would also contribute to building confidence and trust in the Single

Market, since if users could be assured of quality they would be more willing to engage in cross-border purchases.

Defining and measuring quality is particularly important in those parts of the economy where the role of markets and incentives is limited. For instance, in health services it is not appropriate to rely too much on incentives if outcomes cannot be measured. The development of diagnosis related groups (DRGs) not only increase transparency, but allows comparisons between hospitals and between doctors which enables the use of incentives, ultimately to the benefit of patients.

In order to build trust, various accreditation and labelling schemes have been developed for individual sectors at both European and national level. The plethora of such schemes, often of quite limited duration and of doubtful validity, has left consumers confused. It is not obvious whether such schemes should be built bottom up from national markets or top down from the European level. In any case, issues of content, independence and financing regularly crop up. Before a case can be made to go down that route therefore more careful assessment of the success criteria for such schemes needs to be made. If all firms in an industry are to participate, an element of compulsion is likely to be needed. If participation is on a voluntary basis, the avoidance of free rider behaviour or lack of recognition needs to be addressed.

Capacity problems with regard to specific skills are a common feature of many service sectors. Since the level of skills is also the key to providing high quality services, efforts to improve the existing skills base and to improve the provision of new entrants to the labour force in services are measures with high return. Again the EU has an advantage in disseminating best practice in the field and helping to improve the different national systems of qualifications. In turn, this could lead to greater labour mobility, which appears to be the driving force for integration of services at the moment.

Although at present limited in extent, considerable potential exists for the development of cross-border provision of services on a local basis. Indeed such areas can be considered as the laboratory for the Single Market for services. Where there are possibilities, they will be exploited first there. Where there are problems of a regulatory or non-regulatory nature, they will first become apparent in these regions. Some of the barriers relate to regulatory obstacles in the area of the individual service, but many relate to more general problems of taxation, of different administrative structures of the need to bring together public authorities dealing with local provision of services on a cross-border basis. The EU has taken a leading role through its Interreg IIIA programmes to promote cross-border cooperation and the Single Market can build on the experience gained there. Much of this cooperation takes place on a bilateral basis requiring a large number of individual agreements, sometimes between local authorities, sometimes between Member States. At the level of local cross-border cooperation there has been renewed interest in instruments such as that of the European Economic Interest Grouping, but that instrument is only applicable to a limited range of activities. In areas such as health services co-operation instruments of a non economic nature might be warranted. The EU could examine to what extent additional legal or administrative instruments for cooperation would facilitate the development of local cross-border provision of services on a voluntary basis.

Services are increasingly dependent on well functioning infrastructure, particularly with regard to information technology and logistics. Liberalisation of the market for telecommunications has been decisive in the emergence of a number of innovative services that have high potential for growth and facilitate the internationalisation of services. Deficiencies in delivery of goods purchased through e-commerce have already been noted. Further liberalisation of postal services should provide a boost for competition in this area. Many of the most important regulatory initiatives in which the EU is engaged for services therefore relate to complementary areas needed for the efficient provision of a service.

4.3 The relationship between EU and national policies for services

The workshops demonstrated the overwhelmingly national, and in many cases local, character of markets for services. The Single Market will therefore impact the development of services in large part through its effect on the functioning of national markets. EU regulation, for instance in the consumer field, is already having a significant impact on the functioning of certain national markets for services such as e-commerce. In other areas, the impact is much less. From the point of view of the user, the source of a regulation, European, national or local is immaterial. He or she expects the three to work together in a seamless fashion for the benefit of the user.

In view of the fact that most regulation of services will remain national, at least for the foreseeable future, the manner in which different regulatory levels interact is of prime importance for the functioning of the Single Market. This goes beyond national authorities taking ownership for the Single Market, whose legislation they in any case apply along with their own. Up until now, the two major instruments for integration have been harmonisation around a common European standard and mutual recognition. In turn, mutual recognition has been seen as leading to competition between systems while harmonisation has been seen as a quasi-federal solution.

Given the fragmentation, the complexity and the difficulty of regulating many services, the achievement of a high degree of European harmonisation for many services is in any case illusory. Competition between systems is also unlikely to lead to market integration since many barriers to cross-border provision will remain. In addition to harmonisation and mutual recognition therefore a means to ensure that incompatible national systems of regulation do not stifle the development of services needs to found. One solution could lie in a form of regulatory convergence around a common understanding of the purpose and best way to regulate in individual cases based on intensive contact between regulators and the diffusion of best practice. In addition to EU action, such convergence might lead to a dense web of multilateral and bilateral agreements between like minded countries coming to complement efforts at EU level to set basic or framework legislation in a given area.

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Table 1

EU-15

Value Added

	Share of Sectors in Value Added at current prices				Growth in Value Added at Constant Prices (annual average %)			
Sector	1979	1990	2000	2003	1979-1990	1990-2000	2000-2003	1990-2003
TOTAL ALL SECTORS	100%	100%	100%	100%	2.5%	2.2%	1.5%	2.1%
Construction	7.66%	7.12%	6.16%	6.41%	1.1%	0.1%	1.4%	0.4%
Retail trade	4.47%	4.50%	4.46%	4.42%	2.6%	1.9%	1.7%	1.9%
Legal, technical and advertising	2.81%	3.82%	4.94%	4.95%	4.7%	3.6%	1.4%	3.1%
Health and social work	2.80%	3.12%	3.51%	3.58%	2.3%	2.7%	3.5%	2.9%

Employment

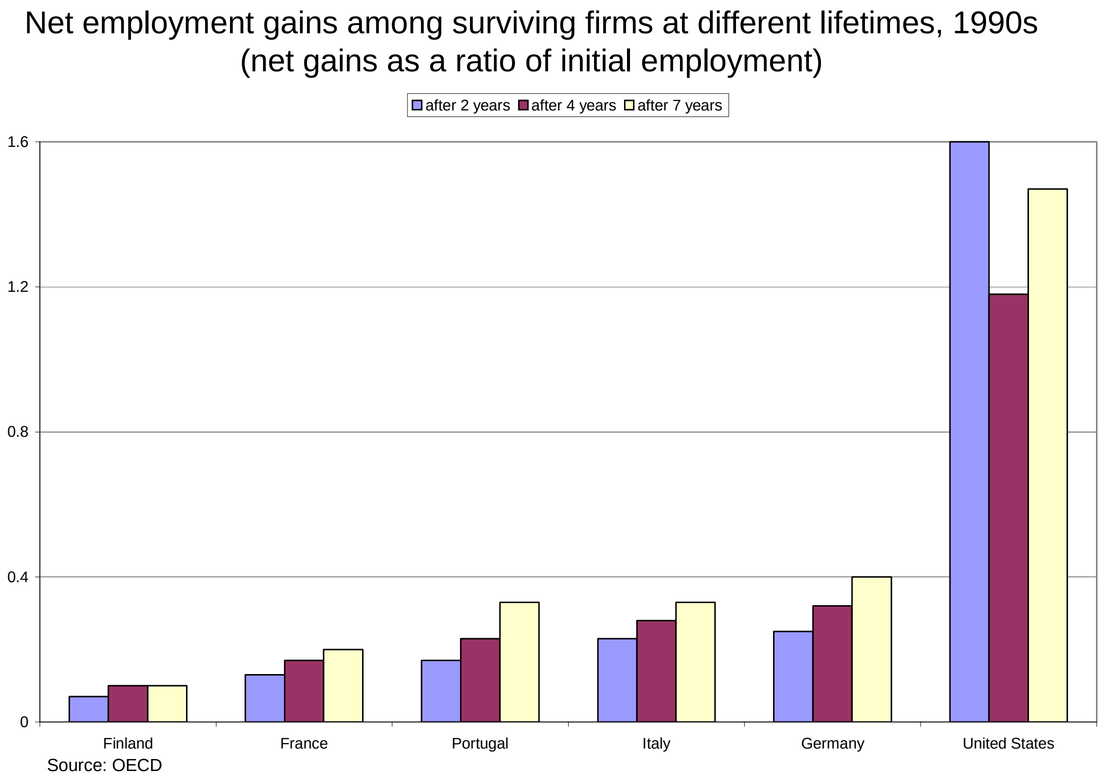
	Share of Sectors in Employment				Growth in Employment (annual average %)			
Sector	1979	1990	2000	2003	1979-1990	1990-2000	2000-2003	1990-2003
TOTAL ALL SECTORS	100%	100%	100%	100%	0.65%	0.54%	0.69%	0.58%
Construction	8.3%	7.5%	7.0%	6.9%	-0.3%	-0.1%	0.4%	0.0%
Retail trade	8.18%	8.46%	8.74%	8.81%	0.96%	0.87%	0.95%	0.89%
Legal, technical and advertising	1.92%	3.04%	3.87%	4.11%	4.93%	2.99%	2.73%	2.93%
Health and social work	6.42%	8.02%	9.24%	9.56%	2.71%	1.96%	1.87%	1.94%

Labour Productivity

	Labour productivity per hour as % of average Labour productivity				Growth in labour productivity per hour (annual average %)			
	1979	1990	2000	2003	1979-1990	1990-2000	2000-2003	1990-2003
TOTAL ALL SECTORS	100%	100%	100%	100%	2.38%	2.12%	1.33%	1.94%
Construction	88.8%	88.9%	80.1%	84.0%	1.7%	0.4%	1.4%	0.6%
Retail trade	55.36%	53.91%	52.20%	51.26%	2.20%	1.55%	1.27%	1.49%
Legal, technical and advertising	149.69%	127.37%	128.58%	121.26%	0.29%	0.92%	-0.76%	0.53%
Health and social work	91.56%	77.57%	75.25%	76.48%	0.08%	1.14%	1.90%	1.32%

Source: Groningen Growth and Development Centre

Fig. 1



Source: OECD

Table 2 **Share of different size classes for main economic variables by sector, 2003**

Size Class (Number of persons employed)	Manufact-uring	Electricity, gas and water supply	Transport, storage and commun-ication	Building and Construc-tion	Wholesale and retail trade	Hotels and restaur-ants	Real estate, renting and business activities
Number of Enterprises							
1 to 9	79.2	71.2	94.9	91.2	93.2	91.4	94.6
10 to 49	16.4	15.9	7.3	7.9	6	7.8	4.2
50 to 249	3.6	7.6	1.2	0.8	0.6	0.6	0.8
250 and over	0.8	3.7	0.3	0.1	0.1	0.1	0.2
Turnover or gross premiums written							
1 to 9	6.8	6.5	13.3	31	25	41.9	35.6
10 to 49	13.2	5.4	14.5	29.7	24.8	25	19.9
50 to 249	20.7	15.8	13.8	***18.4***	***20.4***	***11.2***	***18.6***
250 and over	59	73.1	58.9	20.9	29.8	21.6	25.6
Value added at factor cost							
1 to 9	7.3	5	11	33.5	28.5	38.1	33.5
10 to 49	15.7	4.7	11.6	31.8	25.2	25.9	19.4
50 to 249	22.3	12.3	10.8	***17.3***	***16.7***	***12.6***	***17.9***
250 and over	55	76.9	66.7	17.4	29.6	23.3	28.9
Number of persons employed							
1 to 9	13.8	2.5	18.7	43	40.5	46	34.4
10 to 49	20.8	5.5	14.5	30.6	21.1	25.6	17.4
50 to 249	24.2	14.4	12.3	14.9	***12***	***10***	16.3
250 and over	41.1	81.1	54.5	11.5	26.4	18.2	31.6
Source: Eurostat Summary Indicators: employment size classes for EU25 (all Nace activities)							