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From: Presidency
To: The High Level Working Group on Competitiveness and Growth

Subject: Restrictiveness Indicator and Reform Recommendations on Regulation in Professional Services

Delegations will find in Annex a Presidency discussion paper on Restrictiveness Indicator and Reform Recommendations on Regulation in Professional Services, in view of the meeting of the High Level Working Group on Competitiveness and Growth on 7 September 2018.

Restrictiveness Indicator and Reform Recommendations on Regulation in Professional Services

Business services which include, for example, legal, accounting, architectural or engineering activities, represent a major part of the EU economy. They account for 12.8% of the EU value added and 13.7% of total employment, which represents 31 million jobs¹. Around 80% of outputs from legal, accounting, engineering and architectural services are being used as intermediate inputs for other sectors in the EU both domestically and cross-border, including important manufacturing activities² (see example in Annex, Figure 1). As a result, a well-functioning business services sector can be a source for economic growth and an important competitive asset of the EU economy.

Many of the services professions are traditionally highly regulated because of potential information asymmetries between service providers and their customers. However, the degree of information asymmetries can vary between markets, resulting in different degrees of regulatory interventions needed to address them. At the same time regulation itself, while addressing market distortions, may unintentionally cause adverse effects. Regulation in services needs to therefore strike the right balance between protecting consumers and promoting fair competition between providers, while avoiding unnecessary regulatory costs.

¹ Source: EUROSTAT (data refers to 2014, the latest year with complete data available). Business services here include: legal and accounting activities; management consultancy activities; architectural and engineering activities; scientific research and development; advertising and market research; other professional, scientific and technical activities; veterinary activities; rental and leasing activities; employment activities; security and investigation, cleaning services, office administration activities; computer programming, consultancy, and information service activities. Employment data covers persons who are either employees (working by agreement for another resident unit and receiving remuneration) or self-employed (owners of unincorporated enterprises).

² Source: WIOD (2016) input-output table for 2014 (<http://www.wiod.org/release16>), own calculations of intermediate inputs shares.

Economic literature provides ample theoretical argumentation and empirical evidence supporting the view that regulation, while admittedly instrumental in certain services markets, is often associated with significant economic costs. In particular, restrictive regulation has been shown to potentially contribute to subdued economic outcomes such as weakened competition, lower productivity and employment³. For the EU Member States, restrictiveness of national regulatory environments has been demonstrated to be negatively correlated with enterprise birth and churn rates, as well as allocative efficiency in selected professional services sectors, and to be positively correlated with profit margins in these sectors (Annex, Figure 2 to Figure 5).

Due to important domestic and cross-border links with other sectors throughout the value chains, negative consequences of regulation in business services can have downside repercussions on the overall EU economy. This makes it essential for the regulators to timely assess if market failures, which particular regulatory measures were intended to address, are still present for the relevant professions or have evolved over time. Indeed, rapidly changing market environments, especially due to the introduction of new technologies, can lead to important shifts in consumers' awareness and bargaining power, reducing or even removing the need for the regulator to intervene in solving information asymmetry issues (for instance, architects using 3D-modelling software, or the increased use of algorithms in legal services (“Legal Tech”)).

³ As regards effects on employment, Kleiner (2006) investigates the impacts of occupational licensing on the economies of the United States and several EU countries and finds, among others, a 20% faster growth rate in employment in states in which certain professions are not licensed. Koumenta and Pagliero (2016) review theoretical arguments and empirical examples supporting potentially negative impact of restrictive regulation on employment, and estimate the magnitude of such effect in the short term. They conclude that, depending on the profession and under certain assumptions on labour demand structure, there could be between 3 and 9 % more people working in a given profession in the EU if access requirements were less stringent.

The most appropriate way to assess the effectiveness of national regulation would be to analyse the actual outcomes for firms and consumers, such as the quality of service, safety, availability or prices. Additional factors need to be taken into account, including for example national business and consumer cultures, or regulation by complementary legal instruments. Clearly, the regulation itself and its underlying rationale need to be understood in more detail before any conclusions can be drawn. Information is also needed on the actual impact of regulation on the economic outcomes. Yet, strongly divergent degrees of regulation in the same sector might indicate a need to review the regulatory environments more closely. Therefore, benchmarking of the degree of regulation in a sector with the same sector in other Member States is, in our view, an important aspect for such regulatory assessments.

Improving the regulatory framework in the services markets is one of the top priorities in the Single Market. The Proportionality test directive, which was adopted in June 2018, intends to ensure that before introducing new professional requirements or amending existing ones, Member States assess the impact of these measures and whether they are suitable for achieving legitimate policy objectives. In tandem the Commission also issued guidance to Member States on reform needs in existing regulation in professional services (Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on reform recommendations for regulation in professional services COM(2016) 820, adopted as part of the single market strategy for services in January 2017)⁴. Reforms in services and regulated professions are included also in country-specific recommendations in the context of the European Semester⁵.

⁴ See <http://ec.europa.eu/docsroom/documents/20505>.

⁵ Some prominent examples, applying across the majority of Member States, include: for accountants/tax advisors - the need to reconsider the reservation of simple tasks such as payroll activities or preparation of tax declarations to highly qualified professionals, and for architects, engineers and lawyers - reassessment of the legal form and shareholding requirements.

As a supporting tool for the rigorous assessment and comparison of national requirements in professional services, the Commission proposed a "restrictiveness" indicator as presented in the above Communication and its accompanying Staff Working Document (SWD(2016) 436). The indicator provides a single measure to assess entry and conduct requirements, including qualifications, exclusive exercise rights, legal form and shareholding, for a number of significant professions. The restrictiveness of national requirements for some professions, as measured by the restrictiveness indicator, shows a significant dispersion across Member States (see Annex, Figure 6 for an illustration for accountant/tax advisor).

The Commission's indicator builds on the same principles as the OECD Product Market Regulation Index (PMR) of regulatory conditions in professional services. However, it goes further in a number of methodological aspects. Most notably, the Commission's restrictiveness indicator analyses more professions with finer defined categories of requirements, and takes into account higher or lower impact of certain restrictions. The restrictiveness indicator is also based on feedback provided by Member States and the relevant competent authorities, which makes its underlying data more reliable. The latest update of the OECD PMR indicator has been adapted in order to bring the two indicators closer together. In order to ensure an up-to-date view of the regulatory situation and developments across the EU Member States, regular updates of the indicator are envisaged by the Commission.

Questions for the Discussion:

- Market needs for business services tend to change over time in line with economic and technological transformations and changes in production and value chains. How to better assess what are the benefits and economic costs of existing regulation in professional services?

- Following the assessment based on the restrictiveness indicator and the Commission's reform recommendations, there were certain reforms in a number of Member States, however there has been only limited feedback on national reforms in professional services. Are there new developments?

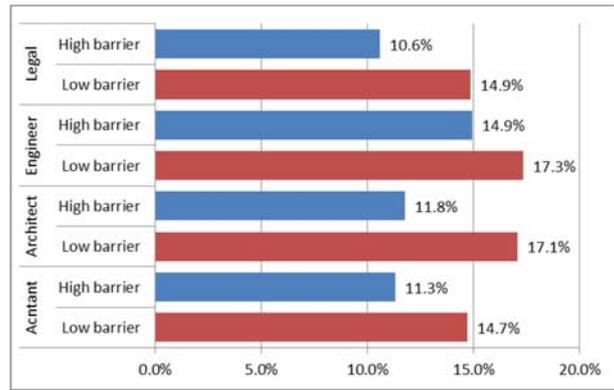
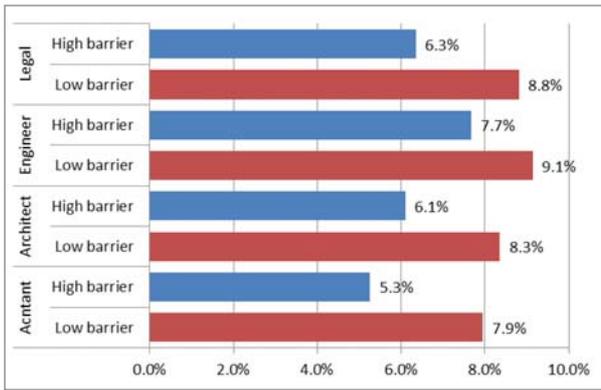


Figure 2. Average enterprise birth rates for high- vs low-restrictiveness Member States. **Figure 3. Average enterprise churn rates for high- vs low-restrictiveness Member States.**

Source: EUROSTAT, own calculations, 2015. Source: EUROSTAT, own calculations, 2015.

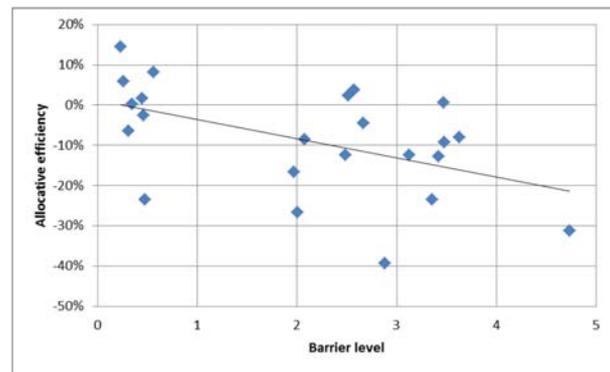
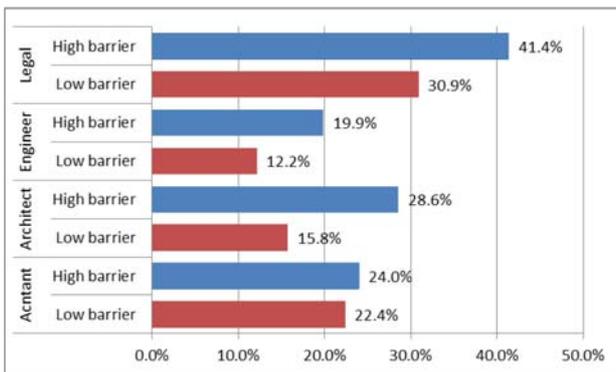


Figure 4. Average profit rates for high- vs low-restrictiveness Member States. **Figure 5. Relationship between allocative efficiency and restrictiveness for legal and accounting services.**

Source: EUROSTAT, own calculations, 2015. Source: EUROSTAT, own calculations, 2015.



Figure 6. Restrictiveness indicator for accountants and tax advisors.

Source: European Commission, 2016.

References

Koumenta, M. and M. Pagliero (2016), "Measuring Prevalence and Labour Market Impacts of Occupational Regulation in the EU". See: <http://ec.europa.eu/DocsRoom/documents/20362>

Kleiner, M. M. (2006). "Licensing occupations: Ensuring quality or restricting competition?" WE Upjohn Institute

COMMISSION STAFF WORKING DOCUMENT, accompanying the document "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on reform recommendations for regulation in professional services". Brussels, 10.1.2017, SWD(2016) 436 final. Available at: <http://ec.europa.eu/DocsRoom/documents/20505>