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From: European Commission

To: The High Level Working Group on Competitiveness and Growth

Subject: Restrictions in services, impacts, spill-overs and economic consequences

Delegations will find in Annex a Commission discussion paper on Restrictions in services, impacts, spill-overs and economic consequences, in view of the meeting of the High Level Working Group on Competitiveness and Growth on 15 February 2018.

The elimination of regulatory restrictions in services sectors within the Single Market has been a stated priority for the EU for the last fifteen years. Following the progress in the establishment of the Single Market for goods, attention has increasingly focused on the integration of services markets. This has put the spotlight on the elimination of obstacles and barriers resulting from structural, regulatory or behavioural interventions and activities of public and private actors.

These policy efforts materialised in a range of measures and proposals such as the 2006 Services Directive, the 2015 Single Market Strategy and most recently the legislative service package of January 2017. In parallel to these policy developments, two major factors have increasingly transformed the role of services. First, the share of services in the economy has been increasingly driven by both the rising demand for services by final consumers but also by other services and manufacturing sectors. Secondly, after a long period of stagnation, the growth of productivity in services accelerated first in the USA and later on in Europe. Investments in Information and Communication Technologies (ICTs) in services sectors were an important driver of this trend, notably in retail, logistics, transport and financial services.

However, policy efforts to remove restrictions and obstacles to integration in services have so far not been entirely successful and effective. As a result of inconsistent and fragmentary implementation, the impact of the Services Directive has only been modest so far. The Commission underlined that the Single Market Strategy and the full and appropriate implementation of the Directive could increase GDP by another 1.8% in the EU.

The rationale for reforms in these markets has been based on the productivity gains and growth resulting from the elimination of unjustified restrictions. Regulatory reforms and further integration of the services market has however been slower and costlier than initially estimated.

Given the prevalence of services in the European economy, the consequences of persistent malfunctions in services go well beyond the limits of their own markets. Hence, the indirect impacts and benefits of reforms in other markets are often neglected.

In many of the above mentioned sectors, observed productivity improvements have been more limited in the EU than in the U.S. In view of the important role of business services supporting industrial production, and of the wider phenomenon of servitization of manufacturing, well performing services markets are also becoming a key determinant of industrial competitiveness.

Restrictions in market services have an impact on the performance of manufacturing sectors using those services. Services contribute with 71% to the value added of the EU economy. The services sector contributes with 38 % of the value added incorporated in manufactured goods along the value chain. Inefficiencies resulting from undue restrictions hinder productivity in the manufacturing sectors. Removing those restrictions can release considerable productivity gains in manufacturing sectors and these gains can be estimated using inter-sectoral relations tables.

In addition to cross-sectoral impacts, restrictions in services in one national market may have spill-over effects on services and manufacturing sectors in other EU countries.

The planned Commission Competitiveness Check-up presentation aims to identify the costs deriving from undue restrictions in services markets and the broad range of benefits that may result from removing them.

Within services, the retail sector deserves special attention. With 4.5% of GDP and 8.6% of total employment, retail has a considerable weight by itself in the overall productivity performance of Member States. The impact of restrictions on productivity in that sector should therefore be closely examined.

There are different types of regulatory restrictions affecting the retail sector. They can be divided in two groups. The first one includes restrictions to establishment. The second one includes restrictions to operations. Both categories may constitute market entry barriers. Within each one of these two categories, different practices and barriers can be found. Knowing the details on the different impacts of each one of these restrictions is important for policy purposes.

Another significant characteristic of the retail sector is its position at the end of the value chain. It is important to explore other vertical effects that may be at play. For instance, the introduction of ICTs and the advent of e-Commerce are a major driver of change in the retail sector.

Incorporation of ICTs holds potential for much faster productivity growth rates. However, for structural and regulatory reasons, incentives for the adoption of those technologies vary considerably across countries. This situation has resulted in a broad dispersion of productivity levels in the EU. Overall, the EU is falling behind some other advanced economies in terms of the productivity development of the retail sector.

Conclusion

While there is a broad stated agreement on the need to introduce reforms in services markets in Europe, resistance either from vested interests or fears of declining social standards sometimes temper their implementation. The allocative efficiency of the EU economy is compromised as a result of sub-optimally functioning product and services markets, which in turn hampers the EU's overall competitiveness, including industrial competitiveness. To overcome these obstacles, we need to broaden the support base in support of reforms, notably by better highlighting their benefits, especially in terms of job creations (often offering opportunities to workers with lower formal education). Ultimately, these efforts would facilitate our transition into the new industrial economy and ensure the stronger presence of EU companies in global value chains.

Questions:

- 1) *To what extent are these indirect impacts taken into account in the national efforts to introduce reforms in services sectors?*
- 2) *Do you think that a better understanding of these impacts can help to build up support for reforms?*
- 3) *Are there other factors that should also be highlighted in our efforts to make progress in the reform process at EU and national scale?*
- 4) *How can we foster reforms to tackle restrictions undermining productivity in the retail sector?*