The Internal Services Market:

Between Economics and Political Economy

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The EU remains confused and bewildered about its fragmented internal market for services after a hectic political debate of almost three years, culminating in the adoption of directive 2006/123. This directive, now in force even if the Member States have until December 2009 to implement it and adapt local laws where required, is quite different from the draft proposed by the Commission early 2004. The present contribution attempts to provide an analytical economic approach, first by explaining what services are and what their regulatory logic is under the internal market regime; second, by making the (strong) economic case for horizontal liberalisation and in stressing the urgency of it; third, by reporting on a few economic impact studies of the draft Bolkestein directive, both with and without the origin principle. Overall, the emerging analytical economic literature supports the move by the Commission and identifies some of the main sources of economic gains (in particular, the establishment section of the directive!). Although it is true that some of these arguments have convinced the EU legislature (Council and European Parliament) that legislative action had to be pushed through in any event, debates have been dominated (and to a considerable extent, "polluted") by grossly misleading political framing, ideological positioning disconnected to the substance of the text and pressures from a long queue of vested interests. Therefore, an attempt is made, be it very brief, to unravel the politicisation of the process by distinguishing five sources of discontent or anxieties. Apart from some misunderstandings where were exploited by opponents, the main explanation of the political turmoil is likely to have been the broader socio-economic context of Eastern enlargement, recessionist circumstances, the fears of globalisation and continuous market-oriented reforms in many Member States. Pragmatic further progress might well be realized due to screening by the Member States and the 2010 "rendez-vous" clause.

Introduction

Almost four decades after the end of the transition period of the EEC treaty, the EU remains confused and bewildered about one of the basic elements of European economic integration: its internal market for services. It is not only a fundamental obligation in the treaty. Realising a well-functioning internal market for services is also necessary and desirable from an economic perspective. In the longer run, Europe's growth and employment, let alone its dynamism, cannot possibly come solely from industry and agriculture. However, the consternation about the horizontal approach to services, which culminated in the drastic amendments of the draft directive proposed by former EU Commissioner Frederik Bolkestein, has shown once again how socially and politically sensitive this domain is and will be for a long time to come. But there was and is a lot of misunderstanding and sometimes outright deceit. Therefore, at the outset, this article will make some seemingly elementary points concerning the definition of services and what does and does not fall under "Bolkestein". It will subsequently recall the economic urgency of addressing the internal market of services, followed by some empirical economic evidence of the impact of the horizontal directive, with and without the origin principle (its most debated element). The reader is warned that this empirical work is highly tentative given the nature of services and the analytical economic problems involved when asked to come up with quantifications of impact. Nevertheless, what analysis there is points to significant gains. The reasons for the often fierce opposition in 2004 and 2005 are to be found elsewhere, and these will be dealt with next. Partly, they can be characterised as fears for losses of (what economists call) "rents". Rents benefit the firms which enjoy a non-competitive

environment. They may include higher revenues or only minimum pressures for economic performance of current service providers made possible by the lack of competition or by rules and institutions pre-empting broader choice for customers or consumers or indeed preventing easy entry into the market. Those enjoying rents are naturally opposed to initiatives which threaten to remove them. Partly, however, the opposition has to be defined from the overall socio-economic context – particularly in Western Europe and this in the very year of a major Eastern enlargement of the Union – as well as by the multi-level lobbying strategies of interest groups and the short-term political agendas of several leaders of Member States. Finally, the nature and very broad scope of the first proposal, the widespread misunderstandings about its legal meaning and the lack of sufficiently hard economic analysis at the outset all militated against a smooth and swift passage through the EU legislative machine.

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Respecting the basics: definitions and coverage of services

The reader should attempt to answer the question "What are services, exactly?" before reading the rest of this article. Some would say, presumably, that services are all the economic activities which fall outside the agro and fishing industries and outside manufacturing and mining. Such a negative definition suggests that it is a leftover category and tells us nothing about the common economic characteristics of these activities. Other readers might recall the famous definition that services cannot "drop on your feet". One might also note that the General Agreement on Trade in Services (World Trade Organisation) distinguishes four modes of delivery of services (not very different from the EC treaty) without, however, defining services themselves. In economic terms, services are credence or experience goods which are usually (but not always) for simultaneous consumption when produced, intangible and unsuitable for tariff duties, for example, (though not for taxation) and highly differentiated. In the EC treaty, services can be temporary (subject to free movement) and permanent (subject to the right of establishment). The temporary services can be pure cross-border, or, the consumer crosses the border to enjoy the service, or, the producer crosses the intra-EU border(s) to deliver the service. All these elements cannot be overlooked if one wishes to understand the internal market for services, but they are anything but sufficient.

What is required is to apply the internal market "regulatory" logic to services categories. In order to do this properly, one has to go through the five consecutive steps which follow (for elaboration, see Pelkmans, 2006, chapter 7). First, distinguish economic from non-economic (e.g., social) services; only economic services fall under the internal market. Second, distinguish B2B from B2C services, the reason being that consumer protection can be justified in the latter case, and, in turn, this might lead to cumbersome harmonisation issues (which should not apply to B2B!). Third, distinguish tradeable from non-tradeable services; if it is non-tradeable, then free movement is irrelevant, though the right of establishment still applies. Fourth, if tradeable, are services regulated or non-regulated? Fifth, if regulated, are services network-based or non-networked, as this is treated quite differently in the treaty.

The non-tradeable category is a complicated, mixed bag, many services of which are non-economic (including most government services, of course). However, a small percentage of certain subsectors might not be so clearly "non-economic", and at times also become potentially "tradeable". This has led to sensitive problems of drawing clear demarcations (be it by the European Court of Justice or in EC directives to come) between non-economic and (sufficiently) market-based activities. Lack of clarity about or resistance against the discretion of EU bodies to decide such demarcations has caused turmoil in the European Parliament and the Council, if not in many Member States, primarily in the health and education sectors.

Many services are regulated. Network-based services fall under Article 86, EC and have become subject to special regimes combining liberalisation, regulation and competition policy (see Pelkmans, 2001, for a survey of all seven sectors specified). The confusion caused by the first Bolkestein draft was that some of these sectors were placed under a derogation and other ones not, thereby inevitably prompting the suspicion that the draft proposal amounted to a further liberalisation through the back door of horizontal liberalisation rather than sector-specific. The non-networked sectors are subdivided into real versus financial services, as well as pure consumer services. The real ones include the dynamic class of business services, with some subsectors nevertheless remaining quite resistant to cross-border competitive exposure (e.g., professional services, with often anti-competitive self-regulation; also, repair and maintenance of larger infrastructure and premises, including, e.g., railway infrastructure) or subject to sensitive local rules (e.g., advertising). Cross-border retail and wholesale belong to the cases where the "economic needs" test was still required in no less than seven Member States in 2002 – a major violation of the economic freedoms in the treaty. Non-networked transport has been liberalised for a long time and is regulated under a separate chapter in the treaty and, hence, falls outside horizontal services liberalisation. The same goes for the three financial sectors ever since EC-1992 and even more after the successful Financial Services Action Plan, completed in 2005. This leaves the pure consumer services, which do fall under the first Commission proposal, but entail some demarcations issues.

A simple fact worth reflecting on in the light of the Bolkestein draft is that the current services trade across intra-EU borders (remember, a mere 20% of goods trade) is largely made up of activities from the very sectors *not* falling under the Bolkestein draft! One should think of tourism and some other "non-regulated" services (true,

they fall under the draft but as they are non-regulated, the impact is minimal), the three financial services, the transport sector (with road haulage dominating above all) and the network sectors. The consternation about the non-economic (and often local, too) services was about socio-politically sensitive demarcation and hardly, or not at all, about the expected economic impacts. Apparently, the remaining sectors have so far hardly generated cross-border services trade! And when the Commission at long last suggested they should be subjected to the internal market in earnest, the sensitivities came out in the open for the first time in fifty years.

The present article refrains from a detailed description of the first draft directive and the one finally adopted (see Dr Timm Rentrop elsewhere in this issue). Only a few sketchy points, which follow below, are needed for the appreciation of a rough economic assessment. The first draft services framework directive (Bolkestein) consists of two parts: that on free movement and that about free establishment. These basic treaty freedoms have been subject to a litany of ECJ rulings (see European Commission, 2001, and Hatzopoulos & Do, 2006). The case-driven liberalisation as well as derogations implicit in this case law have been helpful, but, by their nature, fail to overcome deep-seated resistance against genuine competitive exposure of services, even when combined with appropriate regulation. To put it simply, the EU legislator should have acted much earlier, indeed decades ago. They did so only in selected sectors, not generally. The draft is a belated attempt to do exactly that. In order to catch up rapidly, and given the emphasis on growth in the Lisbon Strategy, the approach in the "free movement" part consisted of (1) the introduction of the radical "origin principle", (2) a list of derogations from the principle, (3) a blacklist of a number of protectionist or disproportionate practices of Member States. The origin principle has caused a lot of misunderstandings and deliberate (mis)framings. Whether or not the principle is undermining social accomplishments (e.g., social dumping) hinges on the accompanying legislation and the justification of domestic regulation which could serve as a derogation. In fact, a lot of protectionist rules and practices would automatically become irrelevant by the principle, because what it says is merely that home-country rules apply. But this does *not* mean at all that, for this reason, it is anti-social or pure deregulation. Before judging that, one must appreciate first all the derogations and, second, the other constraining rules which severely limit the impact of the principle. Thus, the working of the principle was significantly constrained by the explicit maintenance of existing EU directives, by far the most important being the Posted Workers directive. This directive regulates the conditions for workers posted for a temporary service in another EU country. The directive is based on "host-country control" for most of these conditions, in particular wage and some non-wage costs. In economic terms, what this means is that wage competition between workers from different Member States is either directly outlawed or is outlawed by supplementary legislation in the host country. The approach in the "free establishment" part does not hinge on the origin principle, but remains based (as it always has) on host-country rules. The difference is that a blacklist of bad practices (such as the "economic needs" test) now directly forbids them and they must be removed from domestic legislation. There are also provisions for a "one-stop desk" in Member States for EU investors in services and for screening of domestic laws for purposes of future harmonisation where needed.

The economic case for performing services in Europe

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

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

i Annual growth rates of value added (in constant 1995 prices) between 1979 and 2003 (EU-15) amounted to 4.2% for business services, against 2.2% for manufacturing, 2.3% for distributive trades, 2.4% for transport and 2.5% for finance (source: Kox & Rubalcaba, 2007). The shining performance is explained by the close link with the Europeanisation of manufacturing (services following goods), by the trend – forced by fiercer competition in the internal goods market – to go back to "core business" (thereby often divesting internal

services and thus boosting the statistical growth in business services) and by a relatively high share of knowledge-intensive services in the category of business services. Nevertheless, cross-border business services are often unnecessarily costly due to cumbersome obligations and entry barriers, greatly discouraging SMEs to enter cross-border activities, even though these SMEs are dominating services in their home markets. B2C services across intra-EU borders are minimal (apart from tourism) and there is little evidence of growth except through internet sales.

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

iii What matters for the internal market are "tradeable services", that is, services that can be traded across intra-EU borders. Taking into account the diversity of the services sector in the respective Member States, the non-tradeable sector (e.g., government services, local ones, be they for profit or non-profit) can range from 20% to over 30% of GDP. In other words, services potentially tradeable in the internal market could amount to some 40% or more of GDP, which is much higher than the actual intra-EU trade in goods (!) today. In sharp contrast, the *actual* services trade in the EU hovers around one-fifth of intra-EU goods trade! Knowing the many cumbersome restrictions in the internal market for services (European Commission, 2002), it is hard to escape the conclusion that EU countries could greatly boost intra-EU services trade by opening up radically to each other. How far one could expect this boost to go is difficult to know because goods and services are not fully comparable. Services are based on trust and well-established relationships because they are so-called "credence" or "experience" goods, unlike most tangible goods which can be characterised as "search" goods and, hence, easier to verify. Therefore, proximity to customers is crucial for most services, hence, local establishment, rather than distant trade, is the preferred mode of delivery or market access. New technologies have changed that somewhat, but there is no doubt that the potential share of services trade cannot be mechanically derived by a comparison with goods. Indeed, a serious study of the internal market for services must provide reliable data on local production of services by establishments from other EU countries, besides intra-EU trade. One problem here is that many such establishments are small and not easily traced from statistics.

iv There are other indicators pointing to a serious under-exploitation of the internal market for services. Two examples follow. Kox, Lejour & Montizaan, 2005, constructed a trade-openness index for EU countries and found services trade-openness to be low, with very low indices for relatively big countries such as France, Germany and Spain. Turning to establishment, data on services generated by foreign establishments are scarce; what data there is (based on OECD FATS data) shows, for example, that in 2002 the share of employment in overall services employment in the relevant country never exceeded 20% and was as low as 5.6% in France, 2.9% in Germany and 5.1% in Italy. Compared to employment in foreign establishments in manufacturing, their shares were higher than shares for services in every EU country and the gap was never smaller than one-third, and often more than half. When observing these discrepancies, one should not forget that precisely in services, the mode of establishment is far more attractive, if not imperative, for a durable presence in the market than it is for goods.

v In the last few years, analysts have drawn attention to high growth rates of selected services in the United States, compared to the EU, as the main explanation of the transatlantic growth gap between the mid-nineties and (say) 2005. For example, in Van Ark (2004), aggregate labour productivity growth of the US and the EU-15 are decomposed by sectors for the period between 1995 and 2002. He found that four of the five sectors with the highest labour productivity growth were services: retail (except that of motor vehicles), wholesale trade, financial intermediation and activities auxiliary to financial intermediation. Of the eight-year average of 2.46%, these four services sectors account for 1.16%. In the EU, by contrast, the four sectors make up a mere 0.16% of the eight-year EU-15 average of 1.64%. These findings would seem to suggest that the regulatory environment for services and/or restrictions to exploit the internal services market seem to hinder a more or less similar development of such sectors in the Union. This would seem to be consistent with the results of the wide-ranging OECD work on the impact of restrictive regulations (including market entry and cross-border access) for the period up to and including 2003 (Conway, Janod & Nicoletti, 2005). Restrictions and lack of competition might also be a major reason why ICT-usage in European services is falling ever more behind that in the US (see, e.g., Denis, McMorrow, Roeger & Veugelers, 2005).

Economic impact studies about the internal market for services

Since 2003 new EU proposals for legislation have to be subject to Regulatory Impact Assessment (RIA). One would expect the RIA[1] of the Bolkestein draft to comprise a survey of the relevant economic impact studies available and/or the results of a targeted impact study commissioned for RIA purposes. Even though the RIA of "Bolkestein" serves the purpose of analytical clarification and also helps the reader to appreciate the choice between several options for the EU services market, it fails to provide a survey of genuine impact studies and does not provide even proxy quantifications of the economic impact. It is of critical importance to understand why. By the end of 2003 (when the RIA was concluded), quantitative studies were simply not available. In analytical economics, services had long been "stepmotherly" treated and in international economics the absence of modelling work was conspicuous. One amongst several reasons consisted in the tremendous complexity of barriers to entry and to market access; a related reason was that regulatory barriers (not tariffs) had

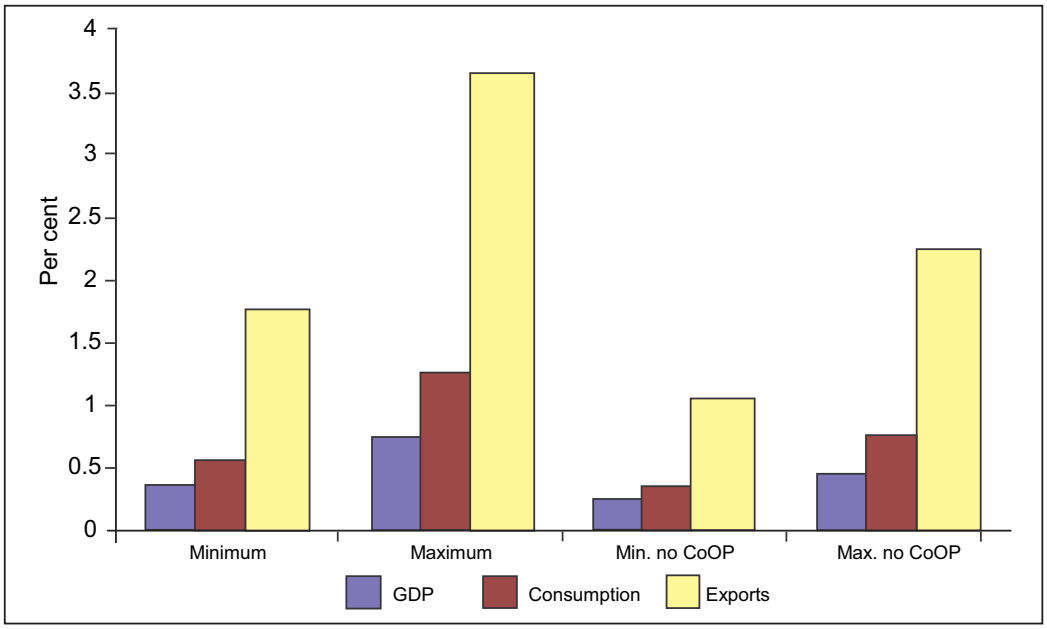
to be assessed as to their price and non-price effects, which is extremely difficult; yet another reason consisted in the lack of reliable data for all the barriers to services trade and Foreign Direct Investment (FDI) for all the Member States, the result of decades of neglect by the EU of the internal market of services! Given all those reasons, the Commission was simply not in the position to "guesstimate" the economic impact. The lack of quantified "guesstimates" in the RIA did not help, of course, to facilitate a smooth passage of the draft through the EU legislator, that is, the EP and the Council.

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

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

This short contribution is not the place to discuss the merits and technicalities of the two studies. For such a sweeping horizontal directive, all one can say is that the two estimates are not that far apart and distinctly positive. It is interesting to note that most of the gains result from the "free establishment" part of the directive, which is consistent with the general notion that services delivery is more naturally conducted via direct presence in the local market. One should not forget, when reading these estimates, that a number of leading services sectors do not fall under horizontal liberalisation and hence are *not* part of these numbers. In follow-up studies, both centres have attempted to isolate the effect of the origin principle (i.e., trade alone) because it was so controversial in the debate. In de Bruijn, Kox & Lejour, 2006, the origin principle was found to generate one-third of the welfare gains – the overall results with and without the origin principle are depicted in Figure 1. Copenhagen Economics come to a mere 10%. These findings confirm that much of the political heat on the origin principle completely disregarded that the establishment part of the directive (which has largely survived the radical amendments in the EP) is the true source of benefits. The removal of the origin principle in the adopted services directive 2006/123/EC[2] is almost certainly detrimental to the erstwhile expected impact on intra-EU trade, but this does not mean that the adopted directive would not signify progress in economic terms.

Figure 1 : Macroeconomic Effects of Services Directive with and without the Country of Origin Principle



Source: R. de Bruyn, H. Kox & A. Lejour, *CPB Document* 108, February 2006; The trade-induced effects of the services directive and the country-of-origin principle.

Few other impact studies appear to have been made. But perhaps it is interesting to mention the PriceWaterhouseCoopers (2005) collection of thirty-eight business case studies of companies anticipating the services directive because its approach is so different from that of economic modelling. The larger services companies typically regard all Member States as separate markets for many reasons, only some of which result from policies or laws affected by the Bolkestein draft. When seeking establishment, companies know beforehand that this is an expensive route, and policy-related barrier removal (as in the services directive) would not so easily affect, in a decisive way, the economics of establishing an office or new subsidiary. The study suggests that up to 40% of the barriers to establishment would be addressed by the directive. As to services trade, the low costs of this mode of delivery – and the absence of almost any fixed or sunk costs – make it ideal for SMEs. Again, there is not so much support in the cases that the directive (then still the draft with the origin principle) would make a major difference as many other barriers, including culture, language, etc., would be more important in the final analysis. Although the number of sectors was limited, the diversity was nevertheless considerable.[3]

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A concluding note on political economy

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

There are many ways in which one can explain the politicisation – all partial, and presumably ignoring the interaction between several political economy processes. The intensity was unusual, surely, but so was the degree of political framing (an academically neutral term for what in this case amounted to often misleading and indeed plainly wrong presentations of the substance of the directive). Among the more important ways to explain politicisation, one may include (1) the complexity of the directive (a horizontal directive over many incredibly diverse services and based on sophisticated ECJ case law), (2) the discourse around the origin principle which led to two very different strategies of politicisation (that is, to political, if not ideological, debate over the principle itself and to a long queue of lobbies seeking a derogation from the principle), (3) the diversity in the way services and related labour questions were dealt with in the various Member States and – as a result – the strong incentives for lobbies to engage in multi-level lobbying (i.e., at domestic and EU levels, via the government and/or parliament to the Council, and directly via European umbrella organisations lobbying mostly the EP), (4) the decisive role of the EP, due in part to the paralysis in the Council, a role which significantly intensified politicisation (indeed, so much so that it might be better to speak of polarisation) and, last but not least, (5) the unfortunate timing of the proposal in the very year that combined a low tide in economic growth of the Union, a semi-permanent emphasis on further reforms under the flag of Lisbon much resisted precisely in Member States with considerable unemployment, the entry of ten new Member States which already caused anxiety due to the huge wage gap with the EU-15 and the upcoming decision about a new constitutional treaty.

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

However, the fascinating effect of the fierce lobbying by the Swedish and Danish labour unions was that they ended up in the same camp as the ideological campaign of (very) leftish labour unions and some politicians in, for example, France and Belgium, holding that the services directive epitomised the "neo-liberal agenda" of Europe, a view which was hardly echoed in Scandinavia or Germany. Somewhere in early 2004, several hardliners in some labour unions decided that only a "nuclear strategy" against the draft directive would have a chance of blocking the tidal wave of "liberal" reforms in the Union. Thus, the *socio-economic context* in which the draft directive landed began to substitute the *actual substance* of the text of the directive. The debate in some countries and, to a degree in the EP and the media, became dominated by the completely misconstrued "plompier polonais". In sharp contrast to the framing in politics, this Polish plumber (if working as an employee in temporary services under the draft text) would have been obliged to be paid the French minimum wage plus adherence to several other non-wage conditions like health and safety and vacation days, for example (this follows from the Posted Workers directive). If the Polish plumber provided temporary services as an independent, he would not need the draft directive because there is no change from a long tradition of concluding a service contract, the implicit hourly wage of which is "free". If the Polish plumber comes to France or any Member State (other than the three mentioned above) as a worker contracted by a French building firm, again host-country control applies. If he comes illegally, again, the directive is of no use – it is up to the national authorities to enforce the law. Linking the draft directive to a "neo-liberal agenda" of liberalising public utilities, the reforms under Lisbon, a lack of "Social Europe" or the too tough Stability and Growth Pact in the eurozone, can all be dismissed analytically as incorrect, but as a "nuclear strategy", it appealed to those labour unions and political parties with many members (often less skilled) who were convinced that they were consistently on the losing side of market-driven reforms. This tended to be exacerbated by the sensitivity of very open markets to the world economy and the sentiment that the EU had become "an agent of globalisation", by offering an open turnpike for Chinese imports or due to the "relocalisation of European business" to the European East or the Far East. A detached analytical approach of the draft directive is of little use if politicisation takes such ominous forms. In this climate of assertions and political framing – often totally disconnected with the legal and economic substance of the draft – it is amazing that the EP finally did accomplish a compromise which at least kept alive the establishment side of the text.

One may also study the positioning of individual countries. Nearly a dozen governments, sometimes the Prime Ministers personally, shifted from a generally favourable view to staunch opposition or Bolkestein bashing without specifying details. This was prompted by complex and varying drifts in domestic politics. However, in Western Europe it is too easily forgotten that the new Member States, as well as countries such as the UK, the Netherlands and Spain, remained in favour of an only marginally amended version of the directive until the French/German/British compromise was hammered out in May 2006. It should be

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telling to many readers that in the Netherlands, the social partners in the Socio-Economic Council (SER, 2005; see also Pelkmans & van Kessel, 2007) unanimously agreed to an amended version of the directive (with a report going into almost every conceivable detail and dismissing a lot of the framing) with the origin principle being upheld! Had the EP adopted this version, all the serious objections would have been dealt with appropriately and the internal market for services would nevertheless have been pushed forward much more than they have been. In several countries the services directive became mixed up with the campaigns about the constitutional treaty. In France, this went so far that numerous French voters came to believe that the constitutional treaty was another example of being too liberal (whereas, in fact, the status quo was purposely kept in socio-economic affairs, already in the Convention, and a few marginal amendments are best regarded as going the other way, e.g., Article III-122).

Conclusion

Services liberalisation in the EU is not going to be realised merely or even primarily on functional grounds. Perceptions of possible redistributive effects and widespread misunderstandings still linger today. The services directive has shown once again how politically sensitive principles like mutual recognition and the origin principle are, once they are applied in earnest (see, e.g., Nicolaidis & Schmidt, 2007). The prudent and usually very carefully drafted considerations in ECJ rulings on such matters – which often help the internal market to be better enforced, yet are balanced by public interest arguments – tend to get completely lost in the hands of the EU politicians and lobbies. The liberalisation of the internal services market should be expected to take another decade or more for this reason alone. The upheaval over the Bolkestein draft surely had the virtue that, though much too late, all political and social actors had to reflect on the notions of mutual recognition and the origin principle and position themselves publicly. Also, the much hailed but never clearly articulated "diversity" amongst the Member States' services regimes and their underlying labour conditions has emerged from the haze around it and, in the future, this is bound to form a better foundation for applying a well-considered governance of the origin principle or an effective variant of mutual recognition.

Cautious optimism about progress in the medium-run can be derived from the current screening process between the Member States and the Commission as well as the so-called rendez-vous clause calling for a review paper by the Commission in 2010. An economic reason for a more optimistic view over the medium-run is the rapid economic convergence between the new Member States and the EU-15, reducing the fear of wage competition. Finally, a few sensitive dossiers (like health services) have now become sectoral ones and should no longer derail the horizontal process.

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NOTES

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1 Commission Staff Paper, Extended Impact Assessment of the proposal for a directive on services in the internal market, SEC (2004) 21 of 13 January 2004.

2 Dir. 2006/123/EC of 12 December, 2006, on services in the internal market, in OJ EU L 376/36 of 27 December, 2006.

3 Six business services (advertising, estate agents, industrial cleaning, IT consultancy, management consultancy and legal services) and four construction-related services (commercial construction, construction advice, buildings services and sub-contractors).