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Consumer Protection**

The New Restrictiveness Indicator for Professional Services: An Assessment

Study for the IMCO Committee

DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

The New Restrictiveness Indicator for Professional Services: An Assessment

STUDY

Abstract

This document was prepared by Policy Department A: Economic and Scientific Policy, at the request of the Committee for the Internal Market and Consumer Affairs. After setting out the background of recent EU initiatives in the realm of services, in particular professional services, it explains in considerable detail the new Restrictiveness Indicator for Professional Services developed by the European Commission, followed by a careful assessment based on seven queries. It shows that, technically, this indicator is an improvement over similar work done by the OECD but that the empirical results are not radically different from those of the OECD in four such professions. The study cautions that the use of the new indicator has to be combined with assessments of proportionality, and that more attention should be paid to barriers to free movement.

This document was requested by the European Parliament's Committee on the Internal Market and Consumer Protection

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LIST OF ABBREVIATIONS

CJEU	Court of Justice of the EU
EPL	Employment Protection Legislation (indicator)
IMF	International Monetary Fund
KIBS	Knowledge-Intensive Business Services
NAPs	National Action Plans (for professional services regulation)
OECD	Organisation for Economic Cooperation and Development
PMR	Product Market Regulation (indicator)
PRO-SERV	Professional Services regulation indicator (Commission)
SHEIC	Safety, Health, Environment, Investor/saver & Consumer Protection
SWD	Staff Working Document (Commission)
STRI	Services Trade Restrictiveness Indicator
TFEU	Treaty of the Functioning of the EU
WGI	World Governance Indicators
WHO	World Health Organisation

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EXECUTIVE SUMMARY

The focus of the present study is on the new Restrictiveness Indicator for national regulation of professional services in the EU, developed by the Commission. After setting out the background of recent EU initiatives in the realm of services, in particular professional services, the new indicator – called PRO-SERV in this study for convenience – is set out and explained in considerable detail. Explicit links are made with the much wider literature and use of regulatory indicators in general, and the predecessor of PRO-SERV originating from the OECD (namely, the PMR) in particular. The PMR has built up a reputation in the OECD and beyond as it has shown for the first time overall levels of restrictiveness of market regulation that can (and often will) reduce the good functioning of markets and hence tends to throttle growth in the longer run. Indeed, it has proven possible to use the PMR in econometric work confirming that reduction of restrictiveness of market regulation can unleash substantial extra growth potential in many countries.

However, this idea of overall reduction of the restrictiveness of market regulation is only appropriate as long as regulation is not aiming to overcome or minimise market failures, but seeks to influence the economic outcome of market processes for political or redistribution motives or e.g. for retaining national control or protecting vested interests. All these reasons can be shown not to be economically justified and/or alternatives leaving market processes unaffected are conceivable. However, professional services are regulated with the aim to minimise market failures such as (insufficient) consumer protection (here, especially sound and reliable conditions for ‘trust’ in the capabilities and ‘integrity’ of providers), health and safety (e.g. medical, para-medical, pharmacists; engineers and architects) and investor protection (e.g. accounting). Therefore, the use of PMRs blending either disproportionate or unjustified regulation with regulation addressing market failures creates a fundamental problem of balance: whereas with unjustified or disproportionate regulation, ‘less is good’, that is, less restrictiveness is helping the better functioning of markets, this is not the case with regulation dealing with ‘societal risks’ (i.e. market failures). Such risk regulation is in principle justified, although this ought to be carefully verified, and it should be proportionate and effective (targeted, in EU case law called ‘suitable’), but one cannot a priori go with the motto ‘less is good’.

The PMRs, and hence PRO-SERV building on the PMR experience, identify many regulations about access to the professions and about its exercise. PRO-SERV improves on the PMR by adding no less than 11 regulatory items (restrictions) to the 10 already included in the PMR. PRO-SERV gives appreciable weight to regulatory exclusiveness, mostly as a result of ‘reserved activities’ but also by the ‘protection of the title’ (or both). This gives a monopoly to such providers and it goes without saying that this shield against charlatans and incompetent market entrants also brings with it a risk that the incumbents can (more) easily exploit their market power and generate high extra rents. It might also stifle new initiatives in such restricted markets, the more so as providers tend to be organised well (or are even obliged to be organised). PRO-SERV (and the PMR before) can be used in order to detect anti-competitive effects of such regulatory exclusiveness and such conclusions have been found repeatedly. Careful reforms can be a way to restore some balance between serving market functioning by minimising market failures (good for consumers, investors, etc.) and restoring proper market functioning by retaining or introducing some degree of competition. The other three building blocks of PRO-SERV (qualification requirements, other entry restrictions and exercise requirements) add to the restrictiveness and similar trade-offs can be discussed. PRO-SERV is a deepening of the PMR by adding 11 items; it is also a widening of the sector coverage from four sectors to seven so-called generic professions.

The assessment of PRO-SERV (other than the improvement over the PMRs) is based on six further queries. First, is PRO-SERV showing distinct empirical results compared to the PMRs for professional services? The answer is that there is no clear overall trend, although for engineers, architects and lawyers PRO-SERV is higher in more than half of the EU countries. In accounting that is barely the case (only four go up, most decrease) and the probable reason is that PRO-SERV (unlike the PMRs) does not include auditing services. For engineers PRO-SERV shows items of restrictiveness which alter the picture inherited from the PMRs in a more restrictive direction. With architects this effect is weaker. Second, the question of balance between serving the prevention of market failures and the objections against restrictiveness shows that PRO-SERV has to be used in a broader policy setting, with a carefully executed proportionality test and a check of effectiveness. Since the differences between the Member States are considerable when it comes to professional regulation, the Mutual Evaluation has had a laboratory function, inviting queries about justification and proportionality also between Member States. The study also briefly goes into the question of 'quality'. Good measures of quality are hard to come by and, in any event, professional services being 'credence' goods renders the evaluation by consumers problematic in numerous cases. One should be careful because quality of services delivered is more narrow an approach than that of market failures. Third, indicators can be useful but are never perfect. In PRO-SERV, especially the scoring of specific items of regulation is not fully transparent. Fourth, PRO-SERV is focused on market functioning and competition (for the EU growth objectives) but only partly on single market questions (namely, on establishment restrictions but not those for cross-border services). This is a drawback. As to market functioning, some 40% of all professions in the EU are medical and para-medical and they have been left out of PRO-SERV as harmonisation and 'automatic recognition' apply (and it works for the single market). But this also means that PRO-SERV is not of any help in finding out whether or not regulation of these professions is more or less anti-competitive.

Fifth, one can ask what should be incorporated in PRO-SERV but is not. Three such 'wishes' are singled out. An often discussed issue is ex post versus ex ante regulation. Ex post refers to regulatory controls or surveillance or certification of the services themselves upon delivery. This goes further than exercise requirements, although one might also see them as ex post. The more strict and elaborate these controls are, the less it would seem necessary to maintain strict and elaborate access regulation. When some professions in some EU countries score a zero or very low in PRO-SERV, this does not mean that the country is irresponsible but that another method of ensuring consumer protection (etc.) is in use. This is unfortunately not in PRO-SERV (nor in the PMR). Examples are the Nordic model of architecture and accountancy in the UK. A second 'wish' consists of including more professions which are restrictively regulated and have enough economic weight to make a difference in the single market. Crafts (related to construction) is surely a candidate given the debates, but also electricians (as a separate category) and possibly some other ones. A third 'wish' is to better address the single market in PRO-SERV. Now, there is no attention for core EU issues as genuinely free movement of the provision of services across intra-EU borders. Moreover, 'automatic recognition' (e.g. of the qualifications of architects) is presumably taken on board in PRO-SERV via the listing of national rules but it is nowhere mentioned in the relevant methodological document (SWD (2016) 436, section V.) which creates a lack of clarity. Some other barriers are left out because they do not fall strictly under professional services legislation, though there are many complaints.

Sixth, PMRs and, in future, PRO-SERV can be used to show more rigorously that high restrictiveness in professional regulation raises mark-ups significantly and reduces the dynamism in these services markets. Over the longer run, it is feared that such features constitute a brake on productivity growth in the EU which is already low. Such studies are valuable as long as they are regarded as part of seeking the right balance between the two

aspects of market functioning: incentives to increase competition, as against ensuring that market failures are and will continue to be minimised to protection consumers, investors, etc. Hence, these studies need to be embedded in a policy evaluation where justification of rules, their proportionality and effectiveness ('suitability') are included as well. In this respect, the laboratory function of the EU single market, with great divergences in professional services regulation between the Member States, can be very helpful as stark differences call forth questions about justification of distinct regulatory methods. But there is also an economic reason to be careful with the results of such studies. Many professional services studied in such research can be characterised as KIBS (knowledge-intensive business services) and in such markets entry is naturally hard given the expertise and reputation requirements. It is therefore difficult to regard such markets as similar to the markets for shoes or toys where margins are slim. The same goes for churn rates: one-off moves of entry following reforms of disproportionate regulation are surely possible (interesting examples in Italy and Poland have shown this) and might be beneficial but they are unlikely to be repeated. In e.g. legal, accounting or patent services, new business strategies or 'models' will not occur or only in marginal respects and churn rates therefore may not have the same meaning as in other markets (details in Annex 2).

1. INTRODUCTION AND BACKGROUND

KEY FINDINGS

- Regulation of professional services and its rationale is complex. One amongst several ways to better understand the nature and restrictiveness of such regulation is the use of a restrictiveness indicator. It also helps to compare such regulation between professions and between Member States.
- The Commission launched its services package in January 2017, including e.g. a proportionality test and a new Restrictiveness Indicator (called PRO-SERV in the present study). The study attempts to assess the merits of PRO-SERV.

Regulation of professional services and its rationale is complex and far-from-easy to appreciate in all its economic and other consequences. One amongst several ways to understand better the nature and restrictiveness of such regulation is the use of a 'restrictiveness indicator'. Moreover, such an indicator has the additional advantage that the restrictiveness can be compared in a simple fashion between EU Member States, which is of great importance in the single market for services.

Regulatory restrictiveness should ideally be a function of the severity of the 'risks' for society that would exist without such regulation. If such risks are low, regulation ought to be 'light' and its economic costs and/or other 'burdens' small. Indeed, it is quite possible - in some instances - that the risks are so low that market players can signal these risks in a credible fashion and how they have been addressed by service providers, which could suffice for consumers/users and would not call for regulation. The higher the risks, the greater the justification for market intervention in the form of regulation for purposes of the public interest. Ideally, on a scale of increasing risks, not only the justification of regulation would tend to become stronger but also the (justified) degree of restrictiveness of such regulatory interventions. This fundamental link between societal risks and the degree of restrictiveness of the relevant regulation is, in turn, governed by 'proportionality': again, ideally, one would not want to regulate 'more than necessary' to address the risks (usually, market failures, see below) – short of imposing 'unnecessary' costs on the economy – and one aims to identify the most 'suitable' (i.e. effective, that is also, targeted) regulatory intervention(s) so as to avoid negative effects on providers or consumers which do not contribute to reduce the risks at stake.

Applying these fundamental insights to the regulation of professional services in the EU has proven to be enormously complicated, if not often controversial amongst market players and/or Member States. Although there is EU regulation on professional services, in particular with respect to qualifications and degrees of mutual recognition, and there is the overall discipline of the 2006 Services directive, where regulation of professional services is not harmonised, it has remained a competence of the Member States.¹ National regulation of professional services is to some extent influenced by treaty disciplines such as 'proportionality', exemplified by some important CJEU cases.² Whether and to what extent this treaty discipline has effectively governed the degree of restrictiveness of national regulation of professional services has remained a difficult EU policy issue. Member States

¹ In principle, it is a shared competence between the EU level and the Member States and, so far, the EU has made use of this shared competence in a number of EU acts, ranging from medical professions, architects auditors to animal health professions.

² The landmark case is C-340/89 (Vlassopoulou); other important cases include C-313/01 (Morgenbesser) and C-345/08 (Pesla). See more generally, Hatzopoulos (2012, esp. ch. 4).

and /or their sectoral professional services associations have long remained lukewarm about, if not resisted, the greater involvement of the EU level in the regulation of such services. For a while, little progress was made because Member States insisted on their prerogative to regulate these services and the providers themselves, and often referred in highly general ways to the national characteristics and traditions in these services markets. This changed with the enactment of directive 2005/36 on the recognition of professional qualifications and with a number of other sectorial acts, focusing on specific professional activities. In actual practice, however, gaining access to professional services markets in other Member States often proved to be costly and time consuming, including for specific professional services where the EU has agreed 'automatic recognition'. Hence, a subsequent modification of this directive by directive 2013/55 simplified further the rules organising the recognition of professional qualifications. Moreover, much more effort was invested in fact-finding and empirical analysis of the relevant services markets in Member States. The 2013 directive introduced a transparency and Mutual Evaluation exercise between the Member States, an intense process taken place over the years 2014 - 2016. This included (art. 59) an obligation for Member States to explicitly consider whether restrictions in access to a profession are 'justified' and 'proportionate'. Also, the Commission launched empirical studies on these markets and improved its database. In the framework of the Mutual Evaluation, the Commission launched a questionnaire based on CJEU case law, and a group of Member States defined a framework for a methodology for considering the regulation of these professions.³

Following these considerable engagements, the Commission launched its services package in January 2017⁴ including (inter alia) a 'proportionality test'⁵ and a New Restrictiveness Indicator⁶ relating to professional services. It is against this background that the function and details of the new indicator have to be understood. In the following, the new indicator is given a name, for convenience: the PRO-SERV indicator, referring to professional services.

The structure of the present study is as follows. Section 2 explains the rationale behind regulatory indicators in general in the EU and beyond, and the purposes of developing a new EU Restrictiveness indicator of professional services rules in particular. Section 3 sets out the design of PRO-SERV, explaining both the deepening of the OECD PMR in PRO-SERV as well as its widening to more regulated professions. Section 4 comprises an extensive assessment of PRO-SERV. After first acknowledging the progress made with PRO-SERV, both in deepening and widening, and the very considerable data efforts this has required (especially with the help of the Member States), the assessment is based on 6 queries (in sections 4.2 – 4.7). These are whether PRO-SERV makes an empirical difference compared to the professional services segment in the PMR, what the upshot for PRO-SERV is when considering risk regulation explicitly (and not only 'economic regulation'), whether some technical issues matter for the assessment, how PRO-SERV can be judged knowing that some professional services or providers are subject to 'automatic recognition' regimes in the EU, whether PRO-SERV might suffer from omissions and, finally, how PRO-SERV – as a kind of successor of the relevant PMRs – can be expected to be used for empirical economic studies possibly guiding reforms. Section 5 concludes.

³ Note by the 11 Member States of the Frontrunners Project in the framework of the Council [Note 6198/1/15 REV. 1, see <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%206198%202015%20REV%201>]

⁴ The 2017 services package consists of four Commission initiatives on respectively: a new European services e-card, a proportionality assessment of national rules on professional services, a guidance document for national reforms in regulation of professionals and an improved notification of draft national laws on services. See the Press Release of 10 Jan. 2017 [http://europa.eu/rapid/press-release_IP-17-23_en.htm] with the references and a useful Factsheet on Questions and Answers [http://europa.eu/rapid/press-release_MEMO-17-11_en.htm]

⁵ SWD(2016)463, Impact assessment, accompanying the Proposal for a Directive [...] on a proportionality test before adoption of new regulation of professions, 10 Jan. 2017 ; see also COM (2016)822 of 10 Jan 2017 (on the Proposal)

⁶ See COM (2016) 820 of 10 Jan 2017 on reform recommendations for regulation in professional services, pp. 8/9; and SWD (2016) 436 of 10 Jan. 2017, Annex V (pp. 154 – 170), accompanying COM (2016) 820.

2. WHY A NEW EU INDICATOR FOR PROFESSIONAL SERVICES?

KEY FINDINGS

Regulatory indicators helping to guide reforms are nowadays used all over the world. The five principal ones are: business environment, governance, services trade, proper market functioning and pure single market. PRO-SERV (and its origin, PMRs) belong to the category of ‘proper market functioning’.

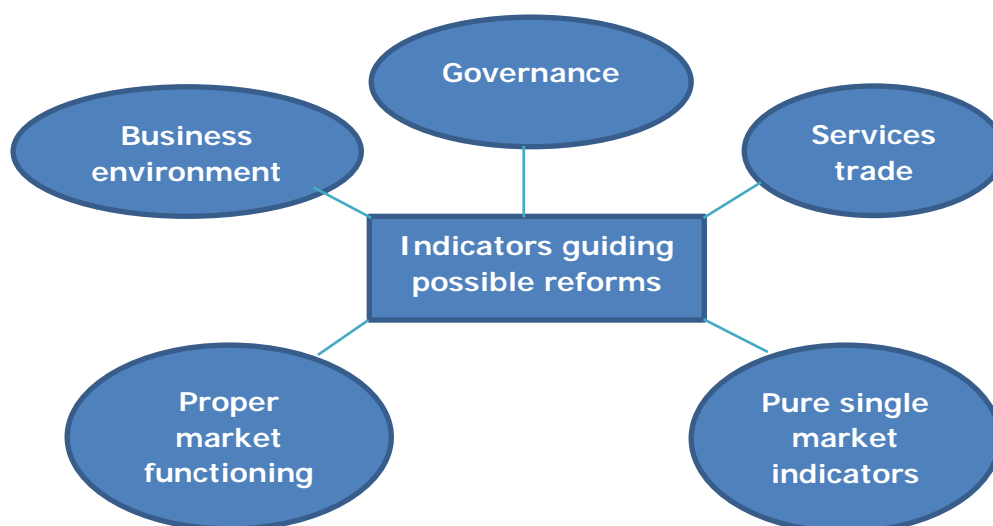
PRO-SERV builds on the PMRs which suggest that less restrictive regulation is good for market functioning. This is correct when (and insofar as) regulation is clearly disproportionate or when market failures are absent (but political motives or vested interests drive regulation). However, in professional services, market failures play a critical role. And Member States also differ considerably in professional services regulation. PRO-SERV is far more detailed and precise in access regulation and with respect to the exercise of a profession and should thus be better in helping to guide regulatory reforms in the EU than the PMRs.

The basic reason why policy-makers appreciate regulatory indicators is a search for an overall view of a regulatory domain, complementary to the highly specific and often technical details of the numerous individual regulations in that domain. This overall view facilitates a judgement on the general importance of regulation, both positive and negative, at a point in time, over time (if data allows) and between countries. It might help detect ‘regulatory creep’ over time and may stimulate discussions between Member States about the underlying rationales when the national indicator(s) is (are) far apart. In addition, if indicators are refined enough, empirical economic techniques can use indicators to identify links between aspects of economic performance and the weight or restrictiveness of regulation. If such links are statistically robust, these findings can form a basis for regulatory reform proposals. However, a regulatory indicator can never be the sole rationale for policy or reform. It has to be embedded in a careful assessment of the underlying rationales for regulation (usually, the ‘societal risks’ to be addressed) and the proportionality of the specific regulatory regime(s).

2.1. Purposes of regulatory indicators

Before going into the specifics of PRO-SERV, it is useful to know that regulatory indicators have become quite popular in many domains, in the EU, the OECD and worldwide. Sometimes, they partially overlap with more general indicators such as the World Bank’s Development Indicators. It is also defensible to stretch the notion of what is ‘regulatory’ to the wider concept of ‘governance’ as has been done by the World Bank since 1996, even though ‘governance’ is a notoriously vague and ill-defined concept.⁷ Figure 1 summarises the five most important regulatory indicators used by policy-makers in and beyond the EU.

⁷ The WGI (World Governance Indicators) show that regulation and its (in)effectiveness are profoundly influenced by several aspects of ‘governance’. The WGI methodology (Kraay, Kauffmann & Mastruzzi, 2010) is based on six composite indicators: voice & accountability, political instability and violence, government effectiveness, regulatory quality, rule-of-law and control of corruption. The data base includes hundreds of individual variables. Some special statistical techniques are applied (e.g. the unobserved component model). Despite its problems, it has been shown that weak ‘governance’ has been of critical importance for e.g. the lacklustre growth performance of Italy (see e.g. Gros, 2011 (showing that structural reform indicators like PMRs do not sufficiently explain low growth but WGI does so), and the Banca d’Italia’s analysis of structural reforms (Giacomelli, 2013, explicitly addressing and quantifying the economic losses of judicial inefficiency for firm size and e.g. interest rate levels). Thus, in some cases, a too narrow focus on spelling out rules of Member States in an indicator might

Figure 1: Purposes of regulatory indicators

Source: CEPS.

Apart from those on 'governance', a set of indicators attempts to capture the attractiveness and efficiency of the business environment with a view to foster growth and jobs in the longer run. Some of these indicators partially overlap with other regulatory indicators, but in different ways. The best known are the 'Doing Business' indicator from the World Bank and the Competitiveness Indicators of the World Economic Forum. A recent indicator with direct relevance to services (but much wider than professional services) are the two distinct STRIs (Services Trade Restrictiveness Indicators) by respectively the World Bank and the OECD (see Mustilli & Pelkmans, 2013, pp. 53-61 for explanation and comparison). The idea is to show, in a comparative fashion, how restrictive countries are in service regulation, resulting in higher (trade) costs to access national services markets. Professional services are included in both indicators.

A fourth one consists of restrictiveness indicators attempting to show to what extent restrictive regulation hinders the proper functioning of markets, essentially one for labour markets (the most well-known being the EPL, the employment protection legislation indicator of the OECD) and one for goods & services markets, the so-called PMR (product market regulation indicators) also of the OECD. The PMR is crucial for the present study as PRO-SERV is a more refined and detailed version of the PMR. One should note that the term 'proper functioning of markets' has to be made explicit before such indicators can effectively support and justify reform efforts. Markets can often function well without regulation, subject to general competition law and monitoring. Ideally, when governments intervene with regulation, this can be justified if, and only if, this is to address and mitigate or overcome market failures.⁸ This point is widely accepted throughout. In this light, the emergence of the PMR more than two decades ago, is interesting: at first, the PMR was mainly about removing or reducing 'economic regulation' of OECD countries, by focussing on lingering regulatory interventions which are hard to justify economically (but might have originated from political motives about 'economic outcomes' of market processes or plain protection of incumbents). In other words, markets failures were not at stake. So, broadly one might hold

not or not sufficiently explain national inefficiencies and/or problems for intra-EU cross-border services provision because of the missing factor of (weak) governance.

⁸ It is assumed here that (re)distribution goals of a government will be pursued via instruments other than regulation (e.g. tax structures or subsidies as well as social allowances). It is well-known in economics that the use of regulation for distribution purposes is inefficient, due to costly side-effects.

that 'less (regulation of this kind) is good'. Its reduction or removal should be expected to improve the working of markets, resulting in higher economic welfare in the longer run. Over time, however, the PMRs have been extended and now routinely include e.g. a number of services markets. In such markets, regulation may well be justified by market failures and the question is whether such regulation is appropriate. That is, market failures reflect 'societal risks' such as unacceptable risks with respect to health, safety, environment, consumer, saver & investor protection which markets – if unregulated – typically do not or insufficiently provide for. This point is important because PRO-SERV is based on the PMR, more precisely on one segment of the building blocks for the PMR, namely, that for professional services. Many professional services are regulated with a view to reduce or minimise market failures; where that is the case, one cannot a priori conclude that 'less (of the relevant regulation) is better'. For this fundamental reason, the use and interpretation of PRO-SERV (a quantitative measure) must be accompanied by an assessment of the market failures and the proportionality of the rules to which PRO-SERV refers. For regulated professions not having a market failures rationale, it is justified to query whether such regulation is necessary and justified in the first place – it would be an example of 'economic regulation', indeed, of restrictions without a broad societal benefit, liable to affect negatively the functioning of markets.

The fifth type of regulatory indicators consists of pure 'single market indicators'. The European Parliament has expressed its desire to develop indicators which show single market 'deficits' as well as indicators applicable to Member States in this respect as a basis for recommendations to Member States in the European semester to pursue specific policies which would help the single market to be deepened and better enforced. There can be no doubt that the single market is by far the most important element of European integration – indeed, its very core⁹ without which the EU would at best be a plain customs- union-plus. But the understandable demands for such indicators to be reliable and operational are not easily fulfilled. Pelkmans, Renda, Alcidi, Luchetta and Timini (2014) concluded - in their report to the EP exploring the feasibility of such indicators¹⁰ – that economic research has developed indicators for market integration deficits, but these are results of long-term processes (hence, not attributable to one or only a few years) and cannot suitably be applied to individual Member States for policy recommendations. These indicators also suffer from some drawbacks. The authors have proposed a more limited 'single-market-gap indicator' but no efforts have been made to introduce it so far. However, highly targeted and limited indicators do exist, the well-known example of the Single Market Scoreboard (measuring the transposition rate of directives for all Member States) being the most prominent and effective one.

2.2. Why PRO-SERV, the new indicator for professional services?

As part of a series of recent initiatives of the European Commission in the realm of services, and supported repeatedly by the Council and the EP, PRO-SERV can be regarded as a tool to help formulate reform recommendations for the Member States in the domain of professional services. This quantitative tool has to be combined with a careful qualitative assessment of rules and legal regimes and with the application of the proportionality test. The technical purpose of PRO-SERV is to measure the intensity of restrictiveness of national regulation of regulated professions with respect to access to and the exercise of these professions.

⁹ See Pelkmans (2016) for the internal market as the 'core business' of the EU.

¹⁰ Title: 'Indicators for measuring the performance of the single market - building the single market pillar of the European semester', study for the EP IMCO committee, September 2014, [www.europarl.europa.eu/RegData/etudes/STUD/2014/518750/IPOL_STU\(2014\)518750_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2014/518750/IPOL_STU(2014)518750_EN.pdf)

This technical purpose is expected to serve two important EU policy objectives : (i) improving proper market functioning in this area, in turn, stimulating additional economic growth in the EU, and, (ii) facilitating intra-EU cross-border free movement (of professional services and of providers in order to provide temporary services) and cross-border establishment for professional services providers, thereby eventually removing one of the more difficult stumbling blocks to further deepen the single market. As is well-known, the deepening of the single market is ultimately motivated by the extra growth potential the EU can tap, which cannot be done by individual Member States. Therefore, in the longer run, the two objectives both serve secular EU growth. In the Lisbon treaty, this complementarity is reflected in Art. 121/1, TFEU stipulating that the economic policies of the Member States are a .."common concern". Indeed, the recent EU 'offensive' in professional services has added a powerful economic dimension to the sector-specific, technical and legal issues of qualifications, access-to-professions, and national regulation on their exercise, and this has been widely recognized inside and beyond the EU. Not only is the magnitude of the total sector of regulated professions rather large (involving some 47 million persons in the EU-28), the additional growth potential via better domestic market functioning and, cross-border, via a deepened single market is suggested to be substantial.¹¹ The latter is a result not only from the greater dynamism and productivity in the sector generated by better domestic and single market functioning, but in addition by 'knock-on'¹² effects in local and EU-wide value chains (e.g. due to business services incorporated in manufacturing) magnifying the initial effects.

¹¹ See e.g. Corugedo & Perez Ruiz (IMF), 2014; World Bank, 2016

¹² Especially forward linkages. See Paterson & Sellner (2012) for a careful derivation of the knock-on effects of 10 sectors, with 'other business services' (mainly, professional services). The knock-on effects are caused by the forwarded embodied content (of professional services, here) in other industries. Altogether, for 20 EU countries as a group, other business services supply inputs, directly and indirectly, to other sections of the EU economy that are over 4 times (!) its own sectoral gross output.

3. DESIGN OF THE PRO-SERV INDICATOR

KEY FINDINGS

PRO-SERV is more precise and ambitious than the PMR for professional services. No less than 11 regulatory items are added to the 10 in the PMR. At the same time, it must mean that it is a demanding approach in terms of required data (this time, helped by the Mutual Evaluation of the Member States). PRO-SERV does not focus on regulation (possibly acting as barriers) affecting the intra-EU cross-border provision of services, but rather on regulation about establishment of professional service providers in the Member States.

PRO-SERV should clarify better the cumulative restriction level due to its much greater refinement. However, it is good to realise that 'regulatory exclusiveness' (i.e. reserved activities and titles) is of relatively great importance. PRO-SERV also constitutes a widening of the coverage of regulated professions, from four (PMRs) to seven.

PRO-SERV has emerged by deepening and widening the OECD PMR for professional services, after the Commission first published a somewhat different exercise in 2015 for the EU on the four professions included in the PMR. In order to prevent confusion, the 2015 exercise will not be discussed.¹³ The *deepening* of the PMR approach in regulated professions consists mainly in incorporating in PRO-SERV many more aspects in the indicator: in a comparative list,¹⁴ PRO-SERV is shown to add 11 items to the PMR total of 10 items. These additional elements include e.g. the protection of the title, continuous professional development obligations, shareholding requirements, incompatibilities of activities of a professional, professional indemnity insurance and (specific additional) authorisation requirements. Table 1 sets out the composition of PRO-SERV and the weights of the four compartments used.

¹³ Note that the 2015 exercise made some different choices, referred to only four professions (not seven, as PRO-SERV) and was not based on the refined data from the Mutual Evaluation exercise. See Business services – assessment of barriers and their economic impact, <http://ec.europa.eu/docsroom/13328/attachments/1/translations/en/renditions/pdf>.

¹⁴ See SWD(2016)436 of 10 Jan. 2017 (as in footnote 6, above), pp. 168/9.

Table 1: PRO-SERV, composition and weights

	Restrictions included in PRO-SERV indicator	Weights	Explanation/comments
A	<u>Regulatory exclusiveness</u> <ul style="list-style-type: none"> • 'reserved activities' • protection of the title 	31 %	<ul style="list-style-type: none"> • legal monopoly, strong restriction • light restriction, entry/competition open
B	<u>Qualification requirements</u> <ul style="list-style-type: none"> • years educat/training • no. of pathways to obtain qualifications • mandatory trainingships • prof. experience for full cap. • mandatory state exam • cont. prof. developm. duty 	17 %	<ul style="list-style-type: none"> • automatic vs. discretionary M.R. • more pathways, less restrictive • [common in many professions] • relevant when auth.n is staggered • restrictive, without M.R. • restriction, but only after access
C	<u>Other entry restrictions</u> <ul style="list-style-type: none"> • membership or registration professional Body compulsory • quota of licences • qualifications regional • age restrictions • other auth.n req.ts 	21 %	<ul style="list-style-type: none"> • registration is a light restriction • quotas can be highly restrictive • can be quite restrictive • restrictive, hard to grasp why • addit. specific auth.n, restrictive
D	<u>Exercise requirements</u> <ul style="list-style-type: none"> • restric.s on corp. Form • shareholding req.ts • voting rights control • no joint exercise prof.s • incompatibilities • prof. indemnity insur.e • tariff restrictions • advertising restrictions 	30 %	<ul style="list-style-type: none"> • most restrictive, if 'as sole practit.r' • % share, held by professionals • idem, for voters (manag.t control) • avoiding 'conflicts of interest' • idem • for 'establishment' only • rules on fees can be quite restrictive • ban or conditionality of adverts

Source: SWD (2016) 436 (op. cit.), pp. 160/1.

Table 1 leaves little doubt that PRO-SERV is more precise and ambitious than the PMR for professional services¹⁵. At the same, it must mean that it is a demanding approach in terms of required data. The unique efforts undertaken by the Member States, in close cooperation with the Commission, in the framework of the Mutual Evaluation, should not be underestimated.

¹⁵ The careful reader should note that the comparison of the PMR and PRO-SERV – based on a table in SWD (2016) 436, pp. 168/9 - contains an error (meanwhile acknowledged by the Commission) in the text explaining that table. The text says that tariffs and advertising restrictions are not covered, which is incorrect: they are.

Member States were expected to review a large number of professional services regimes in their country and report to the EU, also for the improvement of the EU Regulated Professions Database.¹⁶ The 2 – years Mutual Evaluation exercise further intensified and clarified the national regimes. Finally, Member States are under the obligation to make NAPs (National Action Plans) aiming to amend or even reform professional services regulation where proportionality tests and/or the Mutual Evaluation would so suggest. These are not the only challenges. Member States differ dramatically in these regimes. The mere fact that Lithuania has reported only 76 professions that are regulated, as against Hungary with no less than 545, has implications about the comparability of these regimes.

PRO-SERV should, in principle, clarify better the cumulative restriction level due to its much greater refinement of the various requirements. Normally, the cumulative restriction level is well expressed by PRO-SERV: it adds up, be it with distinct weights, the many possible restrictions¹⁷. However, one cannot lose sight of the overwhelming importance of compartment A in Table 1, namely, that of 'regulatory exclusiveness'. No less than 72% of the professions in the EU are subject to 'reserved' activity, that is, a monopoly to exercise the relevant activities for individuals with the required qualification. In 15% of the cases, the 'title' protection comes on top of that. In just 11%, only the title is protected. Still, the weight given to 'exclusiveness' in Table 1 is 'only' 31 %, barely more than the 30 % for 'exercise requirements'. All of this refers to what it takes to 'establish' in a particular Member State in the relevant professions. PRO-SERV does not incorporate regulation (i.e. perhaps barriers) affecting the intra-EU cross-border provision of services¹⁸.

PRO-SERV implies a number of technical choices on what to incorporate or not, and how. Thus, in some professions (e.g. accountants in Austria) there are sub-divisions with, possibly, distinct restrictions for each type of sub-division: PRO-SERV will incorporate all sub-divisions of professions and takes the mean level of restrictions.¹⁹ As shown in Table 1, PRO-SERV applies a weighted average between the four compartments (whereas the PMR uses a simple average). In any indicator, the question of the 'weights' is subject to debate. However, in professional services, with such a preponderance of 'regulatory exclusiveness', it is difficult to defend a simple average. One can then ask questions about the weight of 31% for 'regulatory exclusiveness' but it is equally hard to be firm on what the 'right' weight should be.²⁰ PRO-SERV maintains the PMR tradition of scoring a restriction between zero (no restriction whatsoever) to 6 (most restrictive, or indeed a ban). From the PRO-SERV methodology in SWD (2016) 436 (op. cit.) section V, it is not clear how exactly the scoring has been done, e.g. what is given a 2 or a 5 or a 1. This is by definition somewhat of an approximate exercise, inevitably so. Nevertheless, in Pelkmans (2010), assessing the PMRs of 2008, examples were found where the scoring was biased ²¹ so, in the margin, the scoring does matter. In section 4.4, the scoring will be briefly discussed.

¹⁶ See http://ec.europa.eu/growth/_tools-databases/regprof/

¹⁷ However, there are special cases where cumulation plays out differently and magnifies barriers. An example sometimes mentioned is the indemnity insurance for lawyers (here, solicitors) in the UK which is rather high-cost because it refers to the combination of activities of attorneys and notaries. These costs are so high that they are prohibitive for (say) Spanish lawyers in the UK (who would not conduct notary services). Without 'unbundling' such insurance, thereby lowering the premia, cross-border establishment is hindered but this would not show up in PRO-SERV.

¹⁸ SWD (2016) 436 (op. cit, as in footnote 6), p. 156, bottom. The reader is also referred to section 4.6 below.

¹⁹ The PMR only takes the most restrictive one.

²⁰ Note that, in the 2015 Commission paper (footnote 13), the weight given to reserved activities was only 17%.

²¹ For instance, in the wider PMRs, a 6 for state-owned enterprises which is – in the EU with a strict regime of what such companies can and cannot do – clearly much too high.

PRO-SERV also constitutes a *widening* of the coverage of regulated professions, from the four sectors in the PMR, to seven generic regulated professions in PRO-SERV. 'A generic profession regroups all professions regulated at national level whose characteristics and activities they exercise are similar' (SWD(2016) 436, p. 160, footnote 86). The 5500 professions regulated at Member States' level are regrouped into 600 generic professions in this way. The four sectors in the PMR are architects, lawyers, engineers and accountants; the three added ones are tourist guides, real estate agents and patent agents. But there is one difference with respect to accountants / tax advisors. Whereas the OECD PMR includes statutory audit activities as part of accountancy, PRO-SERV does not, the argument being that such activities are heavily regulated (in fact, an auditor can be regarded as a separate sub-division).²² Auditory services altogether cover some 30% of the turnover of EU accountancy companies, but one has to be careful here: for smaller firms, this is typically a local business (due to required knowledge of local laws and trust), whereas for servicing large multinationals the big accountancy firms are often organised as networks of national partner firms capable of operating across borders to serve major clients for auditing. However, auditing is regulated by the EU in company law directives, hence, by leaving auditing out, this convergence effect is lost from the data.

²² Another such issue is the activities of notaries, which the OECD has included under 'lawyers'. The Commission, rightly, does not do this (also, notaries do not fall under the Professional Qualifications Directive).

4. ASSESSING THE PRO-SERV INDICATOR

KEY FINDINGS

PRO-SERV is an improvement of the PMR for professional services, but one wonders whether that is shown in different (presumably higher) levels of restrictiveness in the four professions compared. There is however no clear overall trend. For three of them - lawyers, engineers and architects - more than half of EU countries show a higher PRO-SERV; for accounting, mostly one finds decreases.

A critical issue is whether the neglect of risk regulation in PRO-SERV risks to prompt biases in policy conclusions based on PRO-SERV. Risk regulation addresses the powerful 'asymmetric information' in professional services, affecting questions such as trust and integrity, health and safety as well as consumer and investor protection. Where PRO-SERV might suggest that 'less (of the relevant regulation) is good' (for market functioning), this does not apply to risk regulation, it depends typically on the aims and proportionality tests (overcoming market failures for e.g. consumers that improve market functioning too). Recent attention for 'quality' might help but only if this is very carefully scrutinised based on credible indicators of quality.

Other aspects of assessment include the neglect of single market issues such as possible barriers to cross-border establishment or free movement of services (e.g. automatic recognition is not explicitly mentioned in the method, hence, somewhat hidden in PRO-SERV), the question of what could be incorporated in PRO-SERV to make it better still – this prompts a discussion of ex post versus ex ante regulation, ex post regulation beyond the exercise requirements is not in PRO-SERV - and a few more professional services known to have restrictive regulation. Finally, the economic rationale of economic studies based on PMRs (and in future PRO-SERV) is evaluated. The studies focus on growth aspects driven by better market functioning and greater competition but the present study cautions that there are natural limits to these arguments in professional services.

4.1. Why PRO-SERV is an improvement

Before making some critical remarks in the remainder of this section 4, it is good to clarify why PRO-SERV is an improvement of the PMR for professional services. The principal reasons are found in the 'deepening', that is, a much more precise and comprehensive list of restrictions of access and exercise, and the 'widening' (of the number of professions covered, now from 4 to 7). These benefits are conditional upon significant efforts of data provision by Member States. Indeed, in professional services where national regulation is prevalent, the full cooperation of Member States is indispensable. However, with the data available at the moment following the Mutual Evaluation and the enrichment of the EU database, it would seem that a further 'widening' to still more regulated professions can be accomplished. The seven professions were selected²³ because they belong to four 'key economic sectors (business services, construction, real estate and tourism)'. Apart from real estate, these service sectors are already under discussion ever since the adoption of the 2006 Services directive. The Commission is not explicit on why other professions are not incorporated in PRO-SERV at the moment. Since the EU Member States have been deeply involved in the data collection and the run-up to the Commission's services package of January 2017, it is not impossible that this is due to sensitivities in (some) Member States.

²³ COM (2016)820 (op. cit.), p. 8.

One example might be ‘crafts’, which is – dependent on how it is defined – a significant sector and where repeated debates on disproportionate restrictions have taken place²⁴.

With PRO-SERV, it might also be possible to conduct empirical economic studies in the 7 professions and the effects of the present intensity of restrictions on competition, turnover and jobs, if not innovation where applicable, which are superior to what has been done so far on the basis of a more simplistic PMR (and fewer professions).

In sections 4.2 – 4.7, a more critical assessment will be undertaken, showing that the nature and use of PRO-SERV has to be embedded in a properly developed evaluation, together with qualitative approaches.

4.2. Does PRO-SERV yield different outcomes than the PMR?

A straightforward query to assess PRO-SERV is, of course, to ask whether it makes a factual difference in the measures of restrictiveness, compared to the less refined PMR. It should be realised that a comparison between results of the two indicators is only possible for four of the seven professions: architects, lawyers, engineers and accountants. This is so because the PMRs have been applied only to those four professions. Moreover, as noted, PRO-SERV is geared to measure restrictiveness of regulation for each (included) profession separately, and not as a sector combining different ones (e.g. auditors and accountants; or, notaries and lawyers).

Table 2 and Annex 1 try to answer this basic query. Table 2 is based on Annex 1, which provides 2 x 28 comparative graphs, that is, comparing (for four professions) the results of the PMR with those from PRO-SERV. Here we (have to) ignore the professions versus sector differences between PRO-SERV and PMR (see above).

²⁴ Some preliminary impression can be had from a study by Rostam-Afschar (2015) and a short section on crafts in SWD (2015) 202 of 28 November 2015, A single market strategy for Europe – analysis and evidence, pp. 36/7.

Table 2: Comparing results of PRO-SERV with PMRs (4 professions)

	lawyer	(civil) engineer	architect	accountant
AUS	same	higher	higher	slightly lower
BEL	much lower	higher (still low)*	higher	slightly lower
BUL	slightly lower	much higher*	much higher*	slightly lower
CRO	lower (but high)	lower	lower	same
CYP	slightly higher	slightly higher	slightly lower	much lower
CZE	higher	much higher	higher	lower
DEN	much higher	much higher*	zero (slightly lower)	zero (lower)
EST	same	slightly higher	same	zero (much lower)
FIN	much higher	much higher*	much higher*	zero (much lower)
FRA	slightly higher	higher *	lower	same
GER	higher	higher	slightly higher	slightly higher
GRE	lower	higher	slightly higher	lower
HUN	lower	higher	same	much lower
IRE	slightly higher	much higher	much higher	slightly higher
ITA	higher	higher	higher	slightly higher
LAT	lower	slightly higher	slightly higher	zero **
LIT	lower	higher	higher	lower
LUX	slightly higher	slightly lower	same	slightly lower
MAL	same	much higher	much higher	much higher
NET	slightly higher	zero*	higher*	lower
POL	slightly higher	slightly lower	slightly lower	same
POR	same	higher	same	slightly lower
ROM	slightly lower	2.4 **	3.0 **	same
SI.kia	slightly higher	same	same	same
SI.nia	higher	higher	higher	much lower
SPA	same	higher	higher	much lower
SWE	much higher	slightly higher	slightly higher	zero (much lower)
UK	much higher	much higher*	higher	same

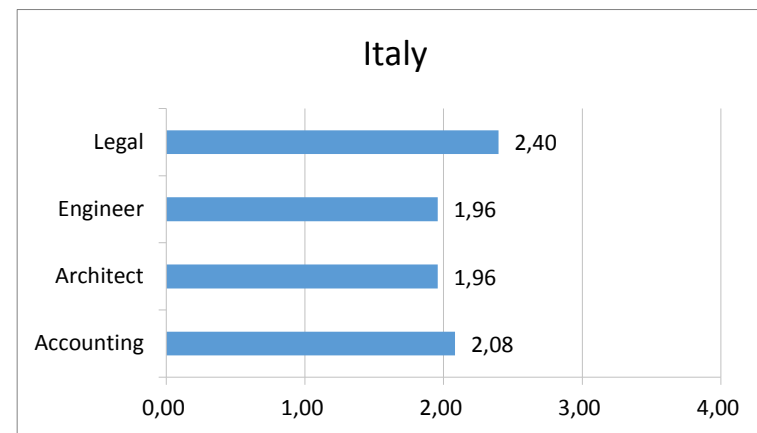
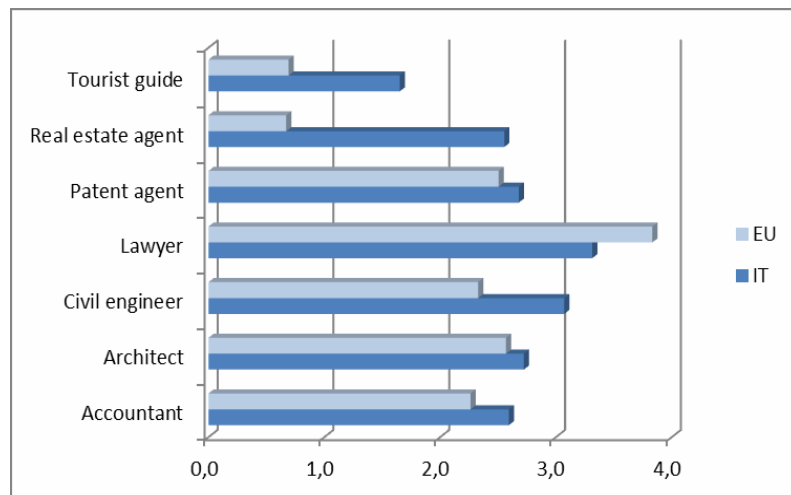
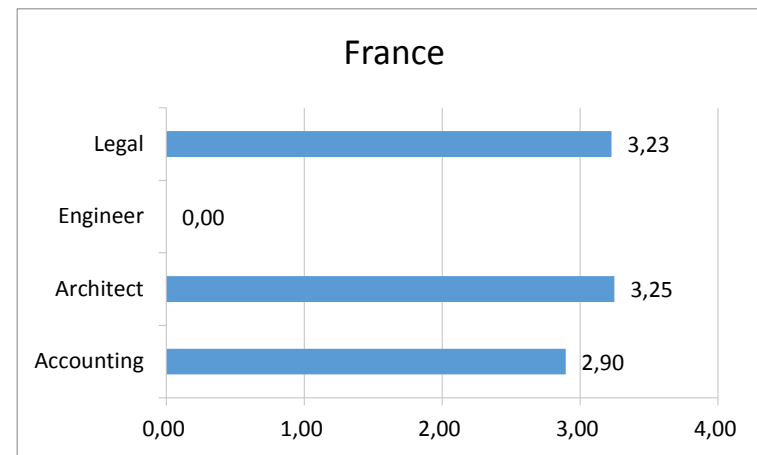
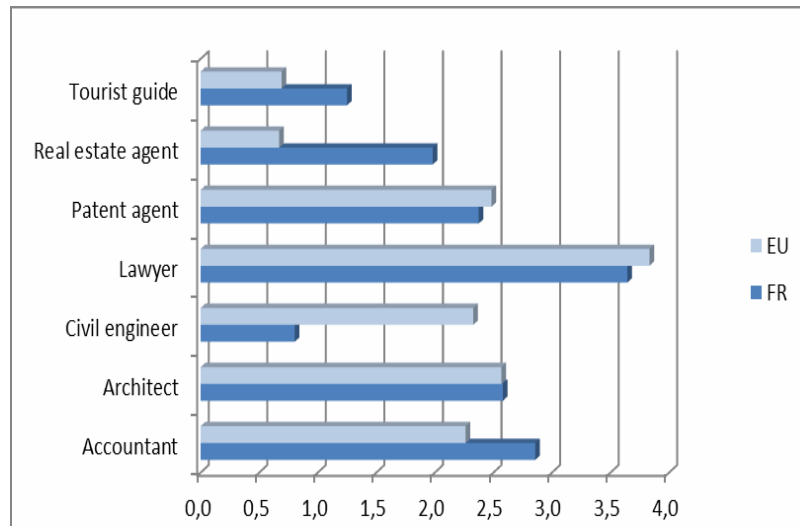
Notes: source, see Annex; * = zero in PMRs; ** = not available in PMRs

A careful inspection of the Annex, as summarized in Table 2, leads to a number of conclusions:

- a. there is no clear overall trend in the results as a whole; whether one goes horizontal between the four professions, or, vertical, between the Member States, all possibilities appear, from 'much higher' via 'same' to 'much lower' and intermediate cases. Given that PRO-SERV has 11 items more than the 10 of the PMRs, this is somewhat surprising. If the Commission might have intended to trace and quantify restrictions not caught by the PMR, one would have expected a trend of higher results in PRO-SERV. Going by professions, of the 28 Member States, 15 of them have higher PRO-SERV indicators for lawyers, 22 of them for civil engineers, 16 of them for architects and only 4 of them for accountants.
- b. Whereas for lawyers, engineers and architects, one can at least point at PRO-SERV being higher in more than half of the cases, for accountants this is only four times the case (and for 3 of them, only 'slightly higher'). In 17 cases, PRO-SERV is lower than the PMR. It is not impossible that the removal of 'auditing services' from 'accounting & tax advice' is the principal reason as this is a strictly regulated activity. For lawyers, compared to the PMR, (strictly regulated) notaries services have been removed in PRO-SERV but this assumes a smaller share of all legal service activities. As a result, the effect of this removal is less clear and other (extra) items in PRO-SERV might well dominate the outcome : of the 15 cases of 'higher', no less than 7 are only 'slightly higher' ; another 8 cases are 'lower' or 'slightly lower' and 5 cases are the 'same'.
- c. (Civil) engineers and architects are interesting for other reasons. Engineers appear more often – than for the other 3 professions – not to be regulated with respect to access. Indeed, no less than 8 of 27 Member States²⁵ registered a zero PMR. In all the zero cases (but one, the Netherlands), PRO-SERV is higher or much higher, partly for reason of access (other items), partly for reason of exercise of the profession (idem). Of the 27 Member States, engineering scores are 22 times higher, only three times (slightly) lower and twice the same. Thus, PRO-SERV shows items of restrictiveness which alter the picture inherited from the PMRs. A seemingly similar effect for architects is weaker: 16 cases are 'higher' or 'slightly higher', another 5 are the 'same' and 6 (slightly) 'lower'. The four cases with a zero PMR come out (slightly) higher in PRO-SERV.
- d. For illustration purposes, comparative graphs for France and Italy have been inserted below. In France PRO-SERV alters little for lawyers and accountants, but modest changes can be registered for architects and engineers. For Italy, the picture is very different: PRO-SERV is higher for all four professions, in particular for engineers. For other countries, the reader is referred to Table 2 and Annex 1 (for graphs).

²⁵ No PMR data for Romania.

Figure 2: PRO-SERV for France and Italy



4.3. Risk regulation versus economic regulation: upshot for PRO-SERV

As noted, the PMRs were initially dominated by what is called 'economic regulation'. Such regulation seeks to influence the economic outcomes of market functioning (hence, the name) for political and/or re-distributional reasons or merely for purposes of political (e.g. national) control. Much of this regulation had been lingering from the 1950s and 1960s when the European economies were much more interventionist, or, had been maintained for ideological reasons or vested interests, even when the economic case for better market functioning had been made convincingly and some countries had already been experimenting successfully. The crucial point is that this 'economic regulation' is not based on 'market failures' such as SHEIC (= safety, health, environment, investor/saver and consumer protection). Regulation based on market failures or 'societal risks' is called 'risk regulation' and is, in principle, justified, subject to conditions of 'proportionality' and 'suitability' (i.e. effectiveness). The fundamental rationale is that markets do not or not sufficiently ensure acceptable levels of such societal risks. The risk regulation that PRO-SERV is related to is about 'trust and integrity', 'safety & health' (e.g. in medical and engineering) and in 'consumer & investor protection'.

As noted, more recent versions of the PMRs represent a 'mix' of economic and risk regulation. The main reason is that many services have been incorporated in PMRs (e.g. professional services, network service industries, retail) which are regulated based on societal risk reduction. Whereas with economic regulation, the broad motive can be that 'less is better' for market functioning, this is not the case for risk regulation. In short, risk regulation is (or should be) based on risk assessment (a careful, scientific task) and policies and processes of risk management (politicians and decision-makers ought to ensure open processes – with accountability - in which societal norms are set for risk reduction, knowing that pursuing lower risks has both benefits and costs).²⁶ Readers will recognise this point when it comes to health and safety questions of goods, but, in principle, it is also applicable to professional services. However, unlike in health or safety matters of goods and substances, where scientifically based 'minimum standards' are often determined by (say) the WHO or reputable testing bodies, this is not the case in professional services. The broad market failure (but not the only one) that underlies much of regulation of professional services is so-called 'asymmetric information' between suppliers and consumers /users. This is due to extreme knowledge/expertise gaps between consumers and the providers of such services. In other words, such services are not 'search' goods where the consumer can be sovereign (say, buying shoes) and only rarely 'experience' goods (one might begin to develop some judgment about price/quality of the service, once repeatedly consumed, nowadays possibly helped by internet comments, consumer surveys; nonetheless, almost every service delivered by such professionals has characteristics of a 'stand-alone' case, given the direct and close interaction with the client). Instead, these services usually are 'credence' goods where the consumer is simply incapable to assess quality (or even price in many instances) with authority, whether before or after the service delivery. Recently, there have been examples of some such (simple, routine) services having been standardised to some degree, with prices notified on websites (for legal services, see OECD [2016]). But for the bulk of the more complicated services, this is simply not possible. Credence goods call for regulation so as to guarantee a minimum of trust amongst consumers in the providers and to ensure a minimum quality of specific services, where relevant. Of course, this could include credible levels of qualification and many other ways of satisfying consumers' (or, at times, investors') strong preference for trust in the providers, their integrity and their services. Looking back at Table 1 yields two observations : (i) there are many different aspects to this type of regulation, more-often-than-not in a cumulative fashion; (ii) whilst ensuring consumers that credence goods can be

²⁶ A third element is risk communication, critical in some cases, but not relevant in the present context.

trusted, in Table 1 PRO-SERV nevertheless defines them as ‘restrictions’. The compelling logic therefore is that such (national) regulation are indeed ‘restrictions’ of market functioning, but at the same time, they can be (should be) ‘justified’ (by market failures) and ‘proportionate’, and in this way *support* a better market functioning. In other words, when assessing regulation of professional providers and services, one inevitably runs into an assessment of balancing the restrictions of market functioning (e.g. Table 1) with the benefits of (sufficiently) reducing market failures (e.g. asymmetry of information, often extremely so in these professions).

Therefore, using PRO-SERV has to be done carefully, always having in mind the conditions of (a) justification (does the restriction reduce an aspect of a market failure?), (b) proportionality, and (c) effectiveness (called ‘suitability’ in EU case law). PRO-SERV cannot be used with the motto ‘less (regulation) is better’. This is only the case once it is shown that societal risks are not at issue or that the measure is disproportionate or clearly not suitable. The intrinsic difficulty in professional services is that ‘hard scientific’ (and verifiable) standards are lacking. This problem is to some extent diminished by the laboratory function of the Mutual Evaluation, showing great differences between the Member States. These differences call forth healthy debates about what market failure has been addressed, knowing that another Member State A has less or no such regulation and the level of services does not seem to be an issue. PRO-SERV forms an appreciable attempt to bring a higher degree of comparability in all these data, but even PRO-SERV is incomplete (see 4.6, below). Moreover, one must have an explicit idea of what shortcoming one exactly tries to overcome by regulation, and whether this is proportionate.

Application of a proportionality test and the desired precision of identifying what the market failures are in practical terms has prompted a debate on ‘quality’ of professional services delivered. Although there might be merits in exploring this empirically, there are also reasons for caution. Quality is at least as vague and malleable as market failures, possibly more so. Moreover, verifying the quality of delivered services risks to by-pass important aspects of the market failures approach such as questions of ‘trust’ in the providers (that is, when the decision of contracting services from suppliers arises, hence, much before services are delivered) and ‘integrity’. For instance, there have been suspicions for a while that some major players in the accounting sector condoned overly lax standards for auditing rather than standing up against their clients when misconduct was traced. Such major issues of integrity must be dealt with effectively – if necessary, via restrictive regulation or surveillance – before the service is even contracted. One may define quality (among other aspects) as the absence (or very low frequency) of such cases of improper conduct but that would seem to be unsatisfactory (if not damaging) to society as it is an unduly narrow and minimalistic approach. The European Commission has recently contracted several scholars to do empirical economic research on ‘quality’ of services of various professions. It is our understanding that the principal focus will be on ‘direct outcome’ (whatever this exactly means) and consumer reactions (including complaints, malpractice suits, the rate of defective or collapse constructions or electrocutions (cf. electricians) or even the premia for liability insurance). Of course, these are relevant and may help to obtain a degree of quantification of aspects of ‘quality’ but nevertheless the list is also a little odd. The extreme faults refer basically to charlatans instead of the (normal) expectation of quality of the service. Regulation must at all times prevent charlatans to enter these professions but the prevention of such accidents is merely the prevention of significant risks to society, not really a measure of quality of the service. It remains to be seen what can be made of ‘direct outcome’ (presumably a critical measure) and how this can be measured. If quality in the sense of ‘legitimate consumer expectations’ can be quantified, and made comparable (e.g. before and after reforms, for example) it would surely represent major progress and serve as a guidance for reforms in specific cases. However, even then one should not forget that one deals with ‘credence’ goods

where consumers do not have a well-developed capacity of assessing the quality of the service, whether before or after delivery.

The literature comprises several attempts to verify the level of or changes in quality of professional services. For purposes of illustration, some examples are given here. In a major survey by the European Commission in 2015²⁷, a study by Humphris & Koumenta (2015) is quoted on nurses and security guards in the UK. The question is whether reforms in these two professional activities were raising, or not, the 'quality' of service. In both cases, the outcome found was that quality was improved as a result of the reforms. In both cases, a greater degree of restrictiveness was the kernel of the reform, suggesting that the appropriate degree of restrictiveness of professional services regulation can be justified by 'quality' considerations. Of course, one has to remain careful because every increase in quality also has a cost side to it. The authors managed to measure quality in the cases of nurses (five criteria) and applied rigorous statistical analysis to underpin their inferences. In the case of security guards, however, the improvement of quality is all about crime levels in certain spots and the relevant (reform) variable turns out to be the blockage of persons with a one-time criminal record for these jobs. This change appears to be a rather obvious one and one wonders whether such an example is a useful and instructive one for the typical professional services dealt with in PRO-SERV. In the Commission survey of 2015 (op. cit.), it is also mentioned that the fact that the Netherlands does not regulate tax advisors has not led to a decline in quality which is interesting if indeed quality is measured properly. In the US, the White House (2015) published a survey on occupational licensing with a research appendix surveying 13 studies on e.g. quality. Overall, its conclusion is that empirical research does not find large improvements in quality or health and safety from more stringent licensing²⁸. Nevertheless, the study does not generalise. One reason is that the main concern about licensing occupations in the US is the strong increase of licensing over the last few decades, raising a suspicion that occupations seek licensing primarily in order to raise wages and prices and/or to reduce competition (have an 'easier life'). That suspicion turns about to be correct in some cases but not in all. Thus, licensing – it is noted – might affect quality through increasing the training of licensed practitioners. It is also acknowledged that not all licensing frameworks fail to increase service quality. Finally, this literature suggests as well that licensing may not always be the adequate tool to address quality concerns.

4.4. Some technical issues of PRO-SERV

There is no such thing as a perfect indicator. As noted, PRO-SERV has added no less than 11 'restrictions' relevant for access to the profession and its exercise, compared to the PMRs. It has improved on the PMRs when a profession has subcategories (e.g. taking the mean of restrictiveness). However, one can always argue about the weights of categories of restrictions (in Table 1, the middle column). As noted, the weight of 'regulatory exclusiveness' is 31% in PRO-SERV but the method (SWD (2016) 436 (op. cit., p. 167) speaks about the 'overwhelming' importance of this element, suggesting that an even higher weight would have been correct. PRO-SERV has seven professions, an improvement, but one could make a case (despite the costs of data collection, also by Member States, now lowered by the EU database) for including another handful of professional groups which are known to have fairly restrictive regulation and are sufficiently large to be of interest. Crafts is surely one that should be included in future work.

²⁷ SWD (2015) 202 of 28 November 2015, A single market strategy for Europe – analysis and evidence, pp. 38.9.

²⁸ The professional services surveyed are from teaching, real estate, dentistry, legal, accountancy, cosmetology, floristry, lab technicians and building contracting.

A highly technical issue is the scoring of individual measures ranging (as in the PMRs) from 0 to 6 (most restrictive or a ban). The main public source of PRO-SERV is SWD (2016) 436 (op. cit., pp. 166/7). The explanation of the scoring in this document is minimal. What can be made up from the short text is that, often, the scoring is either 0 or 6, except where intermediate values can be clearly defended (e.g. variable years of education). Using such a binary (yes/no) scoring method brings with it a risk of an upward bias. The probable reason is that the Commission may have tried to avoid casting detailed judgments on the degree of restrictiveness, even if – in actual practice - this might play a role. It is difficult to assess how crucial the scoring issue is in PRO-SERV. Indeed, one can also become obsessed with too much nitty-gritty which, in the final analysis, does not make much difference for the PRO-SERV numbers one finds. Nevertheless, some examples are given here about queries about scoring that cannot be answered based on the methodology supplied. First, PRO-SERV brings in ‘flexibility’ in choosing pathways of education (p. 162) but whether and when this is scored (say) 1 or 3 or 6 is not indicated. Second, how to score the ‘price’ of continuous professional development’ and this in many Member States? Third, the limitation of the number of professional or licenses is said to be ‘restrictive’ (p. 164) but would that not be ‘very’ restrictive, in other words, justify scores of 4, 5 or 6 ? Fourth, on territorial validity (within EU countries) and the option of ‘equivalence’, one has no clue on how restrictive this is scored. Fifth, the item ‘additional authorisation requirements’ is shown to be very complicated and some might well amount to very restrictive measures, but one has no idea how this has been scored. Sixth, on the joint exercise of professions, the distinction between a ‘general conflict of interest clause’ and a ‘specific’ one (even a ban!) leave one wonder how these are scored.

4.5. PRO-SERV: what about harmonisation and mutual recognition?

The EU database incorporates 5590 professions narrowly defined at the national level. One can consolidate them into some 600 (generic) professions or professional groups. Some 40% of the latter are in medical and para-medical services. This huge group (in numbers of professions and in terms of persons) is left out of PRO-SERV, presumably because of a considerable degree of harmonisation and EU-based ‘automatic recognition’. It is agreed that this form of mutual recognition works well and has facilitated considerable cross-border movement of professionals inside the EU. Hence, the single market seems to be well-served here. But the way PRO-SERV has been set up strongly suggests an interest in the competition and market functioning questions. This prompts the question whether or not the markets for medical and para-medical professions are (in) sufficiently competitive, even when free movement of individuals in this field seems well guaranteed.

There is no ‘automatic recognition’ in accounting but there is far-reaching harmonisation in auditing.²⁹ As noted, auditing services is not in PRO-SERV, again – apparently – because of far-reaching harmonisation. Table 2 strongly suggests that this change (as compared to the PMRs) causes a lowering of restriction levels in accounting, but the beneficial aspect of harmonisation (as well as its level of restrictiveness) remains out of sight.

In architecture, there is automatic recognition, far-reaching de facto ‘equivalence’ and easy acceptance of qualifications, obtained abroad, based on the automatic recognition, in turn based on harmonised minimum training requirements (94%). Yet, as a rule, PRO-SERV for architects tends not to be low (and often higher than PMRs). This discrepancy has prompted a debate. It is argued, with good reason, that what really matters is to observe how many architects receive a positive decision to come and work in another EU country and that depends on more than automatic recognition of qualifications. These additional requirements

²⁹ However, there is still a range of national options e.g. on mandatory rotation periods, causing single market hiccups.

are not always harmonised. It turned out to be not so easy to trace these positive decisions but in 2015 architects were found to be employed in other EU Member States much more frequently than (i) all citizens were (which is 3.6%), (ii) other professional service providers are (accounting 3.2%, real estate professionals (2.8%), civil engineers (2.3%) and lawyers (1.6 5), namely as high as 6.5%³⁰ But easy cross-border access should be a factor increasing actual or potential competition, a beneficial single market effect. Unfortunately, this aspect remains out of sight.

4.6. What is not incorporated in PRO-SERV but should be?

Arguments to incorporate more in a composite indicator may serve sound purposes but have to be weighed against (too much) complexity and data requirements. Keeping this in mind, there are three items that would lead to meaningful additions of PRO-SERV. These are : (i) the question of ex ante versus ex post regulation of professions; (ii) the inclusion of a few more restrictively regulated professions which also have enough economic weight to make a difference in the single market; (iii) the critical issue of free movement of professional services (including temporary cross-border services) and the right of (cross-border intra-EU) establishment of professionals, both possibly hindered in undue ways by the level of restrictiveness of professional services regulation.

As to the first item, it is often held in debates that low scores in PMR – and, by implication, also in PRO-SERV – in some professions can be attributed to the undue focus on ex ante access regulation, and to some extent to regulatory control of the exercise of the professions. The point is that these low scores (even zero, in a few cases) do not reflect a low or even irresponsible intensity of regulation in the light of possible market failures, but simply are the results of an omission: ex post regulation is not incorporated in PRO-SERV. This point has to be assessed carefully. The meaning of ex post regulation and/or control or conformity assessment is that the delivery of the service is subject to forms of intervention. Irrespective of whether access is regulated or not, the service itself is checked when it matters. The more strict and elaborate these controls, the less – one might argue – is it necessary to maintain strict access regulation. What matters is how services are delivered – that is the moment where market failures would have to be reduced or removed (if possible). Important aspects like (say) trust and integrity or health & safety would then depend much less on compulsory qualifications of a detailed and prescribed nature, but rather on private reputation and on the system of ex post controls and checks. Note that this goes further than what is called, in PRO-SERV, the exercise requirements, although they are in a way also ex post. One could mention the Nordic model with respect to architects where not only access but even exercise regulation is minimal or zero, yet safety and consumer protection is ensured via ex post control systems at the moment of licensing or building permits³¹. That is not incorporated in PRO-SERV. Another, somewhat different example is found in the UK model of accounting which is driven by consumer and user protection (including good redress options) and credible quality assurance programmes stimulated by the accountancy associations. Member States also differ quite radically with respect to engineers: just verify the two graphs, above, contrasting France and Italy, or by way of illustration, the UK on the next page.

One has to acknowledge the problem for PRO-SERV when trying to incorporate that in the future. One would need expert judgment for each EU country where what regulation, even

³⁰ European Commission (2016), European Semester Thematic Factsheet, regulation of professional services, https://ec.europa.eu/info/sites/info/files/european-semester_thematic_factsheet_regulation_professional_services_en.pdf (pp. 8/9).

³¹ Given the short time span of this study, it has not been possible to verify whether some Nordic Member States might have been inaccurate in supplying the relevant data about exercise, an assertion which has been made in the debate.

in quite general laws on licensing, (building) permits or surveillance, is found and how to score its restrictiveness. On the other hand, if other EU countries also maintain ex post controls, it would seem that such countries are disproportionate in cumulating restrictions both ex ante and ex post.

The second item has already been touched upon briefly. More of restrictively regulated professions could be added although only few candidates would have enough 'economic clout' to be meaningful for the economic potential of the single market.³² The crafts sector is surely one such candidate. It would require a very careful reading, if not scrutiny, of the EU database in order to select other candidates.

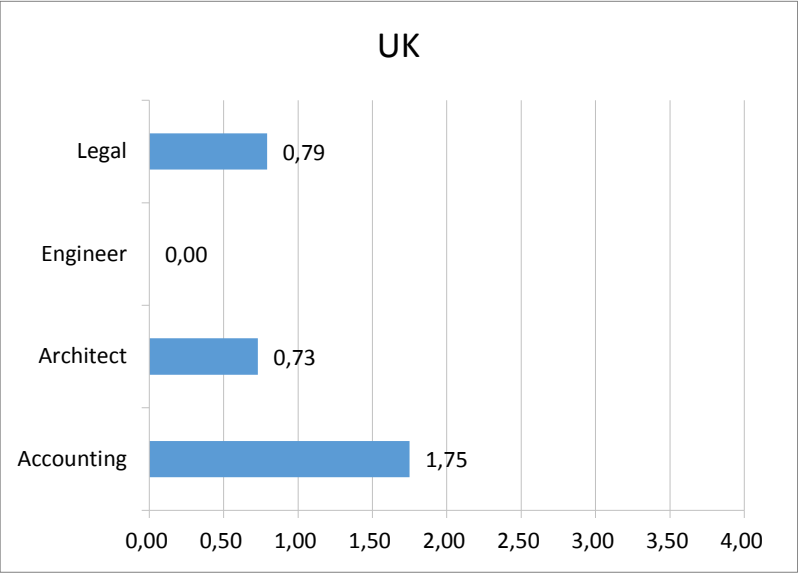
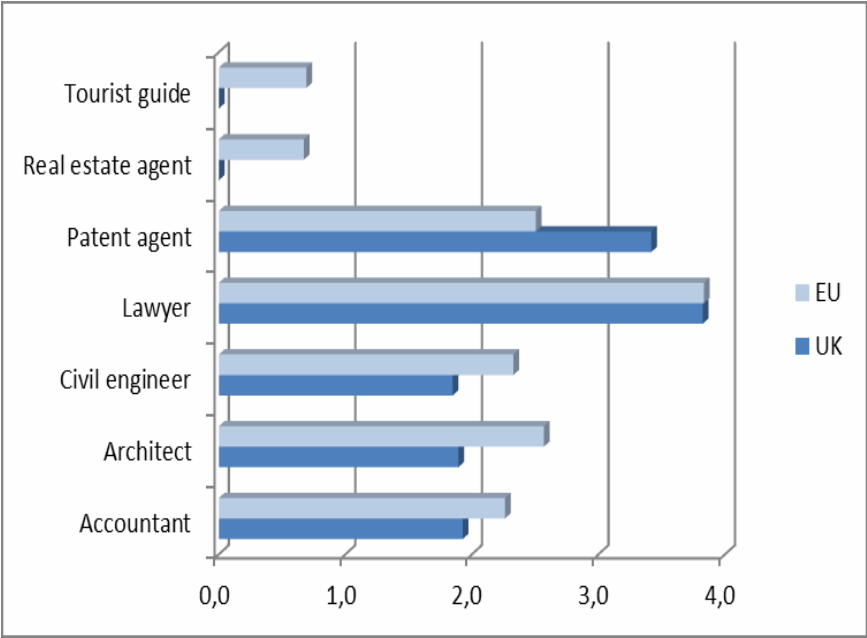
The third item relates to the singular focus of PRO-SERV on competition and market functioning, the latter especially from the supply-side. PRO-SERV is therefore geared towards the economic growth objective of the Union. However, there is no attention for, or indeed an effort to incorporate, core EU issues as genuine free movement and the practical possibility of exercising the right of establishment. Hence, the single market dimension is lost out of sight. Given the legacy of PMRs in PRO-SERV, this might well be difficult to correct. The implication is that the use of PRO-SERV has to be embedded in not only a careful assessment of proportionality, as noted before, but also in a single market framework with empirics about de facto recognition (perhaps helped by credible EU e-card regimes) and, where applicable, harmonisation. One can even raise the question whether more empirical research should be undertaken on these questions as well. Now, the PMRs have been used in economic research in order to estimate cross-border trade effects, for instance, although single market restrictions or recognition as such are not in the PMRs (or in the new PRO-SERV). This is somewhat odd. It has been noted before that the restrictions of the free movement of professional services are not included in PRO-SERV. Of course, indirectly the restrictions on establishment might also affect in some ways free movement. From the 2010 Mutual Evaluation of the Member States of the implementation of the 2006 Services directive, one can find a distinction between free movement and establishment restrictions and it turns out that the explicit restrictions of free movement consist of authorisations and notifications³³. In the 2015 Commission assessment of barriers in business services³⁴, indeed, authorisations for free movement of professionals and of companies have been included. It would be interesting and worthwhile to attempt the incorporation of such crucial internal market elements in a future redesign of PRO-SERV.

³² Remembering that the biggest group (medical and para-medical professions) is not in, at present.

³³ See Mustilli & Pelkmans, 2013, Annex 2 for many details.

³⁴ See footnote 13.

Figure 3: PRO-SERV for the UK



4.7. Discussing economic impact studies using PRO-SERV

The PMRs have been used in numerous research contributions to derive effects on various aspects of economic performance in many countries. For the present study, the PMRs for professional services only can be used likewise, focusing on the EU. With the arrival of PRO-SERV, it is hoped that greater refinement might bring greater robustness of such studies. The main motive of these empirical economic studies is that restrictiveness in regulation – no matter whether justified by market failures, partly or wholly – tends to create shielded market positions, reducing competition and entry, instead of keeping markets lively and even innovative. Over the longer run, these features are feared to lower overall productivity in the (EU) economy. Reforms reducing levels of restrictiveness would thus be good for the secular growth rate of the EU economy.

In Canton, Ciriaci & Solera (2014), this approach has been taken up. The authors find that a reduction of the PMR for professional services with 1 point increases the sectoral churn rate (the birth and death rate together, an accepted signal of competition in a market), which, in turn, increases allocative efficiency by 5.7% and decreases profitability by 5.4%. When splitting the PMR into access regulation and ‘conduct’ (= exercise) regulation, it was found that the latter was most influential. In Thum-Thysen & Canton (2015), these results are confirmed for professional services, focusing primarily on sectoral mark-ups, be it that the relevant PMRs do not fully explain the mark-ups. In Thum-Thysen & Canton (2017), using firm-level data for 13 EU countries, hence a far more precise approach, a significant effect of PMRs on mark-ups in engineering and accounting is derived, and these mark-ups are higher than when only using sectoral data (as in the 2015 study). The authors found some evidence that it is the larger firms which are capable to set higher mark-ups.

Meanwhile, the Commission has tried out a first empirical economic exercise with PRO-SERV as well.³⁵ However, this exercise is limited due to the fact that PRO-SERV has only one point in time and to a problem of insufficient disaggregation. One result is that, if an average EU country would raise the level of restrictiveness as expressed in PRO-SERV by 10%, profitability would increase by nearly 1%. It would also reduce the medium-term annual average growth rate of the number of firms by 0.4%. PRO-SERV would have to be recollected several times in the future, for this empirical economic exercise to be more robust.

The Commission has rightly been pro-active in conducting these studies. The work comprises important policy or reform messages. Nonetheless, a critical note is in order, too. It is implicit in these reform papers and recommendations that restrictive rules can be relaxed or (some) even removed, without undermining the prevention of market failures. Clearly, this implicit assumption can only be verified by assessments based on proportionality and other qualitative work, not by PRO-SERV alone. That also means that there is a limit to how far reforms can go, dependent on the country too. But there is more. Most of the professions now in PRO-SERV are typical KIBS, knowledge-intensive business services, with very high levels of qualification and expertise. The empirical economic studies are based on a much broader economic literature which tends to generalise competition aspects as if KIBS markets can be compared with markets for toys or shoes or simple software. In KIBS markets, it is simply unlikely that access /entry will ever be easy; indeed, even with greater competition, mark-ups are likely to remain considerable. One might make a similar objection about the role of churn rates: legal advice and case work, accounting services and tax advice, or most of architecture, or indeed the routine of patent agents are unlikely ever to be activities with dramatic changes in ‘business strategy’ or with new business models; at best, a regulatory reform might allow new entry at a near-disruptive scale as a one-off move, which is unlikely to be repeated. If anything, the dynamics might well be in mergers. Thus, in Italy there were

³⁵ In section VI of SWD (2016) 436 (op. cit.).

clear signals of disproportionate regulation of professional services and the Bersani reforms of 2006 attempted to address these (Pagliero, 2015). Contingent fees were allowed, a ban on advertising was lifted and over-the-counter medicines were liberalised (by the way, accomplishments that, in some other EU countries, have long been in place and are broadly seen as beneficial to consumers). It turned out that pharmacists benefited from new entrants in the market and lawyers seemed not to be affected noticeably. But architects lament that it has dramatically lowered their earnings suddenly, to the point that the continuity of these firms is said to be in danger. And liberalising over-the-counter medicines is incomparably more simple, in terms of expertise, than the prescribed medicines market. In Poland (Rojek & Masior, 2016) access regulation for lawyers was made less restrictive and, predictably, the number of legal advisers increased noticeably, with a less-than-average price increase. This would seem to be a typical case of a one-off increase in the supply capacity of legal services in Poland. One quickly reaches the point where the key question of balance between the justification of restrictive regulation in the light of market failures has to be combined with the possible benefits of greater competition of less restrictive regulation.

Much of the recent work by the Commission has emphasized churn rates as a signal of greater or lesser competition. These empirics are of utmost importance and imply a firm warning about too high restrictiveness. Nevertheless, the position that churn rates are always a sign of how strong or weak competition is, is incorrect and it also critically depends on the type of (service) market involved and the position in the life cycle of the products or services produced (if relevant). That is why Annex 2 elaborates an assessment of churn rates and the significance for competition. Churn rates *can* be a sign of the degree of competition but this need not be correct. In the case of the main professional services discussed in the present study, some prudence is called for, without suggesting that churn rates is a useful indicator but that would be wrong as well. Annex 2 is not written to serve as an excuse for certain lobbies of course; it is a mere analytical assessment.

5. CONCLUSIONS

KEY FINDINGS

PRO-SERV can help to show that restrictiveness of professional services regulation tends to reduce the good functioning of markets and hence to reduce growth in the EU. This means that a balance has to be found: whereas with unjustified or disproportionate regulation 'less is good', that is, less restrictiveness is helping the better functioning of markets, this is not the case with regulation dealing with 'societal risks' (i.e. market failures).

PRO-SERV gives a lot of weight to regulatory exclusiveness, in fact a monopoly, inducing incumbents to exploit their market power and generate high extra rents.

Does PRO-SERV yield different score than the PMRs? The answer is that there is no overall clear trend.

An often discussed issue is ex ante versus ex post regulation. Ex post regulation is largely absent in PRO-SERV and this is unfortunate.

PRO-SERV, in building on the PMRs, is capable of showing in even greater detail the overall levels of restrictiveness of professional services regulation in the EU Member States. Like the PMRs, PRO-SERV can, in the longer run (when more years of observation will be available) show that this restrictive regulation can (and often will) reduce the good functioning of markets and hence tends to throttle growth in the EU. However, this idea of overall reduction of the restrictiveness of market regulation is only appropriate as long as regulation is not aiming to overcome or minimise market failures, but seeks to influence the economic outcome of market processes for political or redistribution motives or e.g. for retaining national control or protecting vested interests. Professional services, however, are regulated with the aim of minimising market failures such as (insufficient) consumer protection (here, especially sound and reliable conditions for 'trust' in the capabilities and 'integrity' of providers), health and safety (e.g. medical, para-medical, pharmacists; engineers and architects) and investor protection (e.g. accounting). This means that a balance has to be found: whereas with unjustified or disproportionate regulation, 'less is good', that is, less restrictiveness is helping the better functioning of markets, this is not the case with regulation dealing with 'societal risks' (i.e. market failures).

PRO-SERV improves on the PMR by adding no less than 11 regulatory items (restrictions) to the 10 already included in the PMR. PRO-SERV gives a lot of weight to regulatory exclusiveness, mostly as a result of 'reserved activities' but also by the 'protection of the title' (or both). This gives a monopoly to such providers and it goes without saying that this shield against charlatans and incompetent market entrants also brings with it a risk that the incumbents can easily exploit their market power and generate high extra rents. It might also stifle new initiatives in such restricted markets. Careful reforms can be a way to restore some balance between serving market functioning by minimising market failures (good for consumers, etc.) and restoring proper market functioning by retaining or introducing some degree of competition.

PRO-SERV is assessed in the study. One query is whether PRO-SERV yields different quantitative score than the PMR? The answer is that there is no clear overall trend although for engineers, architects and lawyers PRO-SERV is higher in more than half of the EU countries. The question of balance between serving the prevention of market failures and the objections against restrictiveness shows that PRO-SERV has to be used in a broader policy setting, with a carefully executed proportionality test and a check of effectiveness. The study

also briefly goes into the question of 'quality'. Good measures are hard to come by. One should be careful because quality of services delivered is more narrow an approach than that of market failures. PRO-SERV is focused on competition and market functioning (for the EU growth objectives) but not on single market questions. This is a drawback.

One can also ask what should be incorporated in PRO-SERV and is not. Three such 'wishes' are singled out. An often discussed issue is ex ante versus ex post regulation. Ex post refers to regulatory controls or surveillance or certification of the services themselves upon delivery. This goes further than exercise requirements. A low PRO-SERV indicator does not mean that the country is irresponsible but that another method of ensuring consumer protection (etc.) is in use. This is unfortunately not in PRO-SERV. Examples are the Nordic model for architects or the UK approach to accounting. Another 'wish' is to address the neglect of the free movement restrictions in PRO-SERV.

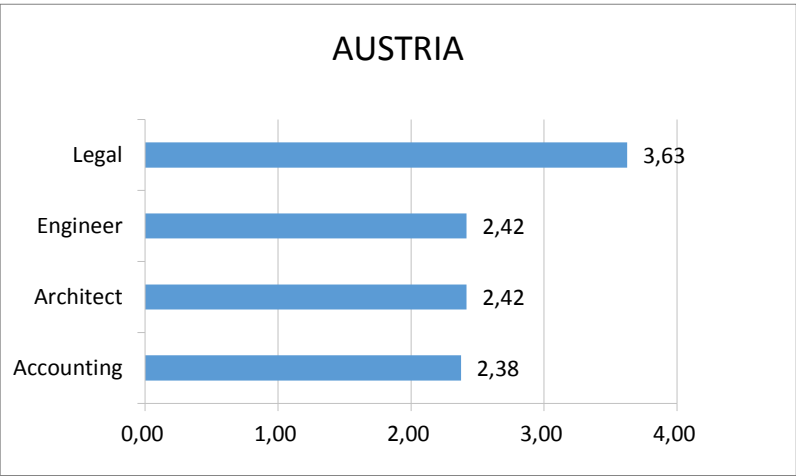
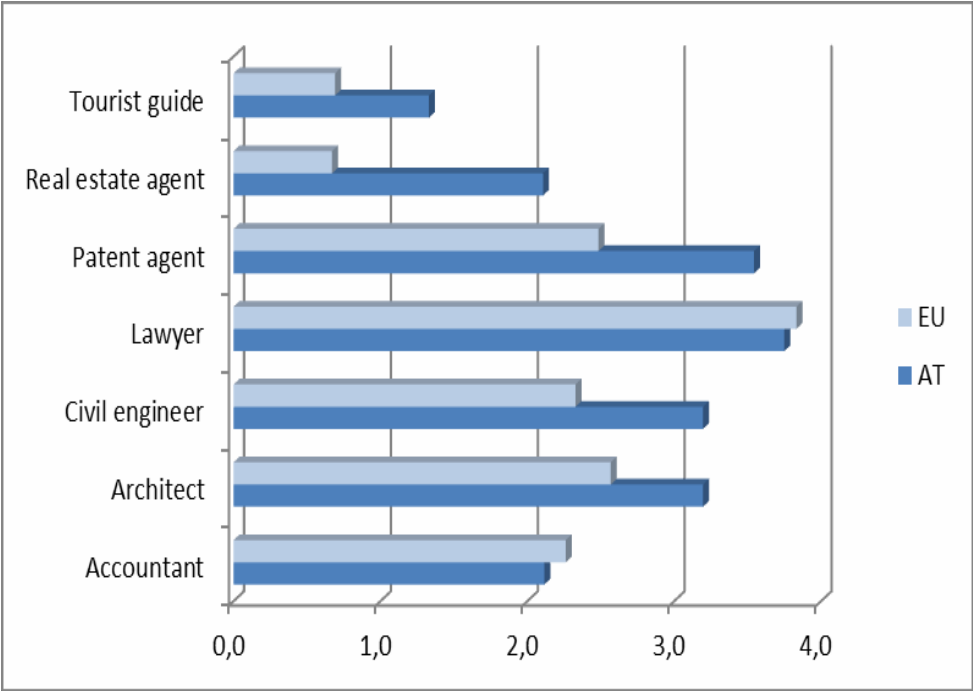
Finally, PMRS and, in future, RO-SERV can be used to show rigorously that high restrictiveness in professional regulation raises mark-ups significantly and reduces the dynamism in these services markets. It is feared that this drags down EU productivity growth. Apart from embedding this work in a balanced evaluation, as noted before, there are also economic reasons to be a little cautious with the results of such studies. KIBS (knowledge-intensive business services, most being professional services) markets are hard to penetrate successfully and it is likely that margins in these markets are always higher than in markets for toys or shoes. The same goes for churn rates: one-off moves of entry following reforms of disproportionate regulation are surely possible (and have occurred in Europe) but they are unlikely to be repeated. New business models in e.g. patent services or classic lawyer tasks are very hard to imagine.

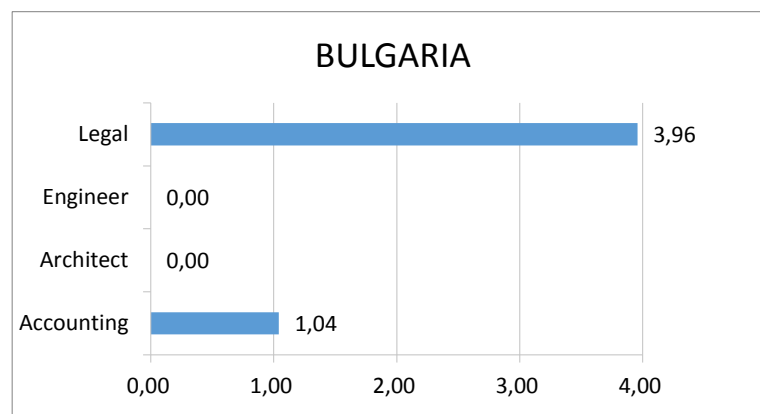
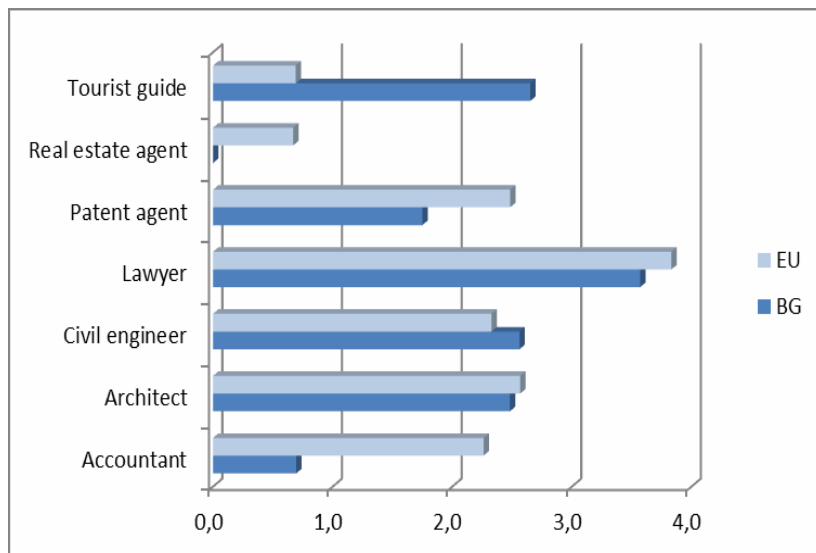
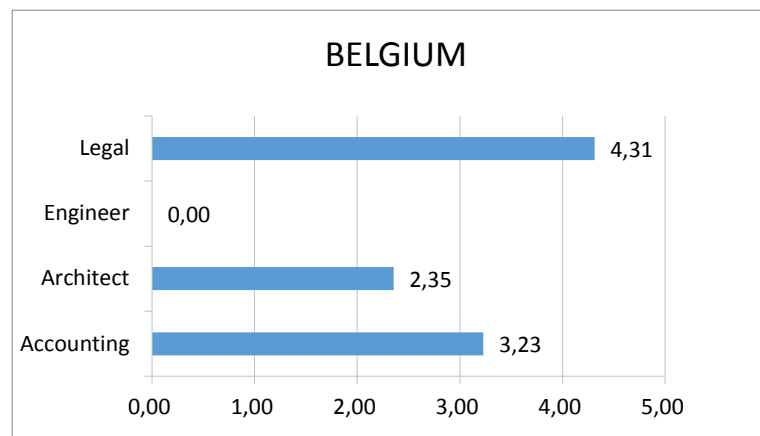
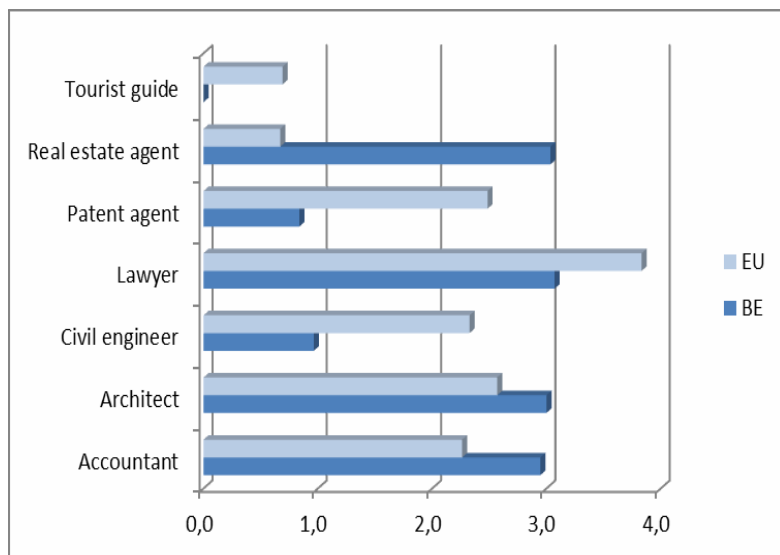
The merits of having PRO-SERV have to be seen in the wider framework of the possible reforms of professional services in the EU. With the proper context it can be a help in substantiating the debates and providing some uncomfortable truths. That is a true step forward.

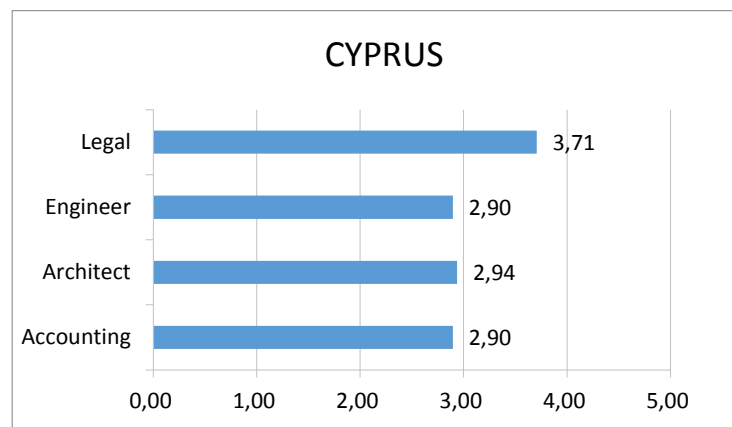
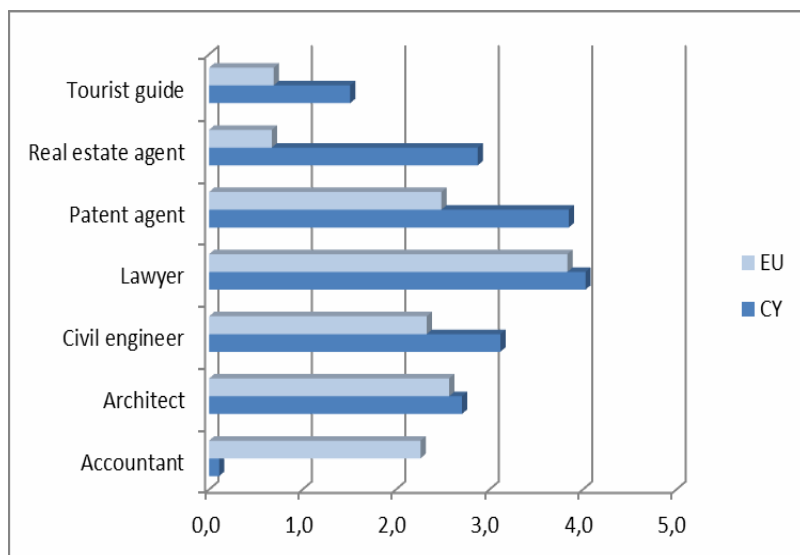
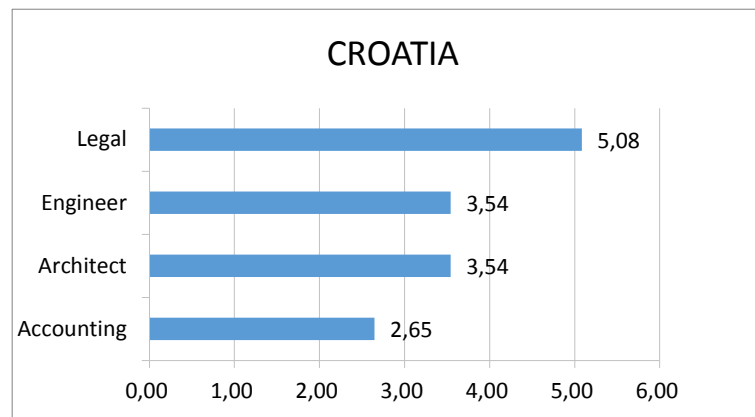
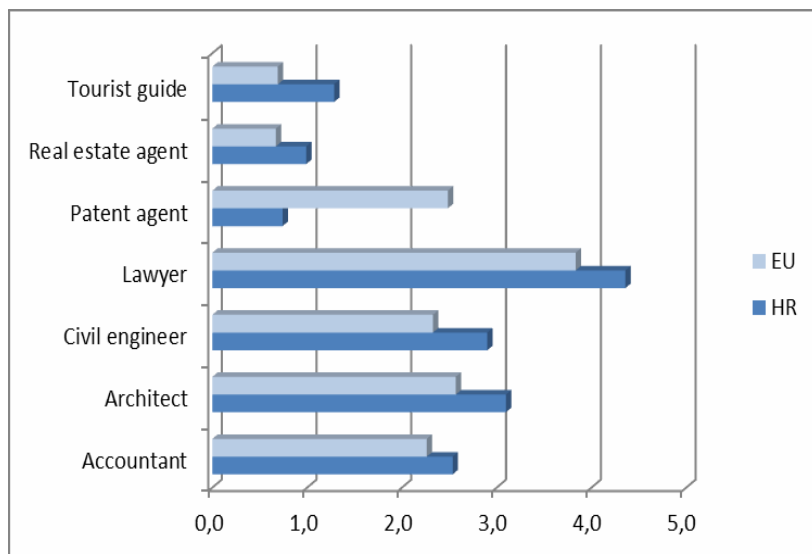
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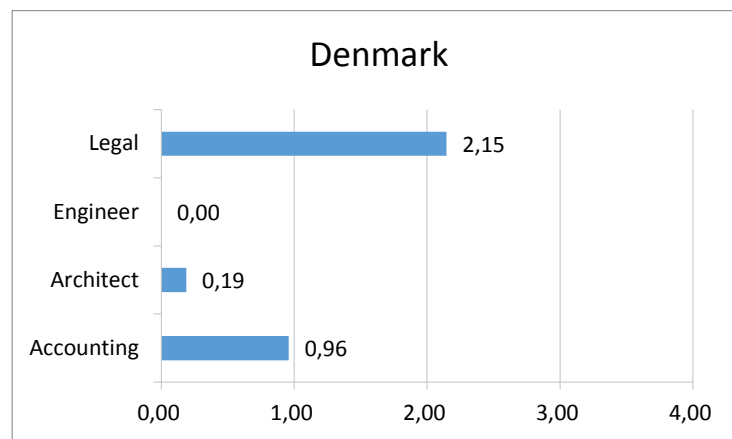
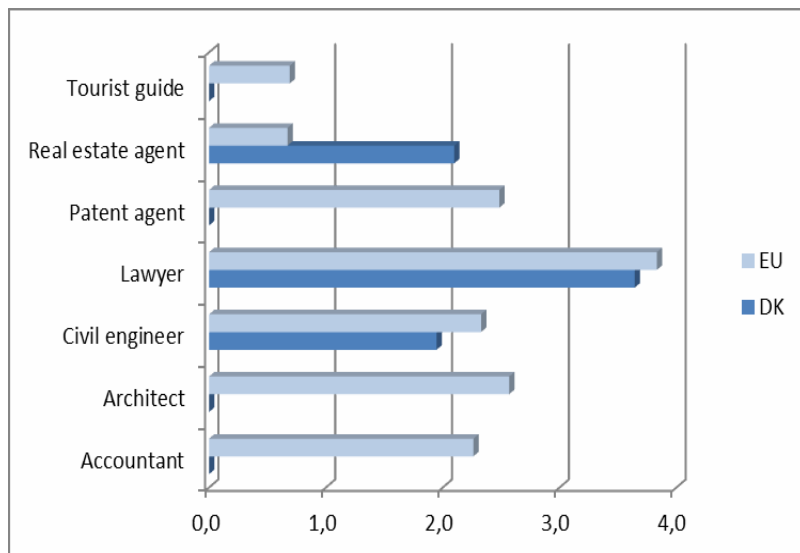
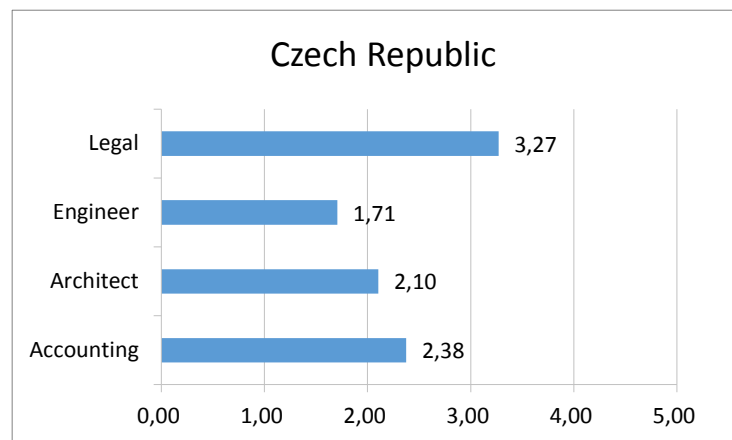
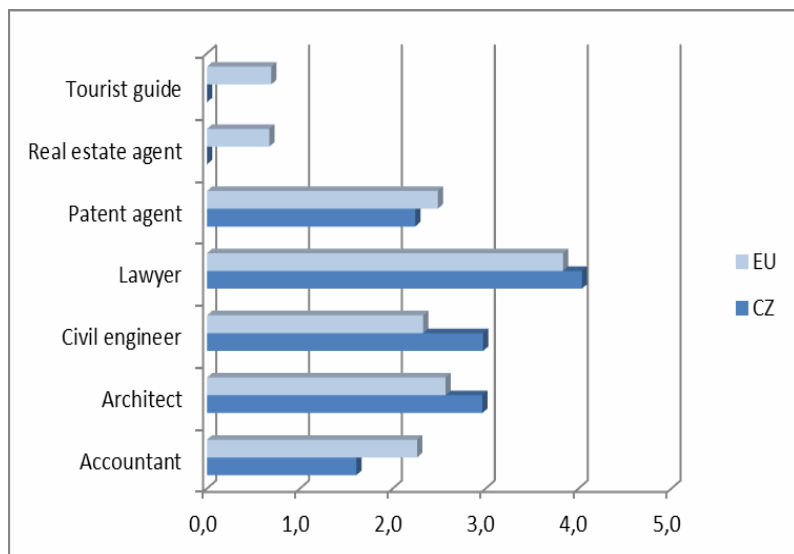
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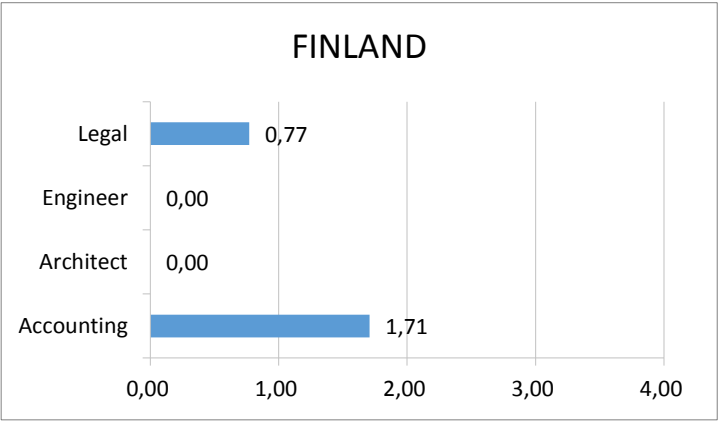
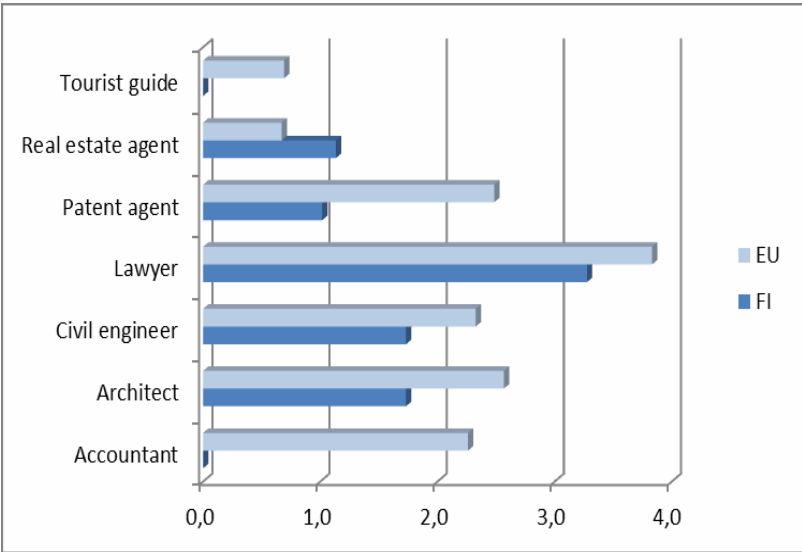
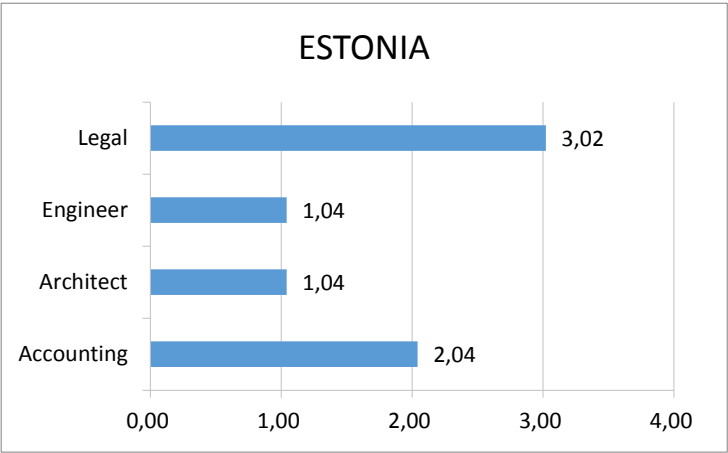
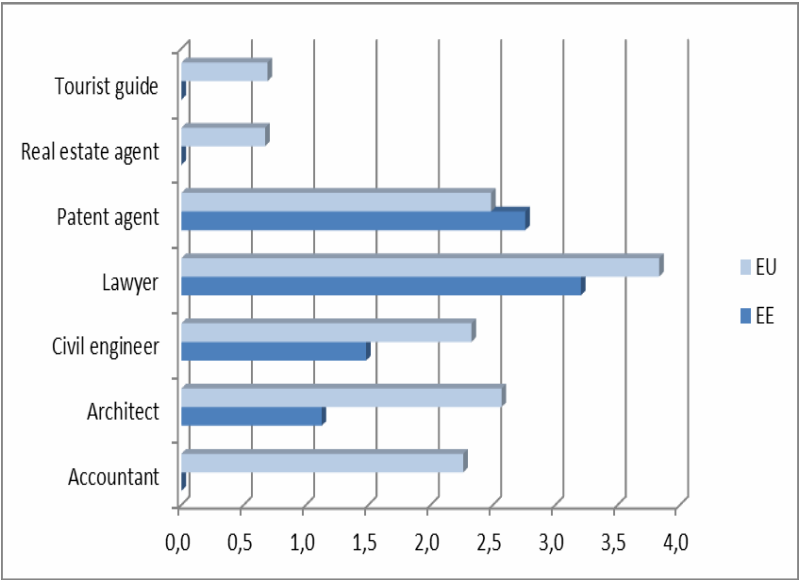
ANNEX 1. ON COMPARATIVE GRAPHS, ALL EU MEMBER STATES

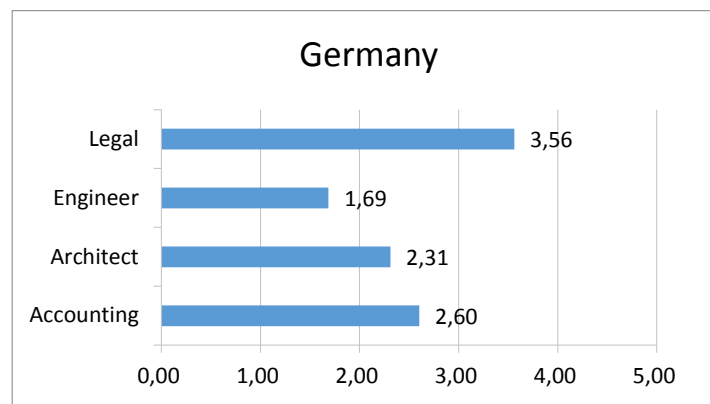
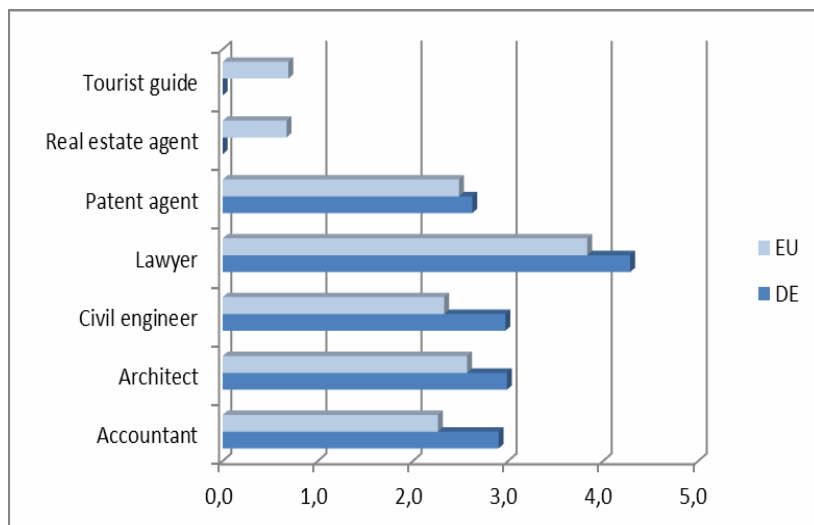
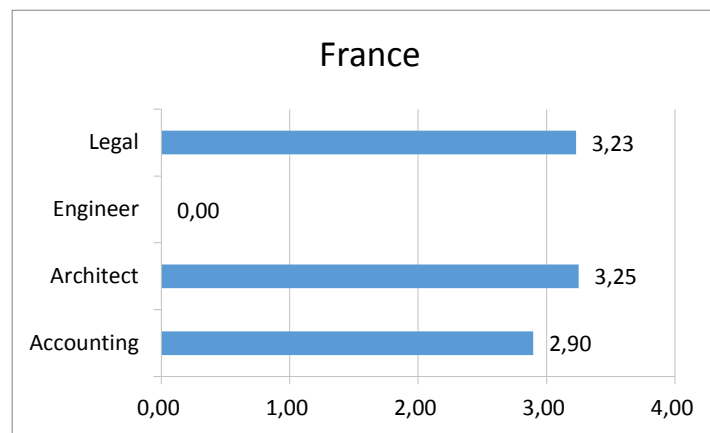
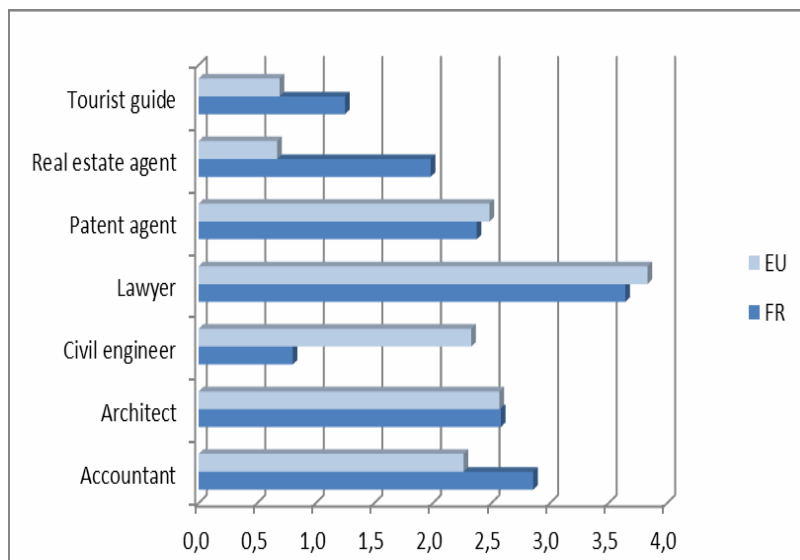


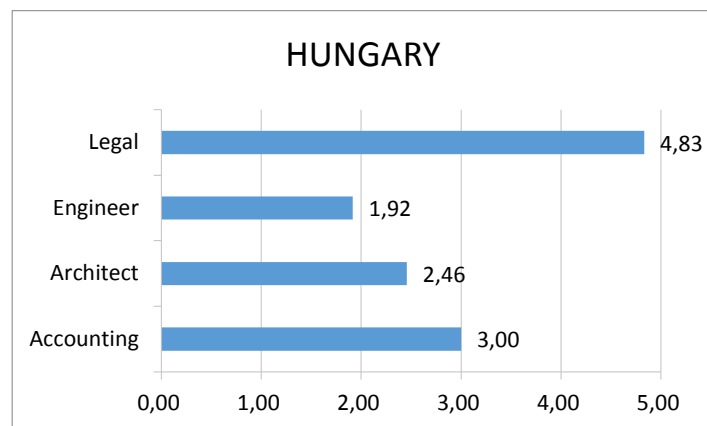
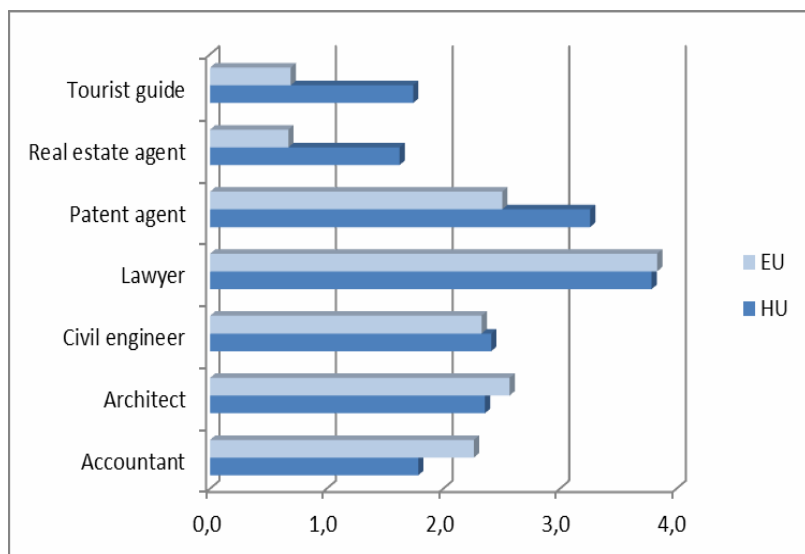
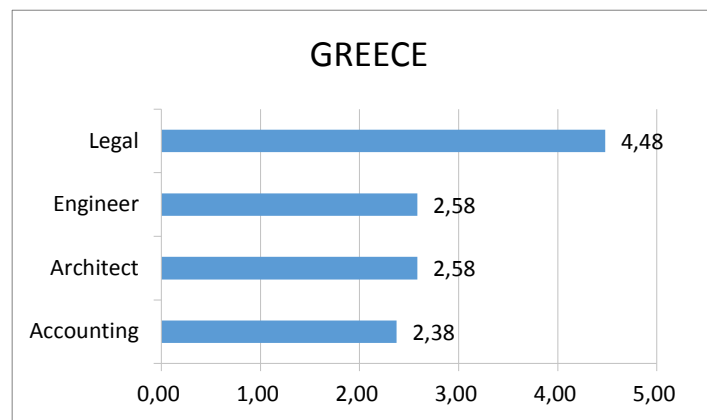
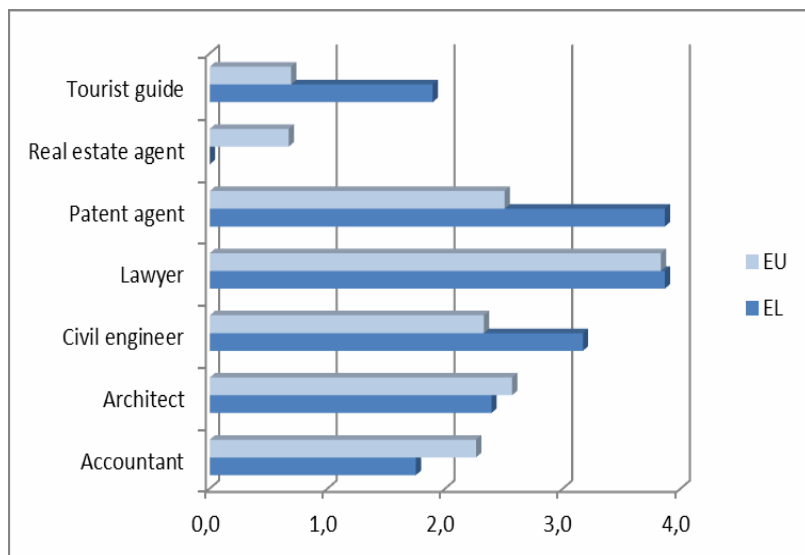


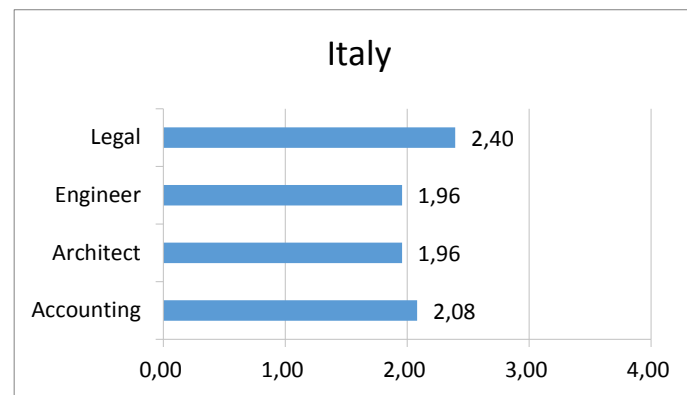
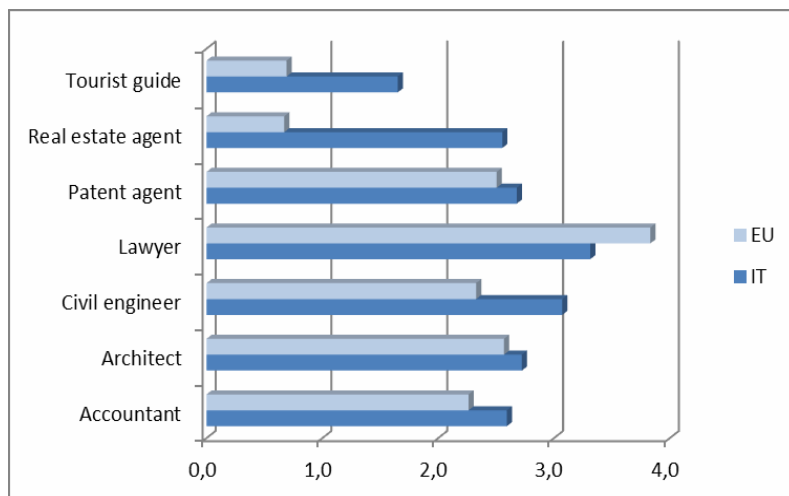
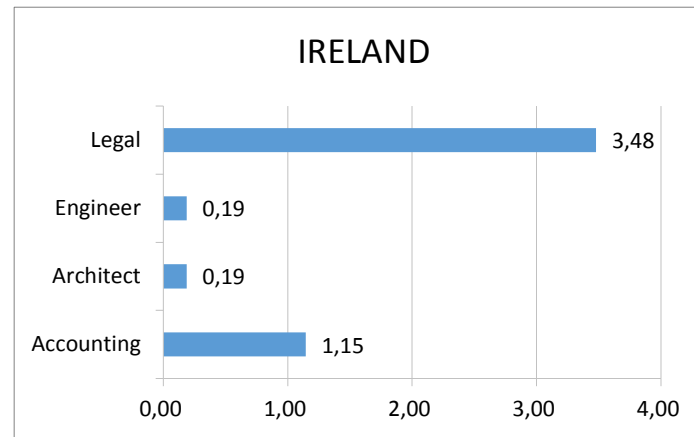
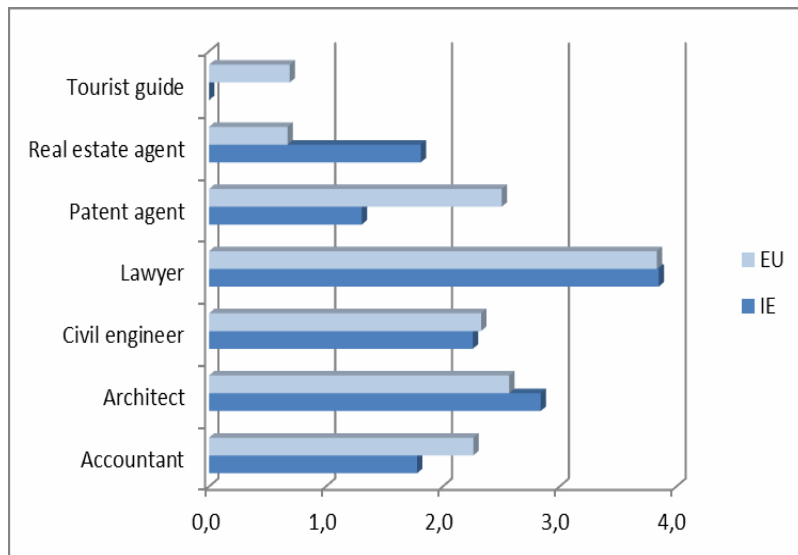


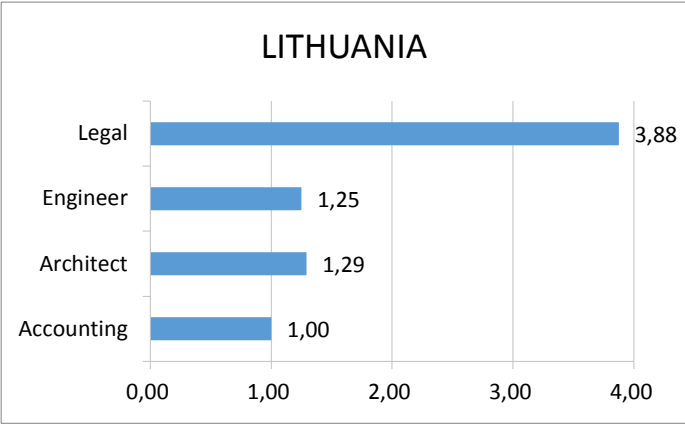
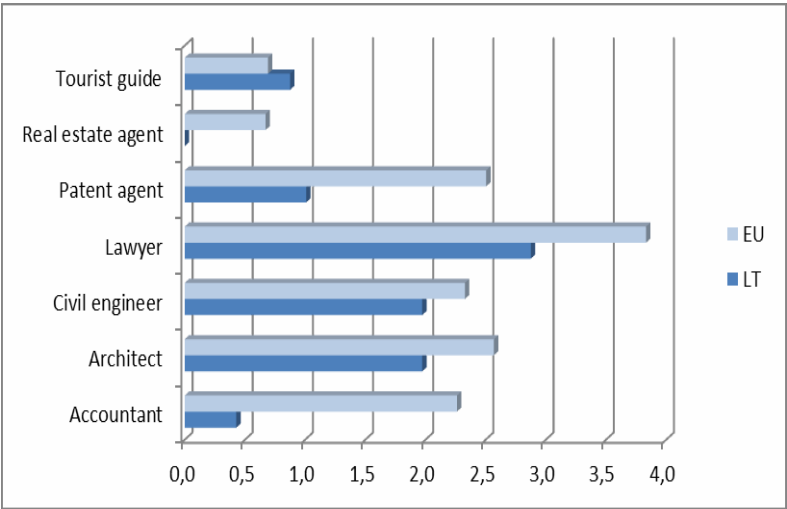
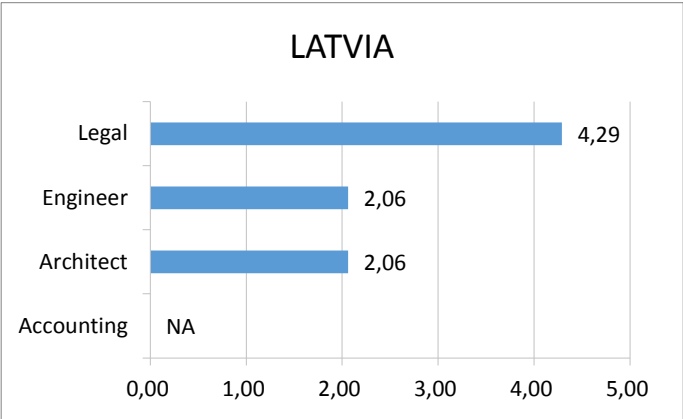
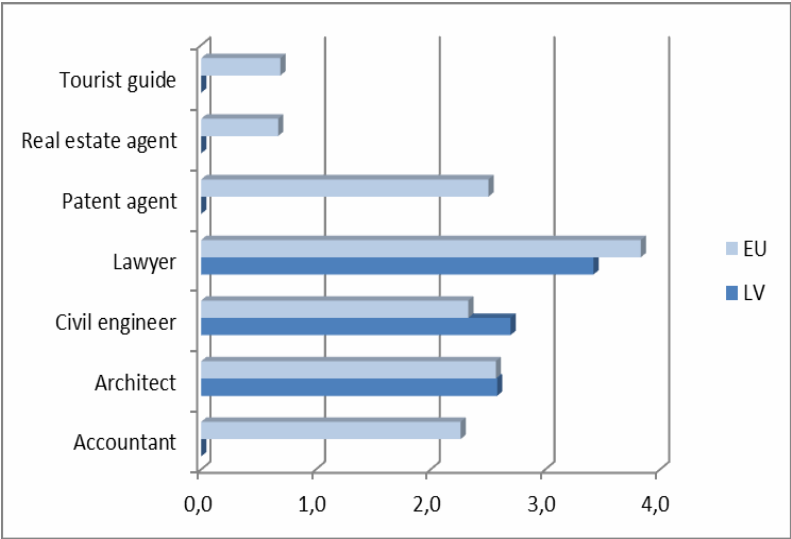


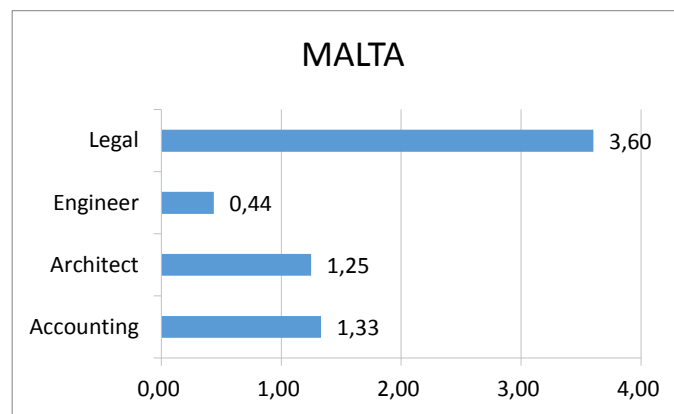
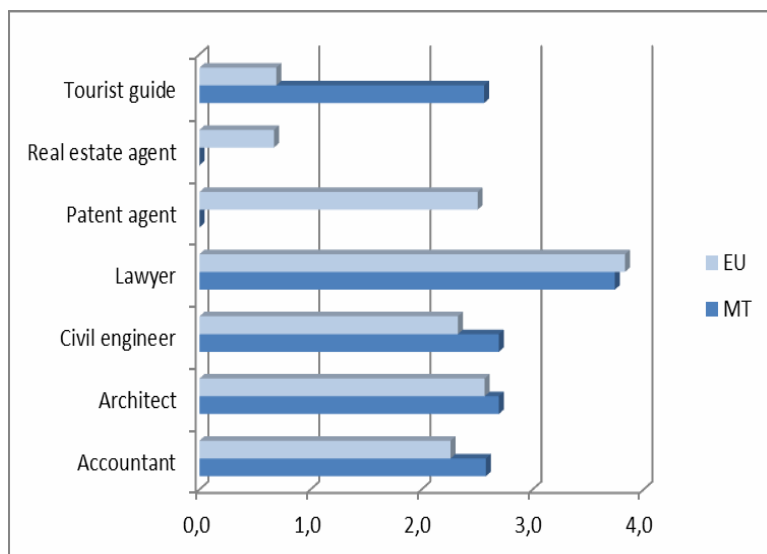
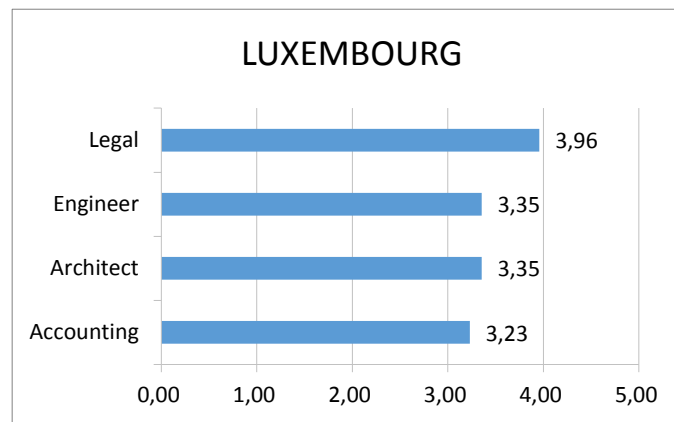
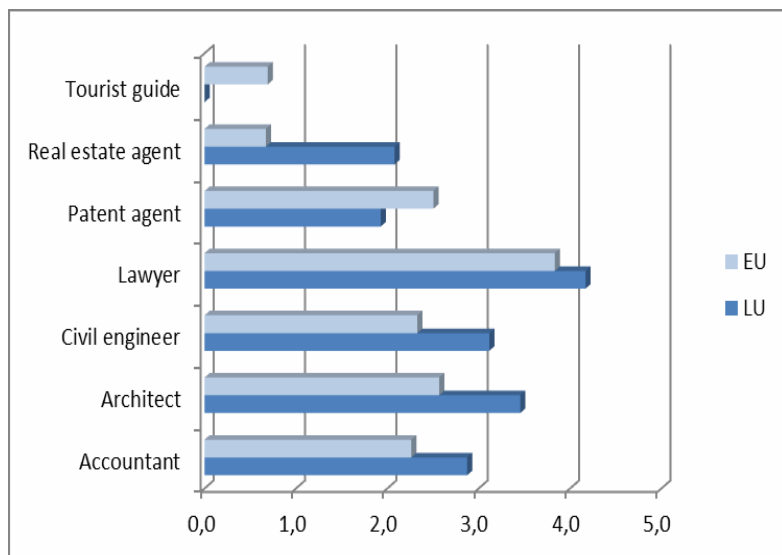


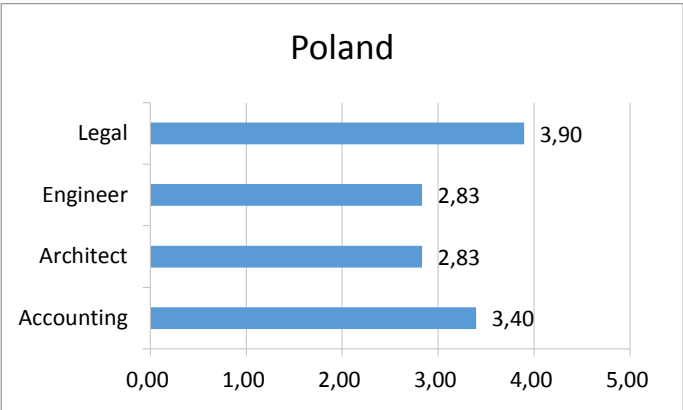
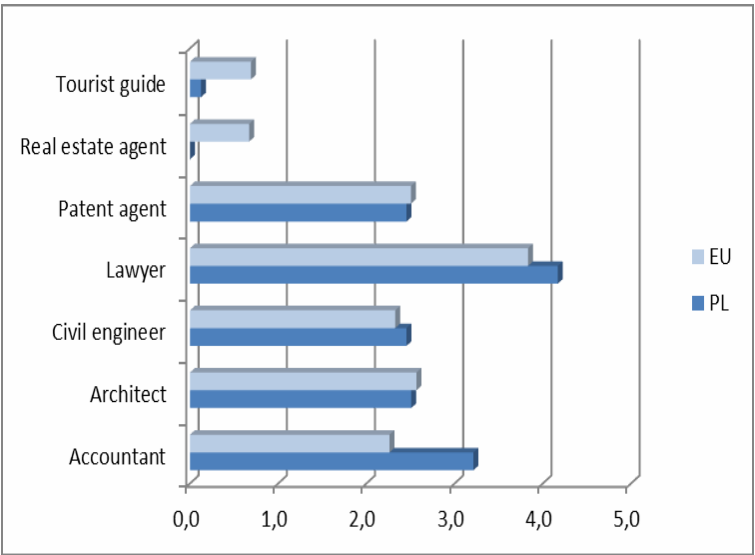
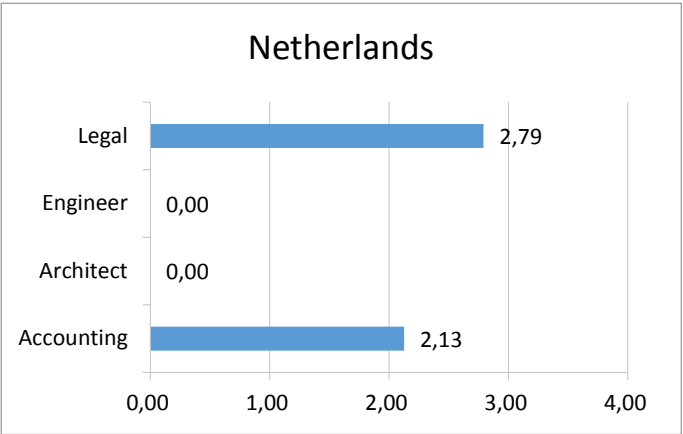
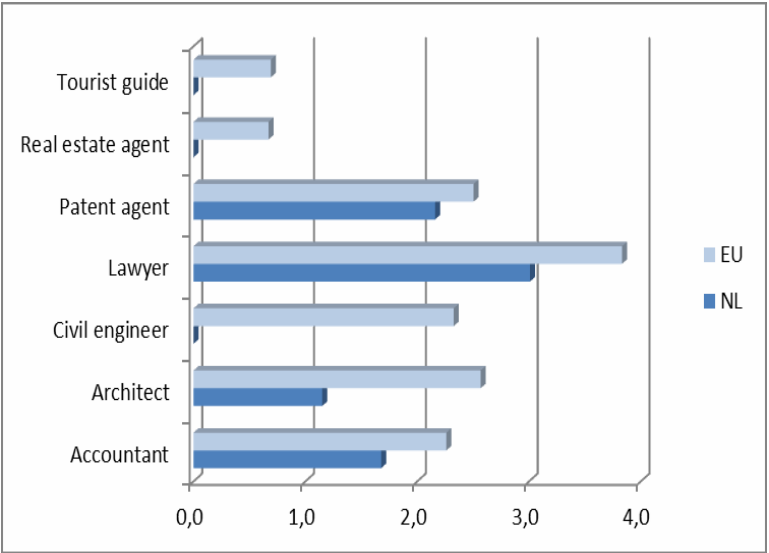


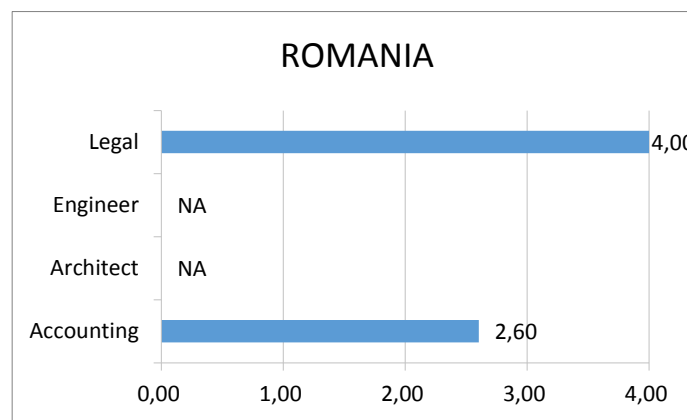
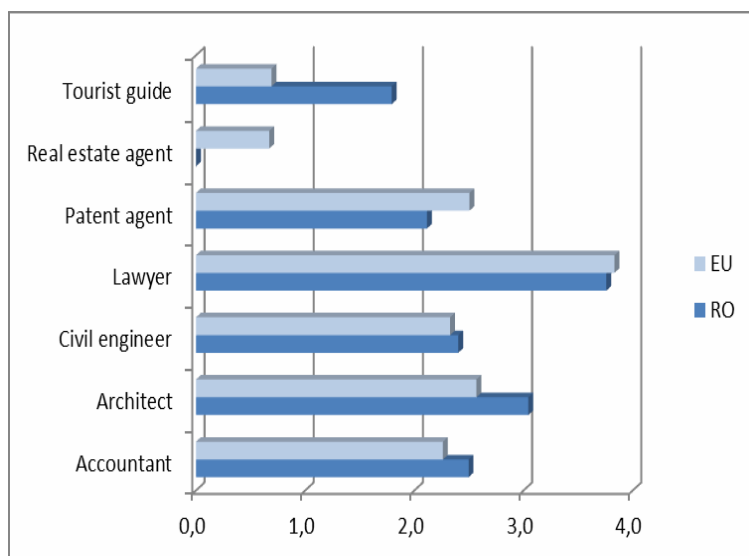
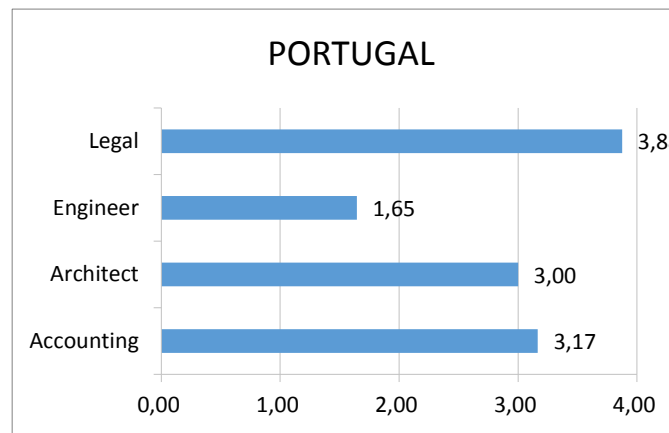
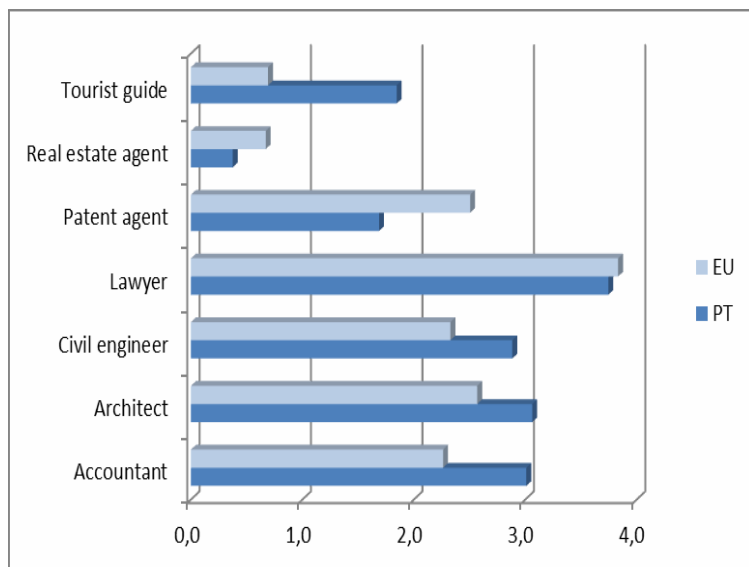


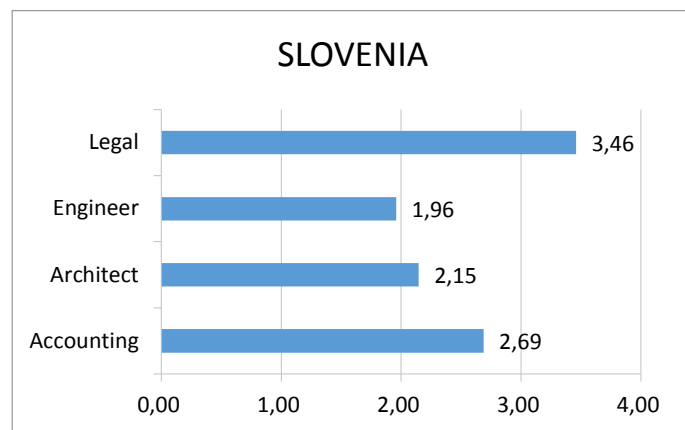
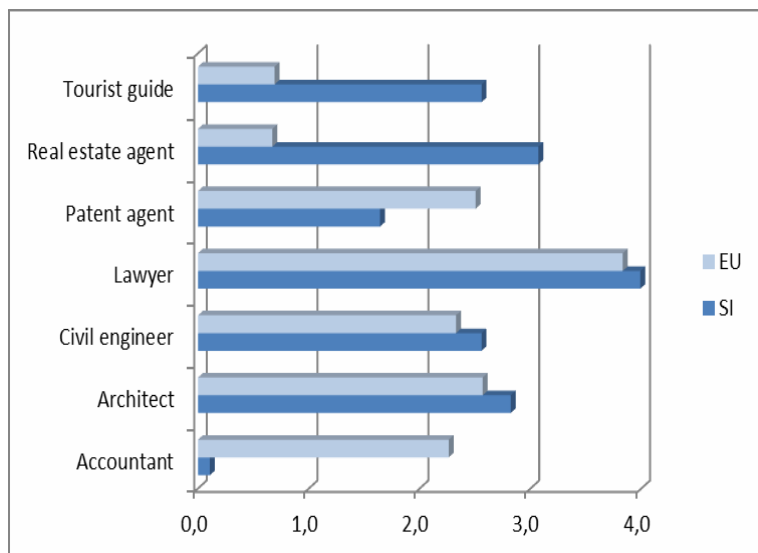
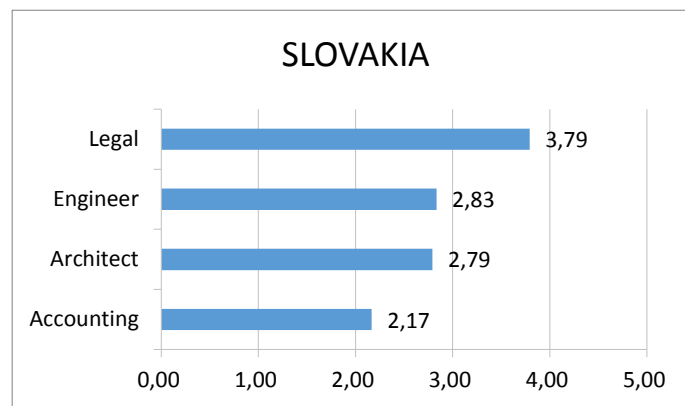
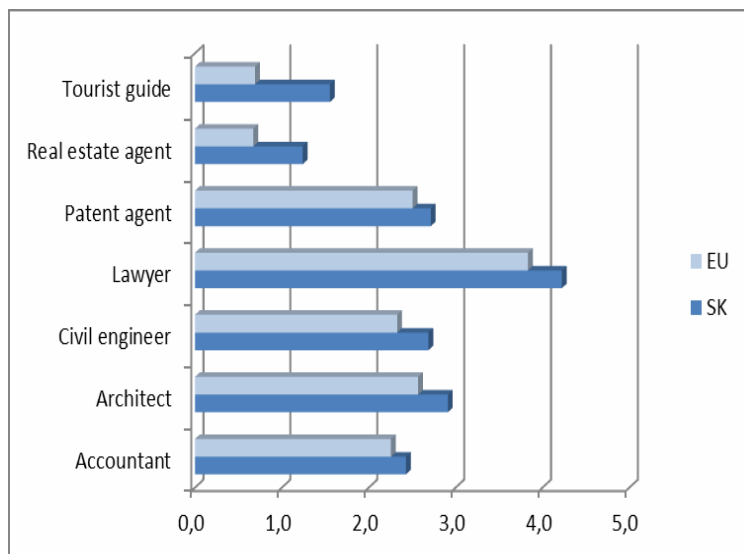


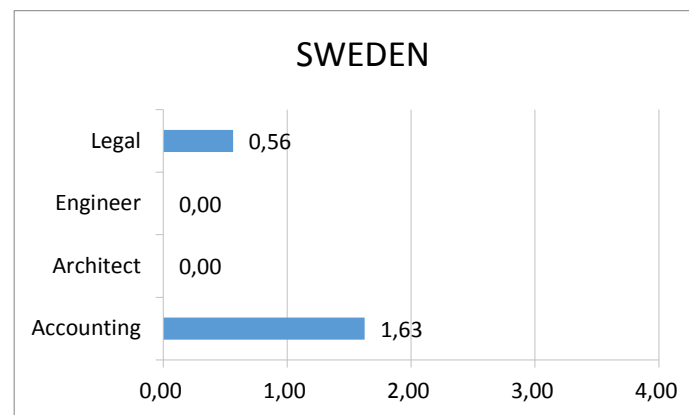
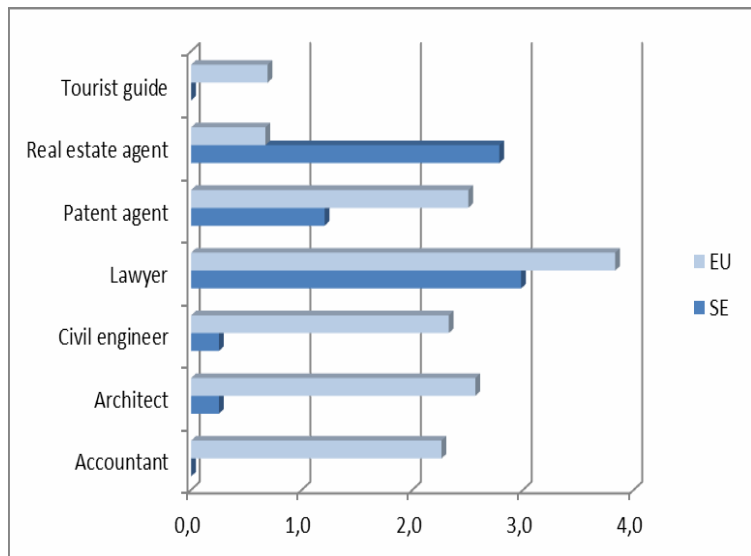
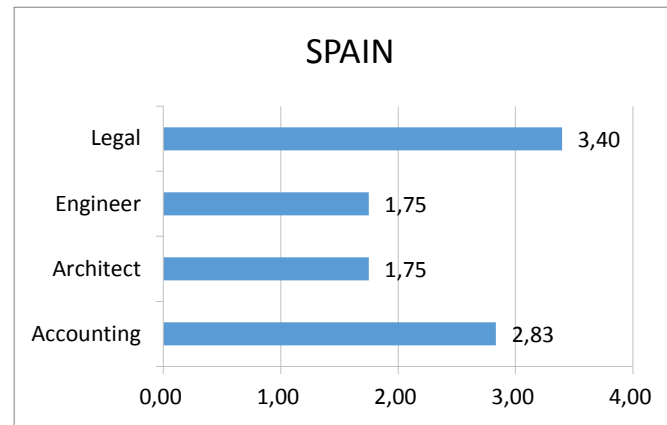
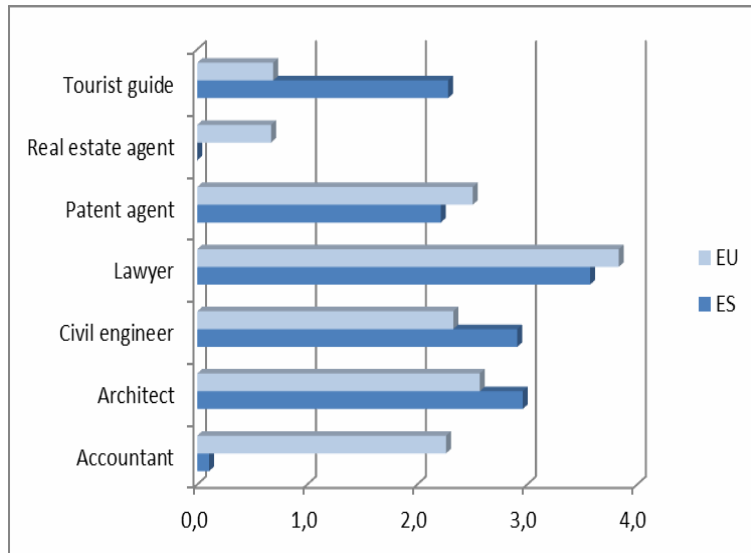


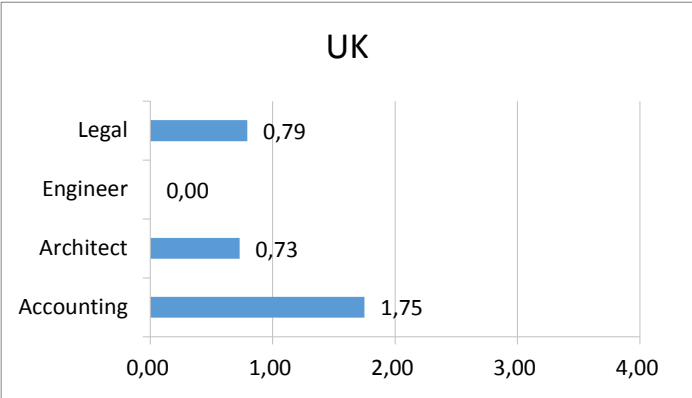
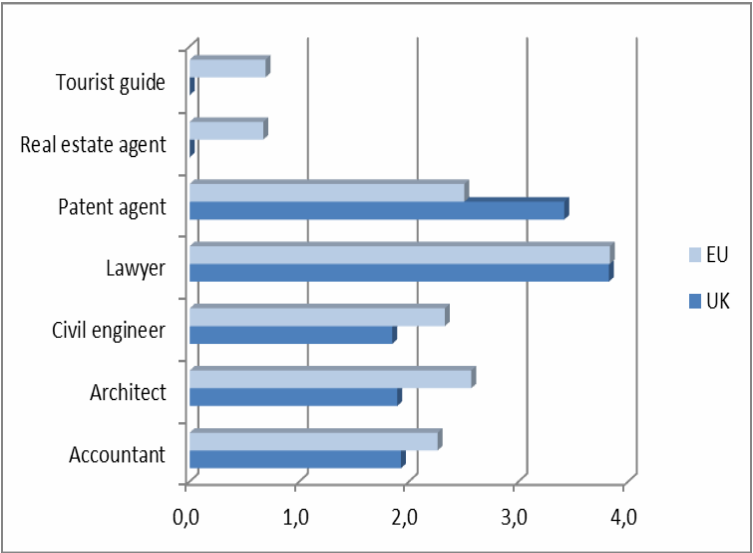












ANNEX 2. ON CHURN RATES AND THEIR ECONOMIC SIGNIFICANCE

Churn rates – that is, the sum of entry and death rates of firms in a given market per year – CAN be one indicator for the degree /intensity of competition in markets. It expresses a Schumpeterian view of the dynamics of competitive markets. If entry barriers are low or zero, over time there will always be the threat of potential competition, that is, new entrants ready to move in as soon as they spot possibilities to use different business models, or higher quality, or charge lower prices, or exploit innovative products or services or serve niche markets within a well-established larger market. Entry is often a risky business, literally, and established firms may well have certain advantages (perhaps entry barriers, but this need not be so) such as scale, reputation, after-sale networks (costly to set up and maintain), long experience (when moving down so-called learning curves) resulting to low average costs based on tacit knowledge and – in some special cases – high consumer switching costs. Indeed, in virtually all markets, many of the firms dying in a year, were in fact entrants only a few years earlier. No doubt that this permanent trying out by new entrants can often force incumbents to remain vigilant about their efficiency and variety, short of losing market share. But it is also true that, in some markets, new entrants appear doomed to remain fringe competitors of a wider oligopoly, thereby failing to affect more than trivially the intensity of competition, which in fact depends on the degree of oligopolistic competition.

The nature of goods and services and other market characteristics therefore have a major influence on whether or not, and to what extent, churn rates can be seen as a reliable indicator of the intensity of competition. Two authoritative surveys of the analytical economic literature about churn (or, survival) rates of firms show this. Manjon-Antolin & Arauzo-Carod (2008) discuss a series of internal determinants of survival³⁶ and several external factors, only one of which is about competition (including entry) as such, the other ones being technology (e.g. in highly innovative industries have higher hazard rates), scale and the overall secular growth of a sector. What also matters is the life cycle of an industry/sector as the following quote summarizes (Manjon-Antolin & Arauzo-Carod, op. cit., pp. 18/9): "...at the beginning of the industry life cycle the number of entries and exits [i.e. the churn rate, JP] is usually high, competition is low and there are plenty of opportunities for innovation. As times goes by, however, this 'entrepreneurial regime' becomes 'routinised': entries and exist progressively slow down, competition increases and there are fewer opportunities for innovation". This wide-ranging survey concludes inter alia, that the literature on the 'effects of capital intensity, price-cost margin and market concentration are less conclusive' (op. cit., p. 22). A final drawback of this literature for the purpose of underpinning the economic studies with the help of the PRO-SERV indicator is that, with a few minor exceptions, the firms studied are industrial ones, not services, let alone, professional service providers as in PRO-SERV.

Bartelsman, Scarpetta & Schivardi (2005) use firm-level data for 10 OECD countries about firm survival and churn rates. Again, for the most part, their article is about manufacturing firms. A striking result of their analysis of a massive data set is that churn rates are high throughout, in the range of 15% – 20% in many sectors and countries. Typically, entrants (and existing firms) are, more often than not, small relative to incumbents. The authors find strong evidence that entry & exit rates are positively correlated, which they interpret as

³⁶ Such as firms being larger and older (+), investing in R & D (+), firms actively advertising and exporting (+), ownership status [e.g. limited liability firms liquidate voluntarily more frequently than those with sole proprietorships, diversifying firms (+)].

meaning that one witnesses a process of 'creative destruction' (à la Schumpeter) in which a large number of new firms displace a similar number of obsolete firms (without much if any effect on the total number of firms). This is called 'market selection', but entering markets is a 'bloody' affair: only 40% – 50% of total entering firms in a given year survive beyond the seventh year. In Schumpeterian eyes, this form of permanent testing of the attractiveness, efficiency, variety and quality-of-offerings of a firm, whether already in the market or entering, is the core of competition and the primary rationale of why a market-based system is and remains vibrant and progressive. In this fundamental Schumpeterian sense, churn rates are critical to competition.

The question is now whether these stylized facts also fit the seven professional services sectors in PRO-SERV or the four in the PMRs. Whilst, it seems, rigorous economic research is not available on this question, one can nevertheless make some relevant observations which cast doubt on the general applicability of the above-quoted literature for these services. First, the surveys above, based on a large body of literature, do not or only very partially deal with services firms, and in any event not (specifically) with the sectors in PRO-SERV. They focus on manufacturing, except when merely reporting firm size connected to churn rates. As Baumol (1967) already stressed 50 years ago, many services sectors are not dynamic or subject to much change by their very nature. His famous example of playing chamber music from Beethoven – with four musicians 200 years ago and still today, and no other inputs – may be a little extreme, the debate on whether services markets are or can be dynamic or innovative, or even turbulent at times, has shown that some services sectors (e.g. digital) can be dynamic and innovative but many other ones are not. It may (and does) happen that new technologies for some elements of the input of service delivery or the technology of delivery may evolve over time, at times quite drastically (modern air travel; ICT in administrative aspects of accounting or even architect services; 'fintech' in banking and insurance; some innovation in basic legal services or standardised documents [OECD(2016)]), but the basics of law suits or contract writing, the core of accounting/auditing, the planning and technicalities of engineering or designing by architects is barely subject to modifications. The same goes for patent agents or tourist guides, essentially. Thus, in the margin there is change and development (in different degrees) but it is far from similar to what happens in manufacturing. It follows that, when regulatory reform is properly based on a discovery of disproportional regulation and enforcement or the lack of a public interest rationale of rules, there is likely to be a one-off effect on churn rates which is pro-competitive but unlikely to be a lasting phenomenon. If one observes a post-reform increase in churn rates (or, at least new entry), this is most welcome for market functioning. However, one cannot a priori generalise from such occurrences that churn rates 'should be' similar to those in manufacturing or to other more dynamic services markets. That does not mean at all that there might not be issues of anti-competitive conduct 'behind' overly protective or intrusive regulation but this deserves a separate investigation. It also does not mean that disproportional or too intrusive regulation is not a hindrance for cross-border intra-EU free movement of services and/or the de facto smooth establishment of professional service providers in other EU countries. Again, this has to be carefully checked on the basis of transparency, proportionality and (public interest) justification of measures in the light of the EU (e.g. single market) interest.

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

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