

THE ECONOMIC IMPORTANCE OF THE COUNTRY OF ORIGIN PRINCIPLE IN THE PROPOSED EU DIRECTIVE ON SERVICES IN THE INTERNAL MARKET

A summary of a study by Copenhagen Economics for the DTI

The study

This study analyses the contribution of the Country of Origin Principle (CoOP) to the total economic gains of the proposed Services Directive.

- With the agreement of the European Commission, this study builds on the detailed economic assessment of the whole Directive carried out by Copenhagen Economics (CE) for the European Commission and published in February 2005.
- The analytical framework developed by CE is regarded by the OECD and WTO as the most exact method developed to date for estimating the economic benefits of trade liberalisation in services¹.
- Nevertheless, for various reasons, the results obtained from their model should be seen as conservative **lower-bound estimates** of the potential impact of the Commission's proposals.
- The OECD² recently noted that because the model omits some of the potentially most important dynamic effects of stronger competition the CE figures underestimate the benefits of the Directive by a wide margin.
- The conclusions of CE's original economic assessment for the European Commission were that:
 - **Total economic benefits** to consumers and producers in the EU would rise by **0.6%** or some **€37bn** (nearly £26bn)
 - **Total value added** in the EU services sector would rise by **1.1%** or some **€33bn** (just over £23bn)
 - **Total net employment** in the EU would increase by some **600,000**

¹ The approach used by CE comprises three stages. First, qualitative information on the regulations facing EU service providers is converted into a quantitative measure of the barriers to service provision. Second, the impact of these barriers on the price and cost of service provision at the firm level is estimated. Third, these estimates are fed into a sophisticated computer simulation model to estimate the economy-wide effects of a reduction in regulatory barriers to service provision across the 25 Member States.

² OECD (2005), "*Economic Survey of the Euro Area 2005: Integrating Services Markets*", p8. This report is available at: <http://www.oecd.org/dataoecd/8/31/35106741.pdf>

The results

- There are significant uncertainties as to the precise impact of the proposed Directive and the CoOP. This is because of certain assumptions and limitations of the model – many of which are likely to lead to the results being underestimates. These include:
 - The model only includes two thirds of the service sectors covered by the proposed Directive. Some important sectors are not included in the analysis – notably construction services (a sector which current European Court of Justice cases suggest might benefit particularly from the proposed Directive).
 - The framework may not fully capture or accurately quantify all the relevant barriers to service provision, or their actual economic effects. For example, if service providers face additional barriers – e.g. associated with regulatory heterogeneity in different Member States – then the analysis may underestimate the importance of the CoOP.
 - The model does not take account of the more dynamic effects of the proposed Directive – e.g. changes in firm behaviour or regulatory competition, which could lead to increased levels of trade within the EU in the long run.
- Within this model, it is estimated that without the CoOP and supporting provisions:
 - Total economic benefits of the proposed Directive would be around 10% lower, equal to around €2-4bn p.a. across the EU [€0.5-1 bn in the UK]
 - The reduction in EU and UK employment would be minimal. This is because in this model, the CoOP affects mainly labour productivity whereas employment is driven by growth in demand.
- The CoOP is of limited importance in this analysis because cross-border trade levels are currently very low and thus only a small fraction of service providers will benefit from the CoOP itself. If services trade in the EU were to increase significantly, then the potential economic benefits lost as a result of removing the CoOP would become greater.
- Because of these limitations, these results do not provide a conclusive assessment of the full value of the CoOP.
- Although a general breakdown of the economic benefits accruing to specific articles has not been possible, it is clear that these are not evenly distributed across the provisions of the proposed Directive. This study implies that **Article 29** (on commercial communications by the regulated professions) and certain provisions in **Article 15** (notably on price-setting) are likely to have **particular economic importance**.