

THE RESILIENT STATE:
THE CASE OF THE LIBERALIZATION OF SERVICES
IN THE EUROPEAN UNION

JEFF LODER



The Resilient State: The Case of the Liberalization of Services in the
European Union

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Abstract

This thesis tests the validity of the ‘constrained-state thesis’ through an examination of the attempted liberalization of services in the European Union (EU). The ‘constrained-state thesis’ (also known as the ‘straightjacket thesis’), which emerged out of the “globalization-as-constraint school”, claims that the state is no longer capable of effectively determining economic developmental strategies or economic policies. Viewed from this perspective, the state is no longer the locus of socio-economic power.

The empirical evidence presented in this thesis does not support the argument that states are losing the ability to control the direction of national economic development. In the EU, Member States have largely retained the power to regulate the operation of services within their territory. Despite what seemed like an unstoppable movement towards liberalization ten years ago, little progress has been made towards achieving a truly open internal market for services. The Services Directive which will likely receive enough votes in Parliament this coming fall (2006), only provides legal certainty that service providers can temporarily operate outside their country of origin. It will not dramatically change the ability of Member States to control the delivery of services on their territory.

In the case of services, Member States have largely retained their regulatory power. For sure, EU institutions will play a role in some service sectors that Member States have agreed are better regulated on an EU wide scale. However, states are still the dominant source of regulatory power when it comes to services in the EU. Domestic political and economic realities will ultimately determine the degree to which Member States give up power to EU institutions with respect to services. Member States have retained the ability to work with domestic stakeholders in the service sector to coordinate economic growth. Considering that service oriented jobs contribute more to GDP in developed countries than any other type of employment, Member States will continue to play an important role in determining ‘who gets what’.

The empirical evidence presented in this thesis also contradicts conventional wisdom that states will eventually be replaced by regional supranational economic institutions that pull member states towards a single economic model. We may see more regional economic supranational institutions. However, the evidence presented in this thesis suggests that if supranational organizations develop into types of confederal economic organizations that include democratic institutions (such as Parliament in the EU), institutional avenues are created through which the economic power of Member States can be protected. This is exactly what happened in the EU. Because Parliament has co-decision legislative power over the internal market, stakeholders lobbied Parliament to protect Member State’s authority over services.

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This thesis I dedicated to my wife, DeAnna Loder and my son Alexander Jason Loder.

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Abbreviations

ACF	Advocacy Coalition Framework
EC Treaty	Treaty Establishing the European Community
EEC	European Economic Community
ECJ	European Court of Justice
EFPSU	European Federation of Public Service Unions
EMCEF	European Mine, Chemical and Energy Workers' Federation
EP	European Parliament
EPP-ED	European People's Party- European Democrats
ESP	European Social Platform
ETUC	European Trade Union Federation
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMCPC	Internal Market and Consumer Protection Committee
MNC	Multinational Corporation
PSE	Socialist group in the European Parliament
SEA	Single European Act
EMU	European Monetary Union
OECD	Organization for Economic Co-operation and Development
UNICE	Union of Industrial and Employers' Confederations

Introduction

In the *Consequences of Modernity*, Anthony Giddens wrote that ‘globalization’ is “a term which must have a key position in the lexicon of the social sciences.”¹ Despite the realization of Giddens’s proposition, globalization is a concept that is used rather loosely, more suggestively than with conceptual rigor. The debate surrounding globalization has also produced a whole range of theories that argue that the era of the ‘state’ is over. Whether approached from a political, social or economic perspective, numerous theories of economic globalization predict the end of the ‘state’ as the organizing principle of the spatial organization of economic power.

In particular, the ‘constrained-state thesis’ (also known as the ‘straightjacket thesis’), which emerged out of the ‘globalization-as-constraint school’, claims that the state is no longer capable of effectively determining economic developmental strategies.² The ‘constrained-state thesis’ is a concept used by scholars to make a variety of arguments relating to the weakening of the state. All these arguments rest on the premise “that changes in the international political economy have radically restricted policy choice and forced policy shifts that play to the preferences of global investors and mobile corporations, rather than to the needs of the domestic political economy and its citizenry.”³ According to the ‘constrained-state thesis’, states no longer control the movement and operation of capital, and hence of international financial markets, and multinational corporations (MNCs), which function according to the logic of neoliberal

¹ Anthony Giddens, *The Consequences of Modernity* (Cambridge: Cambridge University Press, 1990), 52.

² See Linda Weiss, ed., *States in the Global Economy: Bringing Domestic Institutions Back In* (Cambridge: Cambridge University Press, 2003), 1-7. Weiss is a critic of the ‘constrained-state thesis’.

³ *Ibid.*, 3.

capitalism. Consequently, states must compete with other states in order to attract capital and the business of MNCs and to do so they must adopt neoliberal policies. In other words, states must adopt policies that create the conditions that attract global economic actors, namely free trade, low levels of taxation, the free movement of capital, and little government interference in the economy.

Viewed from this perspective, the state is no longer the “primary container of national socio-economic activity,” and its role in determining ‘who gets what’ is continuously diminishing.⁴ Economic globalization implies the existence of a set of processes and actors that can not be controlled by states because they operate outside the realm of the state. It is this claim which leads to the assertion that it is the nature of the global economic system (neoliberal capitalism) that determines economic policy in a globalized world. Domestic political and economic realities have little or no impact on state policies, because states have little or no control over the operation of the global economic system.⁵ The implication of this argument is that protectionist policies or measures that hinder national economic integration with the global economy will ultimately lead to the stagnation of national economies.

In the following pages the validity of the ‘constrained-state thesis’ is tested through an examination of the attempted liberalization of services in the European Union (EU). The EU is a unique example of ‘globalization’, in the sense that Member States have formally and voluntarily given considerable economic power to supranational institutions, processes and actors. Hence, if anything ‘constraints’ if they do indeed exist,

⁴ David Held et al., *Global Transformations: Politics, Economics and Culture* (Stanford: Stanford University Press, 1999), 4.

⁵ See, Kenichi Ohmae, *The Borderless World: Power and Strategy in The Interlinked Economy* (New York: Harper Business, 1990).

should be ever more evident. This is also true because the EU has adopted a form of economic integration largely based on neoliberal economic thinking.

The founding principle of the Single Market in the EU is the free movement of capital, labor, services, and goods.⁶ From the very beginning the EU was based on the neoliberal economic model. The Rome Treaty of 1958 which gave birth to the European Economic Community (EEC) was based on neoliberal economic thinking.⁷ Subsequent economic agreements including the Single European Act (SEA) and the Treaty of Maastricht, which included an agreement on a Monetary Union (EMU), have reinforced this fact and have ingrained the logic of neoliberal economics in the functioning of the EU. The logic of the Single Market is that producers need access to a large market not only to sell their products and services but also to take advantage of economies of scale. As a consequence consumers can buy cheap products and services. Likewise, the European Central Bank controls inflation through a centrally controlled interest rate, while strict inflationary rules prevent states from accumulating high deficits.

Neoliberal economic theory is not only embedded in the EU Treaties, it is also the ideology of the major bureaucratic arm and policy formulation body in the EU, the Commission. Since the SEA was negotiated, the Commission has consistently argued that the liberalization and completion of the internal market in both services and goods is central for EU prosperity.⁸ Because of its power to initiate and shape policies, the Commission has considerable influence on the direction the EU takes on a particular issue. The Commission has been the leading actor in terms of pushing for the completion

⁶ EU, "Consolidated Version of the Treaty Establishing the European Community," *Official Journal of the European Communities*, c 325/33, 24 December 2002.

⁷ Bill Lucarelli, *The Origins and Evolution of the Single Market in Europe* (Aldershot: Ashgate, 1999), 35-39.

⁸ This is discussed in detail in the Chapter 2.

of the internal market, and in this sense it has acted as an external force applying pressure on Member States to move in a neoliberal direction.

Another reason why the EU, and in particular the issue of the liberalization of services in the EU, is an excellent case study to test the 'constrained-state thesis' is that, with respect to formal and informal trade barriers, the same situation exists at the global level as in the EU. In the global economy formal barriers (tariffs) to trade have declined as a result of international trade agreements. However, the significance and number of informal trade barriers (a.k.a. non-tariff barriers) which usually take the form of health and safety regulations, have risen in recent years.⁹ In the EU the same trend has occurred at least in the case of services. Although formal tariffs between Member States have long been removed, informal practices and regulations dramatically restrict the freedom of movement of service providers in the EU.

Also, by looking at an area such as the EU in which states have formally given economic power to institutions and processes above them, we avoid the problem to which studies of the neoliberal policy convergence fall victim, namely that they assume that no hierarchy of types of economic relations exist between states. This confuses the issue because even if states around the world are adopting neoliberal policies, it may be due to the fact that neoliberalism is the model preferred by the most powerful economic states. If this is the case, it is not the global economic system that is producing convergence around the neoliberal economic model. It is the fact that the most powerful economic states in the global economy just happen, at this point in time, to prefer this type of policy

⁹ United Nations, *World Economic Situation and Prospects 2006*, United Nations Publication, Sales No.E.06.II.c.2, 52-54.

program. By studying the EU we avoid this problem because all EU Member States are equally subject to pressure emanating from EU institutions.

The predictions of the ‘constrained-state thesis’ are clear and relatively easy to test. For this reason and for the reasons discussed above the test conducted of the ‘constrained-state thesis’ in this paper is a ‘strong test’.¹⁰ If the ‘constrained state thesis’ is correct, in the EU we would certainly expect to see the liberalization of services and, consequently, a shift in power in the regulation of services from the state to EU institutions and processes. Moreover, domestic political and economic realities in Member States should have little effect on the outcome of service liberalization considering that all the forces, externally and internally, are pushing the EU in this direction. If it can be demonstrated that in the EU economic policies are indeed conditioned by domestic political and economic realities, then the claims associated with the ‘constrained-state thesis’ would appear much less convincing.

In his seminal work, entitled *Governing the Economy*, Peter Hall argued that economic policy is made by governments and “governments are political creatures.”¹¹ This is the fundamental premise of the argument made in this thesis. Domestic political and economic realities still play a major role in shaping economic strategies. Even if one accepts the argument that the nature of the global economy today created incentives to pursue particular policy options over others that does not mean that every state will adopt exactly the same policies. Different states often adopt different economic strategies and policies that reflect domestic economic and political realities. Moreover, the creation of

¹⁰ Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific inference in Qualitative Research* (Princeton: Princeton University Press, 1994) 30.

¹¹ Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (New York: Oxford University Press, 1986), 4.

supranational economic institutions which acquire economic power from sovereign states does not necessarily lead to policy convergence. The creation of supranational economic institutions will not lead to policy convergence because politics is involved and therefore, domestic political and economic realities will influence the way states behave and the policies they pursue within supranational institutions and arguably even more within purely international economic institutions.

Because the main argument of this thesis is that national economic policy is affected by domestic economic and political realities, the Advocacy Coalition Framework (ACF) is used to explain the outcome of the services policy debate in the EU.¹² The ACF approach breaks down complex policy processes into manageable frameworks that explain policy outcomes. This approach simplifies and hence highlights the essence of complex policy struggles. It regards policy change, or the lack of policy change as the result of the struggle between competing groups of 'likeminded' individuals and groups who share beliefs about a certain issue. The ACF is a useful theoretical framework for explaining policy change in the EU because it captures the complex policy process that exists in the EU; it accounts for the variety and number of actors involved, the interaction that occurs between societal and governmental actors and the fact the policy change in the EU is a slow process.

This thesis is organized as follows. Chapter 1 reviews the literature on the state in an era of economic globalization. Chapter 2 examines the events and trends that led to the attempted liberalization of service in the EU. Chapter 3 discusses the Commission's initial proposal for a Services Directive, which is followed by a detailed investigation of the reactions from across the EU to the proposal. Chapter 4 recounts the legislative

¹² The ACF framework is outlined in Chapter 5.

journey of the Services Directive. Chapter 5 explains the outcome of the debate and political process surrounding the Service Directive by means of the Advocacy Coalition Framework (ACF).

The research that forms the basis of this case study is the product of an in-depth review of EU reports and documents related to the debate over the liberalization of services in the EU. It is also informed by a series of interviews conducted with relevant EU and Member State officials in Brussels on the 24, 26 and 28 July 2006.

Chapter 1 The State in the Era of Economic Globalization

The ‘globalization-as-constraint school’ has spun a broad multidisciplinary literature. Scholars who contribute to this literature are referred to in a number of ways, including globalists and hyperglobalists.¹³ Despite diverse theoretical approaches and normative preoccupations their arguments converge on similar claims: “the loss of national autonomy, the powerlessness of governments in the face of transnational capital, the obsolescence of the nation-state as an organizing principle.”¹⁴ Most importantly, those who adhere to this perspective privilege economic factors as the driving force behind declining state power.¹⁵ This is the underlying assumption that connects a whole range of constrained-state arguments and which leads to a shared conclusion, namely that the power of the state as an “organizing principle” is diminishing because of the power of market forces and the free movement of capital, in particular.

Kenichi Ohmae argues that because of the international political economy, which has eroded the significance of state borders, the state should accept the “unarguable truth” that “people have the right to live well and to choose the best and cheapest from anywhere in the world.”¹⁶ Ohmae concludes that governments play no substantial role in determining the choices that people make in terms of what they buy. He is suggesting that if a state tries to adopt policies inconsistent with the promotion of liberal capitalism, its population will suffer. In this sense, the state is constrained in the type of economic policies it can adopt. The problem with this type of argument is twofold. First, the argument is in part normative and operates outside the realm of social scientific inquiry.

¹³ Held et al., 2-14.

¹⁴ Linda Weiss, *The Myth of The Powerless State* (New York: Cornell University Press, 1998), 2.

¹⁵ Held et al., 2-14.

¹⁶ Kenichi Ohmae, *The Borderless World: Power and Strategy in the Interlinked Economy* (New York: Harper Business, 1990), 205.

Second, if we are truly to understand what impact global economic integration has had on the state, we need to conduct detailed empirical investigations of what is happening. Ohmae's structural economic reasoning is more informed by normative arguments than empirical investigation. Adopting a structural economic perspective on globalization presupposes that economic power rests in global market processes and leads to the conclusion that the state is losing economic power.

Although they adopt a different normative position than neoliberal thinkers like Ohmae, Marxists also employ structural economic reasoning. They highlight the oppressive nature of the world capitalist system. For example, Gary Teeple defines globalization as "the unfolding resolution of the contradiction between ever expanding capital and its national political and spatial formations."¹⁷ He further defines globalization as "the arrival of self-generating capital at the global level; that is, capital as capital, capital in the form of the TNC, free of national loyalties, controls and interests."¹⁸ Teeple argues that globalization is the actual "triumph of capitalism," or, in other words, the emergence and dominance of global economic agencies whose interests are not national, whose role it is to facilitate "global conditions for capital accumulation."¹⁹ Marxists like Teeple generally view globalization as a stage in the development of capitalism brought on by a technological revolution precipitated by a revolution in the means of production. Politically, this perspective is the most radical since it predicts the end of liberal democracy and the dismantling of the state. Following the demise of the powers of the state, the erosion of national cultural identities will occur and a single

¹⁷ Stephen McBride and John Wiseman, Eds., *Globalization and Its Discontents* (New York: Palgrave, 2000), 10-11.

¹⁸ *Ibid.*

¹⁹ *Ibid.*, 7.

global culture will emerge. Both Teeple and Ohmae, notwithstanding their different normative positions, argue that states end up adopting policies consistent with capital accumulation. In short, the argument is that MNCs and other international economic institutions and processes have rendered the state totally subservient to their interests.

One of the most lucid ‘globalist’ arguments is made by Susan Strange in *The Retreat of the State: The Diffusion of Power in the World Economy*. Although Strange moves away from a purely economic perspective, her work certainly fits into the ‘globalization-as-constraint school’. Strange argues that “structural change in world economy and society” has rendered the state “just one source of authority among several, with limited power and resources.”²⁰ To test her assertion, Strange reviews ten areas of jurisdiction that are generally considered the domain of the state.²¹ Through this analysis Strange reaches the conclusion that “state authority in society and economy is shrinking.”²²

Most importantly, for the purposes of this thesis, Strange challenges the view that different models of capitalism are capable of coexisting in a globalized world. As evidence, she cites the convergence of liberal economic policy in developing countries and the dominance of neoliberal economic thinking in the US and Japan. Moreover, she argues that the trend toward neoliberal policy is being reinforced by alliances between multinational corporations, which have everything to gain from new technology and

²⁰ Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), 72.

²¹ *Ibid.*, 73-82. The ten jurisdictions are : The responsibility of defending national territory, maintaining the value of the currency, choosing the appropriate form of capitalist development, correcting the tendency of market economies to cyclical booms and slumps, providing a safety-net, the responsibility of taxation, overall development strategy, responsibility for building infrastructure, competitive market in the national economy, and the legitimate use of violence.

²² *Ibid.*, 82-87.

market exploitation.²³ Strange suggests that state spending on social security has reached a peak and a decline in spending is inevitable.²⁴ In terms of taxation, Strange argues that states are no longer capable of increasing spending by taxing businesses and private individuals. International business transactions are no longer directly the jurisdiction of one state and tax havens allow for businesses to escape heavy taxation.

Strange uses this evidence to argue that states have limited capacity to initiate economic developmental strategies. In other words, states suffer from a diminishing capacity to influence the “direction, volume and content of trade flows.”²⁵ Strange cites the inability of the US and EU, despite protectionist intervention, to limit the flow of Asian imports into both markets. In other words, trade is determined by the market place and the principles of supply and demand. Strange takes this argument even further and suggests that because competitiveness in the market place is buttressed by a competitive environment in the national environment, “the protection of national champions and the award of monopoly privileges” is no longer a viable option.²⁶ The logic is that national monopolies will not be able to sustain economic growth in a localized market with limited profits.

Strange’s assessment of the functional capacity of the state certainly reveals her pessimistic view of the future of the state. It is an argument based on the idea that the nature of economic competition between states in the global economy is qualitatively different from that existing in previous historical periods. States no longer enjoy complete economic authority because the costs of interfering in the economy are simply

²³ *Ibid.*, 75.

²⁴ *Ibid.*, 77.

²⁵ *Ibid.*, 78.

²⁶ *Ibid.*

too high. Strange argues that this phenomenon, which she suggests has occurred in the last “twenty or thirty-years,” is driven by “private enterprise in finance, industry and trade.”²⁷ Interestingly, Strange asserts that the current transformation of the state is so extensive and important that she compares it to the transition from feudalism to capitalism.²⁸

The claim that economic integration, or globalization, has been driven by private actors is important because those who argue that globalization is a myth, or in any case a mischaracterization of the nature of economic integration today, generally argue that the proliferation of neoliberal policies is a consequence of that fact that globalization is driven by powerful economic states who benefit the most from their adoption and proliferation.²⁹ This is why skeptics of globalization like Weiss, and Hirst and Thompson prefer to use the term internationalization as opposed to globalization to capture the current level of international economic integration.³⁰ The former implies that economic integration has occurred, but it is best understood as the integration of national economies that still retain their national character. Powerful states drive integration, not exogenous market forces. As Held et al. point out, the term globalization leaves the impression that the world market is totally integrated.³¹

The ‘constrained-state thesis’ is to a large extent an attempt to explain the significance and existence of global phenomena. For example, Scholte cites the existence of 44,500 transborder companies, 250 multilateral regulatory institutions, \$60 trillion in annual transborder movements of scrutinized funds, global environmental problems,

²⁷ *Ibid.*, 4.

²⁸ *Ibid.*, 87.

²⁹ Held et al., 5.

³⁰ *Ibid.*

³¹ *Ibid.*

global communications, and 16,500 civil society organizations to support the claim that “such a large accumulation of data surely suggests a significant trend away from territorialist social organization.”³² The ‘constrained-state thesis’ is an attempt to explain the consequence of these global phenomena, especially the significance of global capital. The problem is that these data are only suggestive evidence in terms of supporting the claim that the state is no longer an important locus of power. One of the problems of the ‘constrained-state thesis’, and globalization theory in general is that it largely relies on evidence that is anecdotal at best. Arguments like the ‘constrained-state thesis’ have increasingly penetrated the social sciences while thwarting the epistemological and methodological traditions of the social sciences, mainly, the positivist reliance on empirical investigation to inform and test theories. This is not to say that only positivist approaches are acceptable. However, all social scientific theory must have some empirical justification. The empirical support for the ‘constrained-state thesis’ is weak at best.

Indeed, a large body of empirically supported research that challenges the main prediction of the constrained-state theory has appeared in recent years. In, *Continuity and Change in Contemporary Capitalism*, Kitschelt et al. find that there is very little empirical evidence to support the claim that globalization leads to a convergence around a single political economic model:

First, convergence on any unique democratic capitalist political economic model is unlikely, both because there are strong theoretical reason to doubt such convergence is even functionally dictated and because path-dependent cognitive, institutional practices and political factors militate against it. Second, there are no strong empirical indicators that convergence is occurring. While national sectoral coordinated market economies are becoming more alike, and more like the latter, they are not becoming more

³² Jan Art Scholte, *Globalization: A Critical Introduction* (New York: St Martin’s Press, 2000), 58.

like the liberal market economies. In fact, it might be argued that the differences between these two types have in several respects grown since the golden age and over the past fifteen years.³³

There is also considerable empirical evidence to support the claim that welfare systems have been resilient in the face of globalization.³⁴ Likewise, there is also evidence to suggest that tax burdens in welfare states have not decreased.³⁵ In an interesting comparative study of corporatist versus weak labor systems Garrett and Lange found that:

The concentration of heightened economic interdependence, increased competition in world markets, and economic decline since the early 1970s has had a marked impact on economic strategies pursued by governments in the advanced industrial democracies. But contrary to common wisdom, this combination of factors has not resulted in a pervasive trend toward convergence around neoliberalism....Governments in weak labor systems have sought to minimize interventions in all facets of the economy and to heighten the disciplinary effects of market forces, although it is clear that these attempts have fallen far short of the pure 'free market.' In market contrast, economic strategies in corporatist political economies have combined traditional welfarist concerns with interventionist government industrial, investment, and labor market policies designed to promote competitiveness and flexible adjustment.³⁶

Beyond the question of neoliberal policy convergence there are other reasons to question the 'constrained-state thesis' as well. In particular, the idea that formal reductions in trade barriers have reduced the significance of state borders is misleading to some degree. There is little doubt that global barriers to trade in goods and services have declined in a formal sense, however informally, barriers to trade have risen.

Environmental and public health and safety regulatory practices in developed countries,

³³ Herbert Kitschelt, Peter Lang, Gary Marks and John D. Stephens, eds., *Continuity and Change in Contemporary Capitalism* (Cambridge: Cambridge University Press, 1999), 459-460.

³⁴ John Stephens, Evelyn Huber and Leonard Ray, "The Welfare State in Hard Times," In *Continuity and Change in Contemporary Capitalism*, Kitschelt et al., eds., (Cambridge: Cambridge University Press, 1999), 164-193.

³⁵ Duane Swank, "Funding the Welfare State: Globalization and the Taxation of Business in Advanced Market Economies," *Political Studies* 46 (3), (1998): 671-92.

³⁶ Geoffrey Garnett and Peter Lange, "Political Responses to Interdependence: What's 'Left for the Left?'" *International Organization* 45 (4), (Autumn, 1991): 539-564, 563.

significantly hamper the ability of less developed countries to gain access to large markets in developed states. For example, it has been estimated that “African banana exports could grow by \$410 million a year if the EU used international standards for traceable requirements and regulations on pesticide residues for agricultural imports, instead of its own standards.”³⁷ This calls into question the vision of a fully integrated world economy in which goods and services are sold and bought at the lowest possible prices, further highlighting the importance of separating normative arguments from arguments built on sound empirical evidence.

One of the leading critics of the ‘constrained-state thesis’ is Linda Weiss. She argues that states still have the capacity to form and implement domestic industrial economic strategies that contribute to national economic growth. She defines state capacity as the ability of “policy making authorities to pursue domestic adjustment strategies that, in cooperation with organized economic groups, upgrade or transform the industrial economy.”³⁸ Moreover, Weiss suggests that the state in many instances is best suited for coordinating change. One of the main themes in her argument is that states that have domestic transformative capacity (the ability to adjust domestic industrial policy) have a significant advantage in an internationalized economy. Consequently, increased internationalization will allow those states that have a strong domestic transformative capacity to influence the direction of international economic integration.

To support her argument, Weiss cites evidence that economic integration in the EU is driven by Germany and reflects German corporatism. Weiss further argues that the same pattern is evident in Asia where economic integration reflects the economic

³⁷ United Nations, 55.

³⁸ Weiss, *The Myth of the Powerless State*, 22.

characteristics of Japan, Asia's main economic engine. Weiss argues that state policy capacities have not been diminished, instead state influence and power have a changing dynamic. This directly challenges the argument that states no longer have the capacity to formulate industrial strategies in light of a globalized economy.³⁹

Weiss rightly points out that the concept of globalization implies that states are no longer important economic actors.⁴⁰ To challenge this view, Weiss questions the foundations of the argument. She argues that the current level of capital flows is not unprecedented.⁴¹ Likewise, she suggests that if you look at trade and foreign direct investment (FDI) figures closely, it is evident that in both cases the trend is downward in the last decade or so, which suggests less economic integration.⁴² In terms of trade and capital flows (the only exception being international money markets), "the result is not so much a globalized world as a more internationalized one, where national and regional interaction networks remain vibrant and continue to highlight the importance of institutions and place."⁴³ The implication of this argument is that differences in state capacities will increase. Differences in state capacity are highlighted by internationalization because states that have strong transformative capacity will be able to influence the nature of economic integration.⁴⁴

In a more recent collaborative effort, Weiss strengthens her challenge to the 'constrained-state thesis' by empirically testing a number of hypotheses, namely that states suffer from "a diminishing capacity to extract revenue over time," show "a

³⁹ *Ibid.*, 189.

⁴⁰ *Ibid.*, 168-169.

⁴¹ *Ibid.*, 171.

⁴² *Ibid.*, 178.

⁴³ *Ibid.*, 187.

⁴⁴ *Ibid.*, 194.

declining propensity to engage in social spending,” and have “a waning ability to promote industry and trade.”⁴⁵ Weiss et al. find increased direct tax yields, differentiated social spending and coordinated economic states maintaining and expanding social spending and increased efforts to coordinate industrial policy and industrial innovation. These findings directly challenge the view that states have been forced to step back from economic planning and simply adopt a neoliberal agenda:

However much globalization throws real constraints in the ways of state activity, most notably in the macroeconomic arena, it also allows states sufficient room to move, and thus to act consistent with their social policy and economic upgrading objectives.⁴⁶

Others have challenged the ‘constrained-state thesis’ by reversing the argument that technology has enabled capital to move and operate outside the control of the state. This is one of the central propositions of the ‘constrained-state thesis’. Without the free movement of capital it would be difficult to argue that market forces impose policy pressure on the state. If states control the movement of capital, their power is much stronger than suggested by the ‘constrained-state thesis’. Eric Helleiner argues that the information technological revolution has increased state capacity to “regulate money movements.”⁴⁷ Helleiner questions the claim that technology innovation is taking power away from states. He argues that states are able to employ new innovations in technology for their own benefit; they can easily track the movement of capital and possibly regulate capital flows more aggressively should they so choose. Helleiner raises the issue of whether the liberalization of capital controls is the result of an inability to control capital

⁴⁵ Weiss, *States in the Global Economy: Bringing Domestic Institutions Back In*, 294-317.

⁴⁶ *Ibid.*, 296.

⁴⁷ Eric Helleiner, “Electronic Money: A Challenge to the Sovereign State,” *Journal of International Affairs* 51 (2), (Spring, 1998): 387-409.

or simply the consequence of “British and American interests in financial globalization.”⁴⁸ Helleiner asserts that one could argue that the liberalization of capital controls was a consequence of strategic choice, not a forced consequence of market forces as suggested by the ‘constrained-state thesis’. To make the case that “competitive deregulation pressures are not overwhelming,” Helleiner cites the 1988 *Basle Accord on Bank for International Settlements* and the cooperative effort of the *Financial Action Task Force* under the auspices of the Organization for Economic Co-operation and Development (OECD) to regulate money laundering, as examples of how states can and do, when they so choose, regulate international financial transactions.⁴⁹

What is particularly striking about the ‘constrained-state thesis’ literature is it that it contradicts a large comparative political economy literature that focuses on national economic policy strategies in an era of increasing international economic integration.⁵⁰ Within this literature, scholars differ with respect to what factors should be privileged in explaining national economic strategies in the face of a changing international economic environment. Peter Hall argues that the most important variable in explaining economic

⁴⁸ *Ibid.*, 392.

⁴⁹ *Ibid.*

⁵⁰ This literature developed in the 1970s in response to two interrelated developments. First, in the 1970s a number of economic circumstances encouraged scholars to re-examine the relationship between the international economy and domestic economic policy. In the 1970s, two major oil crises shook the world economy. No state was left unscathed by the forming of *Organization for Petroleum Exporting Countries* (OPEC) and the subsequent increase in the cost of oil. Also, economic development in third world countries was not occurring despite the promise of modernization theory. Increased global economic integration and modernization efforts were not leading to economic prosperity for many countries. In light of these developments, scholars of political economy began to reexamine the two dominant approaches in the field: political culture and dependency. The result was that scholars began to challenge the view that politics and economics were separate phenomenon. Scholars like Peter Gourevitch began formulating theoretical frameworks to account for both domestic and international factors in explaining economic policy strategies. In effect, the goal was to balance the claims of dependency and political culture theory. See W. Rand Smith, “International Economy and State Strategies: Recent Work in Comparative Political Economy,” *Comparative Politics* 25 (3), (April, 1993): 351-372.

policy is the organization of social and political forces.⁵¹ Gosta Esping-Anderson emphasizes the role of ruling coalitions like Peter Gourevitch, but goes further and examines how economic policy after implementation affects the ruling coalition and social structure within a state.⁵² This entire literature supports the idea that politics matters and that economic policies have to be politically viable as well as economically viable.

The debate between advocates of the ‘constrained-state thesis’ and its opponents discussed in the preceding pages is unlikely to end anytime soon. If anything, both camps are likely to dig in deeper as the debate surrounding globalization increases in importance and intensity. The empirical investigation of the Services Directive in the EU contained in this thesis is a contribution to the increasing empirical evidence that challenges the ‘constrained-state thesis’.

⁵¹ Hall.

⁵² Gosta Esping-Anderson, *Politics against Markets: The Social Democratic Road to Power* (Princeton: Princeton University Press, 1990). Peter Gourevitch, *Politics in Hard Times: Comparative responses to International Crisis* (London: Cornell University Press, 1986).

Chapter 2 Background: External and Internal Pressures for Service Liberalization

Two trends led to the issuing of a Services Directive in the EU.⁵³ First, despite the fact that the Treaty Establishing the European Community (EC Treaty) clearly states that service providers have the right to operate freely throughout the EU, informal and formal practices have prevented service providers from operating efficiently outside their country of origin. Second, it became evident during the 1990s that the economy in the EU was losing ground to other developed countries in terms of the percentage of the gross domestic product (GDP) created by the service industry and in the development of competitive service providers. Even though services account for nearly 70% of the EU's GDP, "the size of.....the services sector is still below the OECD average."⁵⁴ In addition the Commission laid the foundation for the liberalization of services by connecting service liberalization with the construction of a European social model.⁵⁵ The Commission began arguing that social cohesion and social inclusion in the EU depended upon the liberalization of services, especially those of general economic interest (transport, telecommunications, etc). As a result, in the 1990s the Commission began attempting to liberalize services in the EU in order to develop efficient competitive service providers and promote social cohesion and social inclusion. The argument

⁵³ Directives are the most common form of legislation in the EU. If adopted a directive becomes law in the EU and is binding on all Member States, such that Member States must meet the objectives of a Directive. How this is accomplished is up to individual member States. The Commission is responsible for issuing proposals for directives, which depending on the issue go through one of four main decision making procedures: consultation, co-operation, co-decision and assent.

⁵⁴ Line Vogt, *The EU's Single Market: At Your Service?*, OECD, Economic Department Working Paper No. 449, ECO/WKP, 2005, 4. And COM, "The State of the Internal Market for Services," 441 final, 3 July 2002, 7.

⁵⁵ In other words, market efficiency ultimately is best for the European Social Model because it allows workers from all over to gain employment through access to economic sectors, and prices should remain low in a competitive environment.

showed that the Commission espoused the neo-liberal view that the market allocates resources in the most efficient manner.

Legally, the functioning of the service sector in the EU was governed originally by the Treaty of Rome. The Treaty of Rome is now incorporated into the Treaty Establishing the European Community.⁵⁶ The definition of services in the EC Treaty is clear: activities of an industrial and commercial character and the activities of craftsmen and professionals are covered. The EC Treaty gives service providers the right to operate in countries other than their country of origin. Article 49 states that “restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.”⁵⁷ Article 50 states that “the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals.”⁵⁸ However, the phrase “the same conditions” has been a source of conflict within the EU. Some have interpreted this phrase inclusively to mean that all service providers operating in a Member State are subject to the same authorization schemes, the same professional requirements, etc. Others have interpreted in a more restrictive manner to mean that service providers are only subject to the same safety codes, work safety rules, etc, in the Member State in which they are providing a service if it is not their country of primary establishment. At stake is the question of whether service providers must establish their credentials in another Member State, or simply

⁵⁶ For the sake of clarity, EC Treaty is referred to in the remainder of the thesis.

⁵⁷ EU, “Consolidated Version of the Treaty Establishing the European Community,” *Official Journal of the European Communities*, c 325/33, 24 December 2002. Article 49.

⁵⁸ *Ibid.*, Article 50.

provide a service consistent with the laws of the country in which they are established.

According to Onno Brouwer, former legal secretary to the ECJ, the Court has consistently expressed the opinion that:

[...] not [...] all national legislation applicable to nationals of [...] [a] state [...] may be similarly applied in its entirety to the temporary services of undertakings which are established in other Member States. [...] The freedom to provide services is one of the fundamental principles of the Treaty and may be restricted only by provisions which are justified by the general good [...] in so far as that interest is not safeguarded by the provisions to which the provider of the service is subject in the Member State of his establishment.⁵⁹

Indeed, the court has made it clear that service providers not established in the Member State in which they are offering a service should not be subject to all the regulatory mechanisms in that country.⁶⁰ In other words, if the service is of a temporary nature the service provider should not be subject to burdensome authorization and regulatory procedures as long as the service provider is established in the EU. The ECJ has ruled that informal and formal practices that unfairly restrict the free movement and establishment of services between Member States are in violation of the EC Treaty. The Commission had adopted the same interpretation as the ECJ. The Commission had argued since the late 1980s that service providers should be free to operate temporarily and establish themselves outside their country of origin.⁶¹ However, despite the Commission's and ECJ's best efforts, the number of internal market-service related

⁵⁹ ECJ, "Opinion of AG Jacobs," Case C-76/90, *Säger v. Dennemeyer*, 21 February 1991, para 27.

⁶⁰ *Ibid.*, point 13: "Member State may not make the provision of services in its territory subject to compliance with all the conditions required for establishment and thereby deprive of all practical effectiveness the provisions of the Treaty whose object is, precisely, to guarantee the freedom to provide services."

⁶¹ Mauro Miranda, Interview by Author, Commission European Union: Internal Market and Services, 23 June, 2006.

infringements cases has steadily risen since the SEA revitalized economic integration in the EU.

The rise in service related infringement cases is a repercussion of alternative interpretations by the ECJ and Member States of Article 49 and 50 of the EC Treaty. The ECJ and the Commission have interpreted these articles in a liberal way, while Member States have interpreted the same articles in a restrictive fashion. In any case, these different interpretations of the Treaty are a consequence of the different objectives and pressures facing Member States in comparison to those faced by the Commission and ECJ. From an integration and legal standpoint, it made sense for the Commission and ECJ to interpret the articles in the EC Treaty pertaining to services in a liberal fashion. However, Member States have to address domestic political, social and economic realities. It is not hard to understand why Member States have interpreted the EC Treaty in a restrictive manner in this instance. Member State governments have to protect local industry, deal with labor and get re-elected. Interpreting the EC Treaty in a liberal manner would have been politically difficult and may not have been in their best interest economically. EU institutions have a tendency to adopt the view that what is best for the EU is best for Member States. Member States do not necessary believe what is best for the EU is best for them. In the case of services, contradictory viewpoints lead to alternative interpretations of the EC Treaty and consequently a less than liberalized internal market.⁶²

⁶² Evidence supporting this claim would latter become the cornerstone of the Draft Services Directive. The Commissions evidence would be supported by a number of independent studies.

The legal framework that governs the operation of services in the EU is further complicated by the issue of ‘services of general interest’.⁶³ Although this concept is used in the EC Treaty, it is not defined. In practice the concept refers to services of an economic nature that are subject to public service obligations. The concept “covers in particular certain services provided by the big network industries such as transport, postal services, energy and communications.”⁶⁴ The broader concept of services of general interest refers to both services of general economic interest and non-economic services such as health care, social welfare, etc, that have been classified by public authorities as of general interest and hence subject to public service obligations. The importance of services of general interest was recognized by the Cannes European Council held in June 1995. The Heads of State agreed that services of general interest are part of the set of values shared by all Europeans.⁶⁵ This position was subsequently adopted by the Commission in a report to the 1996 intergovernmental conference:

Europe is built on asset of values shared by all its societies and combines the characteristics of democracy-human rights and institutions based on the rule of law-with those of an open economy underpinned by market forces, internal solidarity and cohesion. These values include access for all members of society to universal services or to services of general benefit, thus contributing to solidarity and equal treatment.⁶⁶

⁶³ The concept of ‘services of general interest’ is not defined or specifically addressed in the EC Treaty. However, the term ‘services of general economic interest’ is referred to in Article 16 and 86 (2) of the Treaty. The concept is not defined in either article. Instead, the Treaty states the following: “given the place occupied by services of general economic interest in the shared values of the Union...Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.” EC Treaty, Article 16 and 86 (2).

⁶⁴ *Ibid.*

⁶⁵ Council of the European Union, “Conclusions of the Presidency,” Sn 211/95, 26-27 June 1995, Point A.I.1.7.

⁶⁶ COM, “Reinforcing Political Union and Preparing for Enlargement- Commission Opinion for the Intergovernmental Conference,” 90 final, 28 February 1996.

Subsequently, the Commission issued a communication in 1996 in which it argued that the “context in which general interest services are provided” has changed dramatically in recent years, specifically that concerning services of general economic interest.⁶⁷ As evidence, the Commission cited the rise of consumer demand for cheap quality services, worldwide competition, the need for modernization and the fact that unlike the postwar era after WWII, it is no longer difficult to raise private funding for public infrastructure. The Commission argued that the liberalization of services of general economic interest would allow the market to allocate resources efficiently. However, the Commission recognized that the benefits of liberalization do not always extend to all citizens. Hence, it argued that in some cases public authorities would have to step in to make sure that social cohesion and social inclusion is protected. The Commission proposed a gradual sector-specific approach that would allow each sector to adjust accordingly.

In 2001, in a report to the Laeken European Council, the Commission reiterated this position. The Commission noted that access to services of general economic interest was now included in the fundamental rights of the EU, citing Article 36 of the Charter of Fundamental Rights and Freedoms.⁶⁸ It became a right with the adoption of the Charter that all EU citizens have access to affordable services of general economic interest. Consequently, it became necessary to develop legal certainty in this area. This led to both a Green and White Paper on services of general economic interest in 2003 and 2004.

⁶⁷ COM, “Communication Form the Commission: Services of General Interest in Europe,” 443 Final, 11 September, 1996.

⁶⁸ COM, “Report to the Laeken European Council: Services of General Interest,” 598 final, 17 October 2001, 2-3.

Because the debate over services of general economic interest deals specifically with the question of the state's role in the economy, it was clear to the Commission and Member States that the issue needed to be clarified in Community law. What is important for the purposes of this paper is that the liberalization of services of general economic interest had become much more than just a matter of completing the internal market. It had become a matter of protecting the fundamental rights of EU citizens. This is important because it would become the lens through which the Commission articulated its position on the liberalization of services.

Against this backdrop, the Lisbon European Council of March 2000 formulated the Lisbon Strategy. It was designed to facilitate the transition to a knowledge based economy in the EU while furthering social cohesion and sustaining economic growth. The Council concluded that the EU needed to adopt a new economic strategy in the face of "globalization and the challenges of a new knowledge-driven economy."⁶⁹ The Council argued that both economic prosperity and social cohesion in the EU depended upon economic reform in light of changing global economic realities. Moreover, it argued that achieving comprehensive social cohesion and social inclusion required the completion of the internal market. The Council was adamant that unless a level playing field was created through comprehensive structural improvements, the goals of the Lisbon Strategy would not be met. The Council stated that the liberalization of the internal market, especially in the area of services, is necessary if the "full benefits of market liberalization are to be reaped."⁷⁰ The Lisbon Strategy was and is in every sense a

⁶⁹ Council of the European Union, "Lisbon European Council 23 and 24 March 2000: Presidency Conclusions," DOC/00/8, 24 March 2000. Available on the World Wide Web at: http://europa.eu.int/ISPO/docs/services/docs/2000/jan-march/doc_00_8_en.html

⁷⁰ *Ibid.*, 5.

response to the pressures created by globalization. Completing the liberalization of services was from the very beginning connected to achieving the goals set out in the Lisbon Strategy.

To speed up liberalization, the Council asked the Commission to develop a general strategy for the removal of barriers to services by the end of 2000. In particular, the Council called for the liberalization process in the areas of gas, electricity, postal services and transport to be accelerated. The liberalization of services was viewed as a necessary structural improvement to reduce “the general level of State aids, shifting the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, such as employment, regional development, environment and training or research.”⁷¹ The Lisbon Council envisioned a Europe with a fully integrated economy based on common practices and rules buttressed by an active welfare state protecting the European social model.

In response, the Commission produced a comprehensive plan titled “An Internal Strategy for Services,” in December of 2000. The Commission echoed the concerns of the Lisbon Council arguing that the pressures resulting from the information technology revolution and global competitiveness dictated that the EU allow services to flow freely. Indeed, the Commission feared that if the EU did not facilitate the removal of barriers to services, increased competition from foreign firms would devastate the EU economy.⁷² The Commission recognized that globalization had reduced international trade barriers and hence entry barriers for foreign companies entering the EU.⁷³ Therefore, it adopted

⁷¹ *Ibid.*, 6.

⁷² COM, “An Internal Market for Services: Communication from the Commission to the Council and the EU Parliament,” 888 final, 29 December 2000, 4-5, 6.

⁷³ *Ibid.*

the position that the ability of EU companies to compete domestically and internationally hinged on their ability to operate efficiently within the EU. As an example, the Commission explained how service providers had been unable to export business models outside their country of origin. In other words, different rules and practices across the EU made it difficult, if not impossible, for companies to employ a single business model across the EU. They demonstrated this by highlighting the obstacles that existed to the movement of services at each stage of the business process.⁷⁴ According to the Commission's report, the impact of these obstacles fall directly on the consumer. This reinforced the position adopted by the Commission that the liberalization of services between Member States was essential for consumers to be able to buy cheap and quality services.

The Strategy outlined a two year plan to identify and address the problem of barriers to services in the EU. In the first stage the Commission would complete a detailed analysis of existing barriers. The Commission would also pressure Council and Parliament to speed up the legislative and political process related to ongoing directives that dealt with services such as telecommunications, while simultaneously introducing new initiatives in problem fields such as commercial communications and financial services. In the second stage, the Commission would introduce both legislative and non-legislative horizontal community-wide harmonization measures to address existing barriers to services identified in its analysis.

⁷⁴*Ibid.*, 3. The Commission divided the business process into the following six stages: 1. Setting up the business 2. Use of inputs 3. Promotional activities 4. Distribution activities 5. Sales activities 6. After sales support.

The two stage process was welcomed by all Member States, the EU Parliament, the Economic and Social Committee and Committee of the Regions.⁷⁵ In July of 2002, the end of the first stage of the process concluded with the Commission presenting a report on the “The State of The Internal Market For Services.” The report highlighted the fact that Member States were treating service providers not established in their territory as if they were established in their territory. For example:

A patent agent who occasionally provides a service in another Member State is subject to an obligation to obtain authorization from the latter, to meet the professional qualifications required there, and to enroll in a specific register; or a landscaping architect who is temporarily providing a service in another Member State is subject to the obligation to be a member of the national association and to comply with all the professional rules of that country.⁷⁶

As this example demonstrates, service providers not established in the Member State in which they are attempting to provide a service are facing barriers to which they should not be subject. The report showed that significant barriers exist because of authorization and registration practices that made it very difficult to get approval to provide services outside a provider’s country of origin. The Commission cited the fact that in some cases, service providers are required to register with up to three authorities, each taking significant time to process applications.⁷⁷ Of course, the key question is whether these regulations should be applied to service providers established outside the Member State in question. The European Court of Justice has made it clear that service providers offering a temporary service are not to be subject to the same requirements as established service providers in Member States where they are trying to offer a service. The report

⁷⁵ COM, “Proposal for a Directive of the European Parliament and of the Council on Services in the Internal Market,” 2 final/3, 5 March 2004, 6.

⁷⁶ COM, “The State of the Internal Market for Services,” 52.

⁷⁷ *Ibid.*, 18.

highlighted this fact and demonstrated that there exists considerable barriers to the freedom of establishment of services and the freedom of movement of services between Member States. Likewise, the report established the fact that barriers to services have common features. This was an important finding because it laid the foundations for the horizontal approach the Commission would later adopt. If there had not been significant similarities between the types of barriers that existed across different sectors the Commission would probably have chosen to design initiatives sector by sector. Traditionally, this was the approach the Commission had adopted. Specific initiatives were designed to address particular service sectors within the internal market. However, the report identified that both the legal and behavioral barriers that exist across different service activities “ha[d] a number of common traits in both their origins and effects.”⁷⁸

The report was welcomed by the Council and Parliament, and in March 2003 the Spring European Council reiterated the need for a legal framework to remove the barriers to services in the EU.⁷⁹ The Council proclaimed that the report provided an excellent “basis for the second stage of the Strategy.”⁸⁰ The Council even encouraged the Commission to develop a single legislative instrument to remove barriers to services. Parliament also welcomed the report and reiterated its support for community-wide harmonization measures based on the principle of mutual recognition. Interestingly, Parliament stated that automatic recognition should “be encouraged as far as possible.”⁸¹

⁷⁸ *Ibid.*, 7.

⁷⁹ See, Council of the European Union, “2462nd Council Meeting on Competitiveness,” 13839/02 (Press 344), Brussels, 14 November 2002. And COM, “2002 Review of the Internal Market Strategy – Delivering the Promise,” A5-0026/2003, 5 March 2004, point 35.

⁸⁰ Council of the European Union, “2462nd Council Meeting on Competitiveness,” 5.

⁸¹ COM, “2002 Review of the Internal Market Strategy – Delivering the promise,” 11.

The Commission, in the period leading up to the actual formulation of a draft Services Directive, began arguing persuasively that the liberalization of services in the EU was essential to complete the internal market and to promote the European social model. The Commission's position transcended the question of simply completing the internal market. It became about responding to globalization, promoting social inclusion and cohesion and providing citizens with the enjoyment of their fundamental rights. This position was welcomed by all EU institutions and received support from a number of European Councils. Most importantly, support was building for a comprehensive community-wide harmonization initiative. This was an integral component of the second stage of the Commission's Strategy. In short, the foundations had been laid for the liberalization of the services sector.

Chapter 3 The Commission's Proposal for a Services Directive

3.1 The Proposal for a Services Directive

In May of 2003, the Commission presented a "Proposal for a Directive of the European Parliament and of the Council on Services in the Internal Market," completing the second stage of the Internal Strategy for Services. The Commission's initial proposal for a Services Directive had two main objectives. First, to lay the foundations for a legal framework and to develop a convergence program with respect to codes of conduct at the community level, without which the legal framework outlined in the previous chapters would certainly be ineffective.

Chapter I of the Directive outlines its scope in terms of what services are covered. All "services supplied by providers established in a Member State" are included except for aspects of the financial, electronic and transport industries, which are covered by other community instruments:

The proposed Directive covers a wide range of different services provided to consumers and to businesses. Examples of the services covered are: business services such as management consultancy, certification and testing, facilities management (including office maintenance and security), advertising, recruitment services, and the services of commercial agents; services provided both to businesses and to consumers including legal or fiscal advice, real estate services such as estate agencies, construction (including the services of architects), distributive trades, the organization of trade fairs, car rental, travel agencies, and security services; and finally consumer services including health care services, household support services, such as help for the elderly, tourism, audio-visual services, leisure services, sports centers and amusement parks.⁸²

Chapter II deals with the freedom of establishment for service providers. Articles (6) and (7) clearly state that Member States must establish 'single points of contact' through which service providers can obtain all the necessary information and

⁸² COM, "Frequently Asked Questions on the Proposed Directive on Services in the Internal Market," Available on the World Wide Web at: http://europa.eu.int/comm/internal_market/services/services-dir/faq/200410-faq-point01_en.htm#12

documentation related to the procedures and formalities that are required to establish a service company in a Member State. Information must be made available electronically to assure that it is accessible from anywhere within the EU. Assistance must also be provided in a timely manner and applications must be assessed without delay, in order to assure that problems associated with applications are dealt with efficiently. Section 2 lists the rules that govern the introduction of authorization schemes and how they are to apply to service providers. Articles (9), (10), (11), (12), and (13) restrict the ability of Member States to require special requirements from service providers not established in their territory.

Chapter III deals with the free movement of Services. Section 1 of Chapter III covers the 'country of origin principle'. The premise of the 'country of origin principle' is that service providers are only subject to the rules and regulations of their Member State of origin.⁸³ In other words, service providers offering a temporary service outside their country of origin are subject to the national provisions of the Member State in which they are established, regardless of where they provide a service. Moreover, the Member State of origin is required to monitor the services offered by service providers originating from its territory. Also, Member States can not require service providers from other Member States to establish themselves in the country in which they wish to provide a service, or ban the setting up of infrastructure required to provide a service.

Chapter IV deals with the issue of quality of services. Article (26) outlines the information that Member States must ensure is made available by providers to the recipients of services. The onus is placed on the country of origin to ensure that service

⁸³ In essence, the 'country of origin principle' is the principle applied to the movement of goods in the EU. *Cassis de Dijon* Judgment of the ECJ, Case 120/78, 20 February 1979, 979.

providers are able to produce any information requested related to the qualifications, history and professional rules in the case of professional occupations. Chapter V covers the rules with respect to the supervision of service providers operating outside their country of origin. Member states have to ensure that they have the necessary capacity to monitor and supervise the activities of service providers established in their territory.

The final Chapter outlines the second major objective of the Services Directive. Member States and the Commission are required to formulate community wide codes of conduct “in conformity with community law.” Member states will in turn be responsible for encouraging “professional bodies, organizations and associations” at the national level to implement Community wide codes of conduct. The idea is that by the time of entry into force of the Services Directive, community wide harmonization instruments would exist in all service sectors of the economy.

In summary, the proposal for a Services Directive put forth by the Commission in 2003 was based on a horizontal approach to the removal of barriers to services. Member States would be required to consult and work with other Member States and review their existing legal regulations to make sure that the provision of services was not being restricted. The proposed Directive was comprehensive and inclusive. This is not really surprising for a number of reasons. First, up until this point all the actors and institutions involved agreed that it was imperative that barriers to services be removed. Second, the evidence suggested that a vertical approach based on a sector by sector analysis of the barriers to service would take too long and in all likelihood be ineffective. Moreover, the evidence suggested that the problems associated with services were common amongst

different economic sectors. Finally, the legal precedent to operate without burdensome mechanisms restricting the freedom of services had been established by the ECJ.⁸⁴

3.2 The Reaction

The response to the Commission's proposal for a Services Directive was immediate, unexpected, and mostly unfavorable. The most moderate response came from a number of influential Committees in the EU's vast Committee structure. The opinion of the Committee of Regions (COR) was published on 18 February 2005. Although the Committee welcomed the services Directive, its enthusiasm was mitigated by what it viewed as a lack of clarity in the Directive, especially with respect to the 'country of origin' principle.⁸⁵ The Committee raised the issue of whether it was practical for countries of origin to be responsible for the supervision of social and health care based services in other Member States. According to the Committee it was not clear what legal jurisdiction countries of origin would have in other Member States. The Committee also questioned how the Services Directive would work in light of the large body of existing Community legislation in the areas covered by the Directive. Moreover, it feared that the scope of the Directive would override all national authorization schemes. The Committee was unsure whether this type of interference in national procedural processes was necessary or desirable. It feared that the Directive might undermine existing legislation and the country of origin principle might allow service providers to circumvent domestic standards for such things as professional qualifications and quality of services. The

⁸⁴ ECJ, "Opinion of AG Jacobs," point 13.

⁸⁵ COM, "Opinion of the Committee of the Regions on the Proposal for a Directive of the European Parliament and of the Council on services in the Internal Market," *Official Journal of the European Communities* C 43, 18 February 2005.

Committee also called for services of general economic interest to be excluded entirely from the scope of the services Directive, not just excluded from the country of origin principle.

The European Economic and Social Committee (ESC) echoed the same concerns as that articulated by the Committee of Regions. It also expressed concern over the lack of clarity and scope of the Services Directive.⁸⁶ With respect to the country of origin principle the Committee argued that the blanket application of the principle needs to be revisited. In particular, the Committee argued that services of general economic interest should be excluded from the country of origin principle to ensure that the principle does not apply to sectors like health, thereby interfering with the ability of Member States to ensure that such services are properly provided for citizens of their country.⁸⁷

Outside the EU, opposition to the Commission's proposal quickly mounted. Think tanks, trade unions, and public service unions responded critically to the proposal. The European Federation of Public Service Unions (EFPSU) issued a resolution opposing the Services Directive. The EFPSU argued that the Directive was unclear and might take priority over collective agreements.⁸⁸ The European Trade Union Federation (ETUC) issued a statement calling for drastic changes to the Services Directive. The ETUC argued that the Directive should not cover areas of general economic interest, nor should it be allowed to interfere with collective agreements, etc. The ETUC was worried that the

⁸⁶ EESC, "Opinion of the European Economic and Social Committee on the Proposal for a Directive of the European Parliament and the Council on Services in the Internal Market," INT/228, 10 February 2005, section 3.3.4.

⁸⁷ *Ibid.*, 3.3.6, 3.5.3.

⁸⁸ EPSU, "EPSU Congress Resolution on the Directive on Services in the Internal Market," Adopted by Congress on 15 June 2004. Available on the World Wide Web at: <http://www.epsu.org/a/634>.

Directive would strip away social protection.⁸⁹ Similarly, the European Mine, Chemical and Energy Workers' Federation (EMCEF) rejected the proposed Directive on the basis that the removal of national regulations with respect to the services sector would produce an unstable and unfair labor market.⁹⁰

Also, left leaning think tanks began producing reports that challenged the conclusions reached by proponents of the Directive. Professor Niklas Bruun, working on behalf of the National Institute of Working Life in Stockholm and the Hanken School of Economics in Helsinki wrote a detailed and damning report on the likely repercussions of the proposed Directive. Professor Bruun highlighted the fact that the 'country of origin principle' alters the objectives of the *acquis communautaire* in terms of labor law. Specifically, he pointed out that the "Rome Convention on the law applicable to contractual obligations," states that the employment relationship is governed by the host Member State if a worker temporarily carries out work of a habitual nature.⁹¹ In other words, if a worker is working habitually for a temporary period the employment relationship must be governed by the law of the host Member State. The 'country of origin principle' states the opposite, stipulating that the employment rules of the 'country of origin' apply. Likewise, Professor Bruun argued that the 'country of origin principle' would likely come into conflict with EU insolvency law, health and safety regulations and "EU recognition of collective agreements."⁹²

⁸⁹ ETUC, "ETUC calls for Further Crucial Changes to the Draft Services Directive to Protect Workers and Consumers in Both the Old and New Member States," 6 December, 2005.

⁹⁰ EMCEF, "Motion on the Rejection of the Bolkestein Directive at the EMCEF Congress", 8-10 June 2004. Available on the World Wide Web at: <http://www.emcef.org/news/bolestein-en.pdf>.

⁹¹ Niklas Bruun, "Employment Issues: Memorandum," Prepared for the European Parliament Public Hearing on the Proposal for a Directive on Services in the Internal Market, Brussels 11 November 2004, 5.

⁹² *Ibid.*

However, the Directive did receive support from a few stakeholders, such as EU business associations. The Union of Industrial and Employers' Confederations of Europe (UNICE) issued a statement applauding the efforts of Commission. The UNICE position is clear; it welcomes any initiative designed to "allow rapid removal of obstacles to the exercise of fundamental freedoms guaranteed by the Treaty."⁹³ The Directive also received approval from the economic consulting firm hired by the Commission to provide an objective view of the economic repercussions of reducing barriers to services in the EU. The report produced by Copenhagen Economics argued that the proposed Directive would substantially increase the number of jobs in the EU, intensify competition, and add €30 billion in value to the services sector.⁹⁴

The Directive was also given support by the OECD. In October of 2005, the economics department of the OECD issued a report titled *The EU's Single Market: At Your Service?*, which echoed the findings of the Copenhagen study. The OECD argued that the services Directive would go a long way "towards establishing a single market for services if it is implemented as proposed."⁹⁵ Also, it would allow EU citizens to gain from 'large welfare effects associated with the convergence of prices towards the best performers and faster trend towards economic growth.'⁹⁶ Interestingly, the paper included a warning against allowing the scope of the Services Directive to be watered down. The OECD argued that any attempt to water down the Services Directive through legislative amendments would only delay the achievement of a single market for

⁹³ UNICE, "UNICE Comments on the European Commission's Proposal for a Directive on Services in the Internal Market," BSB/Tdl, 9 August 2004.

⁹⁴ Copenhagen Economics, "Economic Assessment of the Barriers to the Internal Market for Services," Final Report, January 2005, 7-9.

⁹⁵ Vogt, 2.

⁹⁶ *Ibid.*

services.⁹⁷ Of course, it is not surprising that business groups and economic think tanks supported the Commission's proposal. The Commission's proposal is based on the logic of the 'invisible hand' and liberal economic theory, which is generally the view held by the business community, developmental organizations and liberal economic think tanks. Basically, the response by these actors was to reiterate what the Commission and Council had agreed was the appropriate course of action in the years leading up to the Commission's proposal.

However, it should be made clear that the response was overwhelmingly negative and was, by every account, intense and unexpected.⁹⁸ It was at this point that a number of Member States, specifically politicians in Member States, realized that the consequence of moving forward in the direction put forth by the Commission was not a politically viable option domestically.⁹⁹

As a response, EU Internal Market chief Charlie McGreevy had little choice but openly confirm that the Commission would revisit the controversial Directive. Specifically, McGreevy stated "it is crystal clear to me that there are real problems with the services Directive....as drafted it is not going to fly."¹⁰⁰ He also stated that he "wanted to address the country of origin concerns in as balanced way as possible."¹⁰¹

The initial proposal for a Services Directive by the Commission was not received warmly by many stakeholders. Those who opposed the Directive in its original form vocalized their opposition more effectively than those who were in favor of it. This

⁹⁷ *Ibid.*, 25.

⁹⁸ EU Parliament, "Public Hearing on the Proposal for a Services Directive on Services in the Internal Market," Committee on the Internal Market Consumer Protection, Brussels, 11 November 2004. This assertion was also made by the three EU officials interviewed for this thesis.

⁹⁹ This is discussed in detail in the final chapter of thesis.

¹⁰⁰ EU Parliament, "Public Hearing on the Proposal for a Services Directive on Services in the Internal Market".

¹⁰¹ *Ibid.*

reaction was unexpected and Member States, in which opposition was most acute including France and Germany, used their influence at Council meetings to make it known that the Directive was unacceptable in the form put forth by the Commission.

Chapter 4 The Legislative Process

4.1 The Debate at Parliament and Amended Proposal

The Co-decision procedure is a complex procedure that requires agreement between the EP and Council. After the Commission issues a proposal, the proposal is debated in Parliament and Council. Ultimately, Council and Parliament must both agree on a proposal, if not the proposal will be considered not adopted (see appendix 1.). Under the Co-decision procedure, the Commission's initial proposal for a Services Directive was sent to Parliament where the Internal Market and Consumer Protection Committee (IMCPC) was designated as the lead committee in charge of reviewing the Directive.¹⁰² Meanwhile, nine other Committees were asked to review the Directive. All ten committees called for substantial changes to the Services Directive.¹⁰³

Because the European Parliament is arguably the EU institution most responsive to public pressure since Maastricht, it was in Parliament that opponents of the Directive primarily focused their efforts. Protests were organized by groups opposing the Directive and experts representing their position began lobbying Parliament.¹⁰⁴ By the time Parliament held a public hearing on the matter in November of 2004, opponents of the Services Directive were lined up at the door. Although the public hearings involved stakeholders and experts from both sides, it was becoming clear that the Commission's proposal needed clarification, which was of great concern for those worried about issues such as social dumping and work exploitation. The public hearings held by Parliament

¹⁰² Parliament was given co-decision powers over the internal market by the Treaty of Maastricht. See Appendix 1. Co-Decision Procedure Flow Chart .

¹⁰³ European Parliament, "Report on the Proposal for a Directive of the European Parliament and the Council on Services in the Internal Market," Committee on the Internal market and Consumer Protection, A6-04092005 final, 15 December 2005.

¹⁰⁴ Some of the protests involved 20,000 people. These rallies were primarily organized by social groups and unions from across the EU.

provided a platform for those opposed to the Directive to appeal to citizens across Europe.

The debate over the Services Directive lasted almost three years in Parliament. The process finally reached a conclusion on 16 February 2006. However, in the week prior to the plenary vote scheduled for 16 February each of the four major political groups in Parliament maneuvered to get the amendments they wanted, despite agreements reached during the Committee stage. A workable compromise was not reached until 8 February 2006, between the two largest political groups in Parliament, the group of the European People's Party (Christian Democrats) and European Democrats (EPP-ED-conservative), and the socialist group in the European Parliament (PSE-socialist). Despite threats from backbenchers to vote the Services Directive down, they managed to muster enough votes to pass the legislation.¹⁰⁵ A dramatically modified Services Directive received 394 votes, out of a possible 732 on 16 February 2006.

In total, Parliament made 33 amendments to the Services Directive. Most importantly, the scope of the Directive was drastically diminished. Services of general economic interest “reserved to public or private entities,” were removed from the scope of the Directive, nor would the Directive “affect the freedom of Member States to define, in conformity with Community law, what they consider to be services of general economic interest, how these services should be organized and financed and what specific obligations they should be subject to.”¹⁰⁶ Healthcare services and “services

¹⁰⁵ EurActiv, “Conservative and Socialists Vote the Services Directive Through,” Published 24 February, 2006. Available on the World Wide Web at: <http://euroactiv.com/Artciel?tcmuri=tcm:29-152679-16&type=News>

¹⁰⁶ European Parliament, “Position of the European Parliament: Adopted at first reading on 16th February 2006 with a View to the Adoption of Directive 2006/.../EC of the European Parliament and Council on Services in the Internal Market,” EP-PE_TC1-COD(2004)0001, 16 February 2006, Article (1).

pursuing social welfare objectives” were totally removed from the scope of the Directive as were postal services, broadcasting, audiovisual services, temporary employment agencies and public transport.¹⁰⁷

Not surprisingly, the main source of controversy contained in the first Commission’s Services Directive, the ‘country of origin principle’, was removed by Parliament and replaced with the ‘freedom to provide services’ principle. The former states that countries of origin are responsible for monitoring the activities of service providers established in their territory, regardless if they are operating outside their territory. The new principle requires Member States to expand the scope of national law to include the operation of service providers outside their territory but does not require them to carry out “factual checks or monitoring in the Member state where the service is provided.”¹⁰⁸ Parliament’s version of the Services Directive did not change whose rules would apply in the case of temporary service activities. Parliament did not remove the principle that service providers offering a service outside their state of primary establishment would be governed by their country of origin. The difference between the two principles lies in the fact that countries of origin are not required to monitor and enforce compliance, unless the Member State in which a service is being provided requests that action be taken the Member State of primary establishment. Member States in which services are being provided are responsible for “the checks, inspections and investigations requested by another Member State and shall inform the latter of the results and, as the case may be, of the measures taken.”¹⁰⁹ Of course, this requires excellent coordination between Member States and the Commission to make sure each

¹⁰⁷ *Ibid.*, Article 1, 2.

¹⁰⁸ *Ibid.*, Article 16.

¹⁰⁹ *Ibid.*, Article 18.

Member State understands and has easy and timely access to different Member State rules and regulations. In effect, it creates the need for a whole new level of bureaucratic coordination between Member States and the Commission, which are required by the Directive to play a substantial role in coordinating the processes of enforcement, making sure information is easily accessible through single points of contact and in alerting Member States if a service provider established in their country has violated their rules in another Member State.

In short, the scope of the Directive was dramatically reduced and the country of origin principle was replaced with a new principle that arguably creates a more complex regulatory system that requires enhanced coordination. More importantly, under Parliament's proposal, Member States would retain significant power and capacity to influence the nature and direction of national economies. The Directive does not require States to liberalize sectors they designate as 'services of general interest' or as 'services of general economic interest', nor does it require states to dismantle monopolies that operate in sectors designated as either of general interest or general economic interest; meaning that the Directive does not challenge the operation of welfare systems, work conditions agreed upon through collective agreements, or challenge the operation of some of the most important economic sectors, including transport, banking and credit.¹¹⁰

In contrast to the Commissions proposal, Parliament's amended Services Directive received a warm response. Internal Market Chief Charles McGreevy greeted the vote with the following statement:

I am convinced that we can have a workable Services Directive which will provide real value added. In all of this, the challenge is to get the balance right. We need a directive that will facilitate the cross-border provision of

¹¹⁰ *Ibid.*, Article 2 (b).

services and at the same time, we need to ensure that public policy considerations can be safeguarded.....On the Commission side we will begin work on preparing a modified proposal based on the vote in the European Parliament. I look now to the council of Ministers to complete the work which has been done by Parliament.¹¹¹

On behalf of the Council Presidency, the Austrian Federal Minister for Economics and Labor welcomed the vote citing the need for reduced barriers to services while protecting the European Social Model: "We can support the basic principles of removing unfair barriers. Parliament's vote will be the major basis for review of the proposal which the Commission needs to carry out."¹¹² European Commission president Jose Manuel Barroso also welcomed the vote. He emphasized the importance of finally realizing one of the fundamental freedoms enshrined in the EC Treaty and stated that Parliament's revised proposal would be respected by the Commission.¹¹³

After years of heated debate, the compromise reached by Parliament was accepted as the best possible solution given the political sensitivity surrounding service liberalization.¹¹⁴ Even those in favor of a more aggressive approach, including the British, accepted the fact that in order for a directive to be agreed upon, it would have to be relatively consistent with the compromise reached in parliament. The alternative would be no service Directive at all, and for Member States like the United Kingdom

¹¹¹ Charlie McCreevy, "Commissioner Charlie McCreevy's Statement on the Vote in the European Parliament in the Services Directive," European Parliament Plenary Session, SPEECH/06/95, Strasbourg, 16 February 2006.

¹¹² European Parliament, "Strasbourg Plenary 13-16 February 2006 - Debates and Votes," Available on the World Wide Web at http://www.europarl.europa.eu/news/expert/background_page/008-5223-47-2-7-901-20060209BKG05095-16-02-2006-2006--false/default_p001c001_en.htm.

¹¹³ *Ibid.*

¹¹⁴ See Charlie McCreevy, "Commissioner Charlie McCreevy's Statement on the Revised Proposal for the Services Directive."

with a service based economy, this would be the worst possible scenario.¹¹⁵ The Commission wanted a Directive that at least could become the foundation of a system of governance for services, without which there would no legislation guiding the operation of services in the EU.¹¹⁶ There would only be the Treaty articles that have been interpreted differently by different actors.¹¹⁷ No agreement would have meant that no foundation was laid for the future operation of the service economy.¹¹⁸

4.2 Commission's Modified Proposal

The compromise reached in Parliament set the parameters that structured future discussion on the Services Directive within the Commission and Council. With Parliament's revisions in hand, the Commission quickly set out to revise its original proposal. It took the Commission less than two months to issue an amended proposal for the Services Directive. The amended proposal basically followed the approach set out by Parliament. There were some minor differences but all the major and controversial Articles included in the Commissions first proposal were dropped in favor of the changes made by Parliament. Specifically, the country of origin principle was replaced by the freedom to provide services principle and a majority of the derogations introduced by Parliament were incorporated into the Commission's new proposal.¹¹⁹

¹¹⁵ Interviews with Mauro Miranda, Interview by Author, Commission European Union: Internal market and Services, 23 June, 2006. Charis Xirouchakis, Interview by Author, Council of the European Union: General Secretariat, June 28, 2006. Confidential Source, Interview by Author, Brussels, June 26, 2006.

¹¹⁶ Confidential Source, Interview by Author, Brussels, June 26, 2006.

¹¹⁷ This is discussed in Chapter 1.

¹¹⁸ Interviews with Mauro Miranda, Interview by Author, Commission European Union: Internal market and Services, 23 June, 2006. Charis Xirouchakis, Interview by Author, Council of the European Union: General Secretariat, June 28, 2006. Confidential Source, Interview by Author, Brussels, June 26, 2006

¹¹⁹ See Charlie McCreevy, "Statement on the Revised Proposal for the Services Directive. And COM, "Amended Proposal for a Directive of the European Parliament and of the Council on Services in the Internal Market," 160 final, Brussels, 4 April 2006.

When the Commission's amended proposal was presented to Parliament for Debate, Evelyn Gedhardt, Parliament's rapporteur on the Services Directive stated the following:

The Commission has bit the bullet on the Services Directive...I am delighted that the Commission has kept its word and has followed the vast majority in the Plenary. I know that it took hours of work by the heads of Cabinet even yesterday, but now the most important law besides the European Constitution is well on its way. We can go along on this way – or should one rather say the Commission goes along with Parliament.¹²⁰

The president of the Social Platform (ESP), Anne-Sophie Parent, stated that “the Commission has been wise to follow the European Parliament's line, cutting social services out of the services directive. The Social Platform welcomes the new proposal, which provides for a broad exclusion of social services. This is crucial to ensure that social services and society at large do not lose out from a directive not suited to the nature of the sector.”¹²¹ The EPP-ED Group in the European Parliament also welcomed the Commission's proposal, specifically welcoming the freedom to ‘provide services principle’.¹²²

4.3 Political Agreement: Council's Common Position

The next step in the co-decision process was to achieve a common position in the Council. The issue was first addressed by the Brussels European Council in March of

¹²⁰ European Parliament, “Debate on the Commission's Second Proposal on the Services Directive,” 4 April 2006. Available on the World Wide Web at: www.euractiv.com/29/images/Services_Debate_060404_tcm29-153990.pdf

¹²¹ *Ibid.* “The Platform of European Social NGOs is the alliance of representative European federations and networks of non-governmental organizations active in the social sector. The Social Platform promotes social justice and participatory democracy by voicing the concerns of its member organizations.” Available on the World Wide Web at: <http://www.socialplatform.org/code/en/hp.asp>

¹²² Malcolm Harbour, “Services Directive – Commission Must Now Promote Service Market Plans,” EPP-ED Group in the European Parliament, 4 April 2006. Available on the World Wide web at: <http://epp-ed.eu>.

2006 at which time the heads of state from the 25 EU Members expressed their support for the vote of Parliament and the Commission's decision to follow the changes made by Parliament.¹²³ The first steps were made towards a common position at an informal meeting of EU Competition Ministers held in April, 2006 shortly after the Commission issued its modified proposal. The Commission's proposal, based on the compromises reached in Parliament received broad support from Member States.¹²⁴ Interestingly, for the first time, MEP participated in the Council discussions to make sure that Council understood the fragile nature of the compromise reached in Parliament.¹²⁵

In May at the Competitiveness Council Meetings, a political agreement was reached: "The Council's agreement [was] based on a compromise text, put forward by the Austrian presidency which in substance [was] closely in line with the first reading of the European Parliament and the Commission's amended proposal based on that opinion."¹²⁶ It was agreed that Articles (16) and (17) would not be altered because these articles were the result of intense political debate and represent a delicate political compromise. Articles (16) and (17) cover the freedom to provide services and the derogations from this principle

Two major additions were added by Council to the Commission's proposal. First, a review clause was added that requires the Commission to review the "application of the Directive," five years after the adoption of the Directive and subsequently every three years. Furthermore, the Commission has the responsibility of bringing forth any measures

¹²³ Council of The European Union, "Presidency Conclusions," 7775/1/06 REV 1, Brussels, 18 May 2006.

¹²⁴ Austrian Presidency EU, "Bartenstein: The Package For The Services Directive Will Not Be Unwrapped Again Now," 22 April 2006. Available on the World Wide Web at: [Http://www.eu2006.at/en/News/Press_Releases/April/2204bartenstein.html](http://www.eu2006.at/en/News/Press_Releases/April/2204bartenstein.html).

¹²⁵ *Ibid.*

¹²⁶ Council of The European Union, "Press Release 2731, Council Meeting: Competitiveness," Internal Market, Industry and Research, 9334/06, Brussels, 29-30 May 2006, 10.

“for matters excluded from the scope of application.”¹²⁷ In other words, the Commission can introduce legislation that it feels is required in area outside the scope of the Directive. However, any new directive related to services issued by the Commission would have to go through the co-decision procedure. Therefore, this legal phrase serves only to solidify the Commission’s role in shaping the future of services policy in the EU, a role that is guaranteed by the Treaty. Second, a screening process was added which requires Member States to examine the compatibility of national legislation with respect to laws which may restrict the flow of services across borders.¹²⁸ The reason these amendments were added is because unlike Parliament, the Council and the Commission have to worry about implementation. There was a lot of discussion and concern about implementation in Council and these articles were added to meet these concerns.¹²⁹ The Council also decided to clarify the point that the Directive does not cover “labor law or social security legislation.”¹³⁰

The discussions in Council over the Commission’s modified proposal were shaped by the compromise reached by Parliament, as were those in the Commission. The Common Position which will be debated again in Parliament ahead of a 2nd reading is very similar to the proposal that left Parliament in February. In all likelihood the Common Position will get enough votes in Parliament because the compromise reached at Parliament in February was not changed by the Commission or Council. In fact, the Council brought the Services Directive in line with what Parliament had agreed upon.

¹²⁷ Council of the European Union, “Common Position adopted by the Council with a view to the adoption of a Directive of the European Parliament and of the Council on Services in the Internal Market,” 10003/06, Brussels, 17 July 2006, Article 41.

¹²⁸ *Ibid.*, Article 39.5.

¹²⁹ Confidential Source, Interview by Author, Brussels, June 26 2006.

¹³⁰ Council of the European Union, “Services in the Internal Market: Council Adopts its Common Position,” 11688/06 (Press 222), Brussels, 24 July 2006.

The Council clarified some of the more controversial articles to make sure that Parliament's position was in fact respected.¹³¹

In Parliament, the Common Position was applauded as a breakthrough. Evelyne Gedhardt, Parliament's rapporteur on the Services Directive stated that she was "very pleased" with the Directive.¹³² Malcolm Harbour, speaking for the EPP-ED, stated that the Common Position "keeps intact all the core political points that we agreed in Parliament."¹³³ Parliament will vote on the Common Position later this fall (2006) and unless Parliament agrees on any new major amendments that would require the Directive to go back to Council, the Directive will become part of the *acquis communautaire*.

¹³¹ *Ibid.*

¹³² EU Parliament, "MEP Applaud Breakthrough Agreement on Services," 29 May 2006. Available on the World Wide Web at: http://www.europarl.europa.eu/news/expert/infopress_page/049-8533-149-05-22-909-20060530IPR08532-29-05-2006-2006-false/default_fi.htm.

¹³³ *Ibid.*

Chapter 5 Explaining Policy Output in the EU

5.1 The Advocacy Coalition Framework

The Advocacy Coalition Framework developed by Paul Sabatier “views policy change over time as a function of three sets of factors.”¹³⁴ First, policy change results from the interaction between competing advocacy coalitions operating in a policy subsystem. When applied to the EU we find numerous policy subsystems that have developed around EU policy fields, especially in the internal market.¹³⁵ Policy subsystems can be analyzed by distinguishing advocacy coalitions within the subsystem that consist “of actors from many public and private organizations at all levels of government who share a set of basic beliefs...who seek to manipulate the rules of various governmental institutions to achieve those goals over time.”¹³⁶ Advocacy coalitions use *guidance instruments* to turn their beliefs into policy, “such as rules, budgets, personnel or information.”¹³⁷ The interaction between competing advocacy coalitions produces conflict which “is mediated by policy brokers...i.e. actors more concerned with system stability than with achieving policy itself.”¹³⁸ In the case of the EU policy brokers are Member States which through Council ultimately decide the policy direction of the EU. The essence of the “Common Position” is political and it is a policy compromise. Member States must broker their own conflicting policy objectives and those of EU

¹³⁴ Paul Sabatier, “Toward Better Theories of the Policy Process,” *Political Science and Politics* 24, (1991): 147-156, 152. Paul Sabatier, “An Advocacy Coalition Framework of Policy Change and the Role of Policy-oriented Learning Therein,” *Policy Sciences* 21, (1988): 129-168. Paul Sabatier, “The Advocacy Coalition Framework: Revisions and Relevance for Europe,” *Journal of European Public Policy* 5(1), (1998):98-130.

¹³⁵ For example, policy subsystems exist for telecommunications, banking, etc.

¹³⁶ Paul Sabatier, “Toward Better Theories of the Policy Process,” 152-153.

¹³⁷ Paul Sabatier, “An Advocacy Coalition Framework of Policy Change and the Role of Policy-oriented Learning Therein,” 104.

¹³⁸ Paul Sabatier, “Toward Better Theories of the Policy Process,” 152.

institutions and stakeholders. Second, policy change is affected by factors external to the subsystem, such as “socioeconomic conditions, system-wide governing coalitions, and decisions from other policy subsystems.”¹³⁹ In the case of services in the EU this is particularly relevant because changes in the global economy created the pressure to liberalize the service sector in the EU. Third, policy change results from the effects of stable system parameters, “such as basic social structure and constitutional rules—on the constraints and resources of various actors.”¹⁴⁰ In other words, coalitions use institutional avenues available to them to affect policy outcomes.

Sabatier’s ACF rests on the premise that policy change occurs over time. Also, it views policy change as a complicated process that involves processes and coalitions both inside and outside government. The ACF assumes that within policy subsystems, coalitions form around belief systems “such as the proper scope of governmental vs. market activity and the proper distribution of authority among levels of government.”¹⁴¹

The ACF is a useful theoretical framework for explaining policy change in the EU because it captures the complex policy process that exists in the EU. As opposed to explanations of policy change that rely on structural economic reasoning i.e. ‘the constrained-state theory’, the ACF approach accounts for systemic macroeconomic pressures but recognizes that different policy positions form within states and in supranational economic institutions in response to these pressures. It is the political process in which competing policy coalitions operate in that ultimately determines policy, not systemic macroeconomic pressure.

¹³⁹ *Ibid.*, 153.

¹⁴⁰ *Ibid.*

¹⁴¹ Paul Sabatier, “An Advocacy Coalition Framework of Policy Change and the Role of Policy-oriented Learning Therein,” 132.

5.2 The Services Policy Subsystem (Table 1.)

The Services Policy Subsystem consists of what could be called the Single-Market Coalition and the Socio-cultural Coalition. These coalitions of 'likeminded' individuals and groups took advantage of the institutional avenues available to them to try and turn their beliefs about services into policy in the EU (see Table 1.). The Commission was able through its power to shape and initiate policy to introduce a comprehensive proposal for a Services Directive that reflected the policy beliefs of the Single Market Coalition. The Socio-cultural Coalition was able to influence the direction of services policy, and ultimately turn its core beliefs into policy, by taking advantage of the institution in the EU most responsive to public sentiment, Parliament. The Single Market Coalition focused its efforts on Parliament which responded by adopting a radically different Services Directive than that proposed by the Commission. Member States, acting as brokers, had little choice but accept the position adopted by Parliament because the position adopted by the Socio-cultural Coalition was politically viable in domestic political arenas.

Table 1. The Service Policy Subsystem

<i>Single Market Coalition</i>	<i>Socio-cultural Coalition</i>
Belief System	Belief System
<i>Deep Core Beliefs:</i> The promotion and protection of the four fundamental freedoms. Liberalization is understood in terms of negative integration, meaning that liberalization involves the removal of barriers to the movement and establishment of services in the internal market.	<i>Deep Core Beliefs:</i> The promotion and protection of national economic traditions and practices. Liberalization is understood in terms of positive integration that strikes a balance between economic integration and the protection of national economic traditions that are culturally rooted.
<i>Policy Core Beliefs:</i> The core assumption is that the liberalization of services is guaranteed by the Treaty and, therefore, service providers should not be subject to different rules and regulatory regimes in different countries. The same principle that applies to goods should apply to services, or Community-wide codes of conduct and regulations need to be developed. In any case legal certainty is needed to create a foundation to further service liberalization.	<i>Policy Core Beliefs:</i> Service Liberalization is guaranteed by the Treaty, but that does not mean that service providers should be free to operate without abiding by national regulations and rules in the Member State they are providing a service. Regulatory regimes protect national economic traditions and practices. To allow service providers to operate outside national rules is not liberalization it is unfair competition.
<i>Secondary Aspects:</i> Understand that service liberalization will likely be slow given the political and economic difficulties associated with liberalizing services.	<i>Secondary Aspects:</i> Understand that service liberalization is needed but are unwilling to accept liberalization as understood by the single market coalition. Prefer a slow gradual process of liberalization that respects national realities.
<i>Actors:</i> The Commission and the ECJ are primary actors. Liberal economic think tanks, and business oriented organizations and associations (Copenhagen Economics, OECD, UNICE).	<i>Actors:</i> EU Committees (ESC, COR), left leaning think tanks and social organizations (ETUC, ESP).
<i>Institutional Avenues:</i> The Commission plays a substantial role in shaping and initiating EU policy. The ECJ interprets the Treaty and works with the Commission to guard the EU's legal framework.	<i>Institutional Avenues:</i> Parliament, Member States, EU Officials.

5.2.1 Single Market Coalition

The Single-Market Coalition led by the Commission, put the issue of service liberalization on the policy agenda in the EU in response to changing global economic realities. The Commission's proposal for a Services Directive reflected the core belief of the Single-Market coalition; that the EC Treaty guarantees the free movement and

establishment of service providers throughout the EU, therefore every Member State has a legal obligation to allow service providers from outside their territory operate in their country without burdensome regulatory requirements. The Commission's initial proposal was comprehensive and included the controversial 'country of origin principle'. The Commission used its power within the EU institutional structure to both place services on the policy agenda, and to introduce a draft Services Directive that reflected its membership in the Single Market Coalition. The problem was that the Commission did not anticipate that it would only receive support from a small number of Member States. The Single Market Coalition only received unanimous support from the United Kingdom and partial support from new Member States.

The explanation for why the UK supported the Single Market Coalition can be found in the nature of the services sector of the British economy. Considering that the UK economy is a service based economy that would stand to benefit dramatically from easier access to the EU market in services, it is not surprising it supported the Single Market Coalition. The UK's economy is already open to service providers established in other Member States. The UK is the only Member State in the EU with low barriers to entry in the large service sectors of the economy. The UK ranks near the bottom in terms of barriers to entry in the following service sectors in the Internal Market: banking, accounting, legal services, telecommunications, architecture, distribution, engineering, and maritime services.¹⁴² In the context of the EU, the UK has fought attempt to regulate the working of the UK's economy. Most notably, the UK intensely fought the infamous Working Time Directive which tried to apply uniform working time rules across the

¹⁴² Copenhagen Economics, 77.

EU.¹⁴³ Since the days of Thatcher, the UK has moved closer and closer towards the neoliberal model. This is why the UK often challenges Directives from Brussels that try to interfere with the British economy and why they support directives, such as the Services Directive, which are based on the logic of neoliberal economics.

This means that a complete liberalization of the services sector in the EU was a politically viable option in the UK because, to a large extent, it already existed between the UK and other Member States. It comes as no surprise that the United Kingdom has continuously expressed support for the liberalization of services in the EU. It supported the first draft of the Services Directive and continued to express support for the liberalization of services throughout the period of political turmoil which erupted after the Commission issued the first proposal for a Services Directive.

The UK listed services as one of its priorities when it took over the EU Presidency on July 1, 2005: “Free movement of services was foreseen in the original Treaty of Rome. Realizing this is a crucial next step for the Single Market, vital for growth and jobs, the UK Presidency will take forward discussion with a view to resolving the political and social concerns about the Directive.”¹⁴⁴ The UK Presidency did not avoid the issue even though it was controversial. Instead, it used the Presidency to push the issue forward and facilitate avenues of dialogue and discussion.

However, like all Member States the UK did not anticipate the strong negative reaction to the Commission’s initial proposal for a Services Directive that emerged across Europe. In response the UK adopted a pragmatic approach, recognizing that the Directive

¹⁴³ Jeff Loder, “Globalization and the State: A Case Study of Policy Convergence,” Honors Dissertation (B.A.), Memorial University of Newfoundland, 2005.

¹⁴⁴ UK Presidency of The EU. Available on the World Wide Web: <http://www.eu2005.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1079979819948&a=KArticle&aid=1119516697365#>.

was not politically viable in the context of the EU in the form presented by the Commission. The compromise reached by Parliament was accepted by the UK as the best possible political compromise. In other words, it was better to have a Services Directive in the form agreed upon by Parliament than no Services Directive at all. There are two reasons for this. First, the UK believes that any agreement considering the controversy surrounding the issue, will act as a symbol that progress can be made in this area. Second, the current text will deliver substantial benefits for the UK services sector. There was evidence to suggest that the ‘country of origin principle’ only accounted for a small portion of the potential benefits the UK would receive if services sector was liberalized. Therefore, the removal of this principle did not really affect the UK’s reasoning for supporting a directive for services in the first place.¹⁴⁵

In response to what can only be termed a defeat, the Single Market Coalition (led by the Commission) has taken the view that what is important is the symbolic statement made by Services Directive; that progress can be made, which will hopefully lead to a truly liberal internal market for services in the future.¹⁴⁶ However, this is a very optimistic view considering that it has taken almost fifty years to get Member States to agree with the principle agreed upon by the original six members of the EU in 1957.

5.2.2 Socio-cultural Coalition

The core belief of the Socio-cultural Coalition is that service liberalization must respect national economic traditions and practices. The Socio-cultural Coalition argued that by allowing service providers to operate without being subject to the same regulatory

¹⁴⁵ Confidential Source, Interview by Author, Brussels, June 26 2006.

¹⁴⁶ Mauro Miranda, Interview by Author, Commission European Union: Internal market and Services, 23 June 2006.

procedures to which established service providers are subject, they are given an unfair advantage in the market place. The Socio-cultural Coalition is not opposed to liberalization as they understand it. Service providers should be free to move throughout the internal market. However, any EU regulatory regime for services must respect and protect national economic practices and traditions. The Socio-cultural Coalition received considerably more support than the Single Market Coalition from Member States after the Commission released its initial proposal for a Services Directive. France, Germany and Belgium, amongst others, began supporting the Socio-cultural Coalition once they realized the Commission's proposal was not politically viable in domestic political arenas. At this point, they accepted the view that when national economies are opened up to outside service providers, unfair competition is created; the logic is that it takes a lot of time and money to start a business in any country, especially highly regulated economies like Germany. Why should any service provider be excluded from having to go through the steps required to operate a business when this requires money and time. Moreover, Member States will lose the ability to make sure that services are provided at an appropriate standard. Of course, the key question is whether France and Germany understood what the Commission was up to, or did understand but wanted to see what type of reaction would occur in response to the Commission's proposal. According to Charis Xirouchakis, Director of Communications for the Council Secretariat, only the Commission understood the economic logic and consequences of liberalizing services in the EU prior to the release of its initial proposal for a Services Directive.¹⁴⁷ However, it is equally plausible that a majority of Member States did indeed want to support the single

¹⁴⁷ Charis Xirouchakis, Interview by Author, Commission European Union: Internal market and Services, 28 June 2006.

market coalition, however they had to be sure that domestically, it was a politically viable option. When they realized it was not, their support swung over to the socio-cultural coalition which ultimately was victorious.

France was the first and arguably most important Member State along with Germany to oppose the Commission's original proposal for a Services Directive. In France, the issue of the Services Directive became entangled with the debate over the EU Constitution. The Services Directive had become fuel for the 'no side' in the constitutional referendum debate in France. After protests in Brussels support for the 'no side' in France increased.¹⁴⁸ The 'no side' argued that the Services Directive would destroy the European social model. Indeed, French resistance to the Services Directive was growing rapidly, even from within the French Government.¹⁴⁹ The pressure forced President Chirac to call for a complete review of the Services Directive. Officially, the reason was that there was a possibility that the Services Directive could facilitate social, fiscal and regulatory dumping.¹⁵⁰ Unofficially, it was clear Chirac was willing to sacrifice the Services Directive if it meant victory in the referendum scheduled for the summer of 2005. During the Spring Council in March 2005, France gained the support of Germany, Belgium and Sweden in its effort to have the Services Directive revisited. Swedish Prime Minister Goeran Persson stated that "there is agreement to have a far reaching revision of the proposal which is in line with the social European model."¹⁵¹ Consequently, as the

¹⁴⁸ EXPATICA, "French 'non' Drives EU to Revise Services Plan," Published March 22 2005. Available on the World Wide Web At: www.expatica.com/source/site

¹⁴⁹ EIROOnline, "French Social Partners Respond to EU draft services Directive," Available on the World Wide Web at: <http://www.eiro.eurofound.eu.int/2005/03/feature/fr0503105f.html>

¹⁵⁰ EurActiv, "France Wants Full Review of Services Directive," Published 3 February 2005. Available on the World Wide Web at: <http://www.euractiv.com/Article?tcaturi=tcu:29-134994-16&type=news>

¹⁵¹ Henrietta Billings, "Brussels Confirms EU Services Directive Shake-up," EUPolitix.Com, Published 3 March 2005. Available on the World Wide Web at: <http://www.eupolitix.com/EN/News/200503/f0acb30e-983d-42f5-42f5-8b95-42860c02f646>

referendum approached, Chirac attacked liberals across Europe claiming he had squashed the Services Directive.¹⁵² On March 2, 2005, French Prime Minister Jean-Pierre Raffarin stated that the Directive was “unacceptable” and added that the French Government would “take every measure to oppose [it].”¹⁵³

Similarly in Germany, it was perceived that the Commission’s proposal would threaten the German tradition of high standards of quality because the state would lose the power to regulate the delivery of services.¹⁵⁴ Germany has a strong attachment to its system of professional qualifications which is buttressed by powerful trade unions. The media which focused on the controversial country of origin principle fed growing fears that the country of origin principle would destroy Germany’s tradition of high quality of standards.

The core beliefs of the Socio-cultural Coalition were transposed into EU policy. The Socio-cultural Coalition was able to gain the support of more brokers than the Single Market Coalition because it was able to demonstrate in Parliament that a majority of EU citizens supported their position. Consequently, it became obvious to a majority of Member States that they could not support the policy position of the Single Market Coalition because it was not a politically viable option domestically.

¹⁵² Guardian Unlimited, “Chirac Takes Aim at EU Liberals in Race to Win Yes Vote,” Published 24 March 2005. Available on the World Wide Web at: politics.guardian.co.uk/eu/story/0,9061,1444589,00.html

¹⁵³ Henrietta Billings.

¹⁵⁴ Mauro Miranda, Interview by Author, Commission European Union: Internal market and Services, 23 June 2006

Conclusion

The evidence presented in this thesis contradicts the claim that globalization reduces the “importance of institutions and place.”¹⁵⁵ The Service Directive will not encourage convergence around a single neoliberal economic model in the EU. In fact, the Services Directive will have little effect on the overall direction and nature of national economies. Member States have retained the power to regulate the service industry on their territory. The effect of reducing the scope of the Services Directive and leaving regulatory power with Member States is that national economic traditions and differences will not be drastically affected. For sure, service providers in the EU will in all likelihood extend their scope of operation to other Member States. However, they will largely be playing by the rules of the Member State in which they are providing a service.

Despite what seemed like an unstoppable movement towards liberalization ten years ago, little progress has been made towards achieving a truly open market in services in the EU. The Services Directive which will likely receive enough votes in Parliament the fall of 2006, only provides legal certainty that service providers can operate outside their country of origin. It will not dramatically change the ability of Member States to control the delivery of services on their territory. Moreover, it will not restrict the power of Member States to designate particular service sectors as services of ‘general economic interest’ or as ‘services of general interest’, which will provide states with the ability to completely direct the way services designated

¹⁵⁵ Weiss, *The Myth of the Powerless State*, 42.

In the case of the regulation of services, Member States are not simply “just one source of authority among several, with limited power and resources.”¹⁵⁶ For sure, EU institutions will play a role in some service sectors that Member States have agreed are better regulated on an EU wide scale. However, states are still the dominant source of economic power when it comes to services in the EU. Domestic political and economic realities will ultimately determine the degree to which Member States give up power to EU institutions with respect to services. Member States have retained the ability to work with domestic stakeholders in the service sector to coordinate economic growth. Considering that service oriented jobs contribute more to GDP in developed countries than any other type of employment, Member States will continue to play a important role in determining ‘who gets what’. States will still be able to provide aid in service sectors of the economy which contradicts what the Commission and Member States originally agreed was the primary goal of the Services Directive.

The empirical evidence presented in this thesis also contradicts conventional wisdom that states will eventually be replaced by regional supranational economic institutions that pull member states towards a single economic model. We may see more regional economic supranational institutions. However, the evidence presented in this thesis suggests that if supranational institutions develop into confederal economic organizations that include democratic institutions (like Parliament in the EU), institutional avenues are created through which the economic power of Member States can be protected. This is exactly what happened in the EU. Because Parliament has co-decision legislative power over the internal market, the Socio-cultural Coalition was able to protect Member State authority over services.

¹⁵⁶ Strange, 72.

Parliament became the institutional avenue on which the Socio-cultural Coalition focused its efforts. Interestingly, it was in Parliament that Member State power over the regulation of the services sector was largely protected. Although Member States themselves have no control over Parliament, it was the actions and efforts of stakeholders in the Socio-cultural Coalition, acting in concert to oppose the Commission's proposal, which ultimately reinforced the significance of borders between Member States. The irony of the situation is that it would appear that when it comes to protecting the power of Member States, stakeholders in the EU organize and operate as if the EU was truly borderless.

If Parliament's role in shaping EU policy increases, there is the possibility that the pace of EU integration will reflect the political compromises which can be reached in Parliament. Moreover, enlargement reduces the likelihood that Member States can agree to change the Treaty, which means that the policy proposals put forth by Parliament are more likely to be viewed as acceptable policy options politically. As the empirical evidence presented in this thesis demonstrates, Parliament is the institution in the EU most responsive to public sentiment in the EU. Indeed, enlargement reduces the probability that Member States will agree to change the Treaty, thereby reducing the chance that Member States will simply change the Treaty as opposed to accepting a position put forth by Parliament or the Commission.

By applying the ACF to the case of service liberalization in the EU it becomes clear that explaining policy outcomes in the EU requires a theoretical approach that takes into account the complex nature of the EU system of governance. Moreover, the ACF demonstrated that one can not simply adopt structural economic reasoning to explain

policy outcomes. What is required is a theoretical framework that accounts for the interaction between macroeconomic pressures and domestic political and economic forces. For sure, one can not explain economic policy outcomes by simply looking at the domestic situation. Economic globalization may lead to systemic macroeconomic pressures that alter the costs associated with adopting a particular policy program over another. However, they do not determine national economic policy; this is ultimately determined by political processes and governmental institutions.

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Appendix 1. Co-decision Procedure Flow Chart





