Redefining the Aims of the Lisbon Strategy: The Case of the Services Directive

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Introduction

One of the more important and audacious objectives of the Lisbon Strategy was the completion of the single market for services. Indeed, the Lisbon European Council identified the integration of service markets as a prerequisite for the development of a competitive knowledge-based economy in Europe. It was agreed that in order to create EU-wide competition between service providers, a comprehensive horizontal approach towards services integration should be adopted and a broad range of service industries should be targeted, including health services, business services, and consumer services. This approach was eventually codified into a Proposal for a Services Directive (Proposal) that, it was hoped, would become the legal and regulatory instrument needed to complete the single market for services by encouraging ‘deep’ integration between service markets in the EU.

However, immediately after the release of the Proposal an intense public discourse emerged in the European Union (EU) that focused on the question of whether more regulatory power should be upgraded to the EU level in order to complete the single market for services. It became a highly salient political issue that created patterns of popular and interest group mobilization that moved the debate away from the technical issue of how best to integrate service markets to whether this should even be a goal of the EU. This debate was unexpected and although a Services Directive was adopted in 2006, the European Parliament (Parliament) substantially reduced the scope of the Commission’s Proposal and removed the controversial ‘country of origin’ principle. Instead of promoting ‘deep’ integration by either harmonizing national regulatory regimes or through ‘mutual recognition’, the Services Directive promotes a kind of ‘shallow’ integration that makes it easier for service providers to operate throughout the EU but leaves the power to regulate the provision of services with member states.

This policy episode is interesting for two interrelated reasons. First, the decision-making process that surrounded the Services Directive was highly politicized in the sense that political parties were involved, there was an intense public discourse, and both state and non-state actors were involved. Second, Parliament became the decision-making arena that produced a political compromise that ultimately determined the policy outcome. What is unclear is why the policy process in this case became politicized and why the compromise reached at Parliament was accepted by policy makers as the appropriate way forward. Is there something unique about the regulatory and redistributive implications of services integration that causes the policy process to become politicized? Was the politicization of the policy process in this case a consequence of institutional factors, such as the extension of legislative power to the European Parliament? These questions draw our attention to one of the most puzzling features of EU policy studies which is the lack of focus on how politicization and processes of interest intermediation affect policy outcomes.1 Even though policy-making in the EU is increasingly the focus of research by international relations, comparative politics and new governance scholars, little effort has been made to systematically conceptualize how politicization influences policy outcomes across policy domains.2

1 There is a considerable amount of research that focuses on EU interest groups and lobbying in the EU, however this vein of research has focused primarily on capturing the upward shift in interest group activity to the EU and developing “robust and better-specified theoretical tools to explain it,” See Richardson, Jeremy. ‘Organized interests in the European Union,’ In Jorkenson, Knud Erik, Mark A Pollack and Ben Rosamond. The Sage handbook of European Union Politics, Thousand Oaks: SAGE Publications, 2007.

Indeed, the majority of EU policy research treats EU policies and EU policy-making as dependent variables focusing on how the independent variable, the nature of the EU polity, affects policy outcomes. Both the new governance approach and theories of public policy that are used to study policy-making in the EU assume that policy-making in the EU is best understood as depoliticized process. The ‘new governance’ approach views policy making in the EU as a distinctive process that is driven by the need to solve common problems within an institutional structure that is void of ‘politics’. Likewise, public policy approaches that have been used to study EU policy-making such as policy network analysis and the advocacy coalition framework rest on the assumption that policymaking in the EU occurs in policy specific domains and through networks of actors who share a common understanding of policy problems and a common desire to solve these problems.

Neither approach examines why in some cases policy-making becomes politicized and in others it does not.

In this paper it is argued that instead of employing approaches that draw our attention away from the politics of policy-making and away from a key institution in the EU policy process, the EU Parliament, we need an approach that will help us uncover how politicization influences policy outcomes and affects the institutional settings in which policy decisions are made. What the case of the Services Directive demonstrates is that policy making can become politicized and politicization impacts decision making. Parliament was able to change the substantive content of Commission’s Proposal precisely because of the controversial nature of the issue which legitimized its role in the policy process. As part of the Lisbon Strategy, the Commission, with the full support of member states, produced an aggressive horizontal framework to complete the single market for services. However, they were seemingly unaware of the fact that liberalizing trade in services requires deeper levels of policy coordination and harmonization than is the case for trade in goods. The consequence was that the perceived redistributive and regulatory implications of the Commission’s Proposal created a massive backlash and set off an intense mobilization effort to alter the Commission’s Proposal. Because these efforts were focused on Parliament, Parliament was presented with an opportunity to empower itself, which is exactly what happened when it produced a modified proposal that was viewed as a politically acceptable compromise. In other words, the power of compromise-making and coalition building shifted from Council to Parliament because of the controversial nature of the issue. This enabled Parliament to play an important role in reshaping the aims of the Lisbon Strategy. Moreover, it suggests that Lisbon Strategy has indirectly acted as a catalyst in terms of the politicization of the EU policy process.

This paper is organized as follows. First, the factors that led to the inclusion of services liberalization in the Lisbon Strategy are examined and the Commission’s original Proposal for a Services Directive is reviewed. It is argued that a consensus emerged during the initial policy formulation stages shortly after the release of the Lisbon Strategy for Growth and Jobs amongst policy makers and member states that a comprehensive horizontal framework was needed to complete the single market for services. The second section examines the policy processes and


political debates that surrounded the reformulation of the Commission’s original Proposal. The claim is that Parliament became the decision-making arena that ultimately decided the regulatory and substantive content of the Services Directive.

The Lisbon Agenda and the Proposal for Services Directive

The completion of the internal market for services was first identified as a precondition for economic prosperity in Europe in the 1985 White Paper titled Completing the Internal Market. However, beyond recognizing the importance of completing the single market for services the Cockfield report and the internal market programme launched in the 1980s by Delors did not lead to a comprehensive program designed to complete the single market for services. Instead, the focus was placed on specific service sectors. While the report made it clear that completing the internal market for services was necessary if the true benefits of a single market were to be realized, it did not contain a detailed strategy for how this was to be achieved. The White Paper only went as far as laying out the steps necessary for furthering the liberalization of services in what it called ‘traditional’ service sectors and new services related to technological change such as audiovisual services and information services. For financial and transport services specific guidelines were laid out because of what the report referred to as the ‘prime importance’ of these service sectors. For example, the principle of ‘home country control’ was introduced as a means of liberalizing financial services.5

The point is that the pattern of service liberalization that occurred as a result of Cockfield’s White Paper was one characterized by sector specific initiatives that involved what Nicolaïdis and Schmidt call ‘managed mutual recognition’. Managed mutual recognition ensured that “regulatory competition did not lead to consumer confusion and general downgrading of standards.” 6 It involved the “minimum prior harmonization or convergence of standards as with goods, but also other attributes, such as diminishing the automaticity of access to host-country markets by granting residual host-country control, reducing its scope in various ways and setting up mechanisms of ex-post guarantees and monitoring.” 7 This approach to building the single market for services did lead to the creation of partially integrated EU wide service markets in a number of important service sectors during the 1990s. A variety of ‘market-making’ regulations were passed in the telecommunications, transport, and financial service sectors as well as series of directives related to the recognition of professional qualifications.

Despite these achievements it was, however, becoming abruptly clear throughout the 1990s that the EU’s economy 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 accounted for nearly 70% of the EU’s GDP, “the size of…..the services sector is still below the OECD average.” 8 It was against this backdrop that the Lisbon European Council of March 2000 decided to include the completion of the single market for services as an integral part of the Lisbon Strategy. To speed up liberalization, the

5 The idea was that providing that a political agreement at the EU level could produce a minimal harmonization of financial standards, the regulation of financial institutions would be the responsibility of the country where the headquarters of a financial institution is located.
7 Ibid.
Council asked the Commission to develop a general strategy for the removal of barriers to services by the end of 2000. Note, that unlike the 1985 White Paper the Lisbon Strategy explicitly called for the devolution of ‘general strategy’ that would facilitate the completion of the single market for services.

In response, the Commission produced a comprehensive plan titled An Internal Strategy for Services (Strategy), in December of 2000. 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 ongoing legislative and political processes related to proposals dealing with services, 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. 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. The Commission recognized that globalization had reduced international trade barriers and hence entry barriers for foreign companies entering the EU. Therefore, it adopted 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. This was demonstrated by highlighting the obstacles that existed to the movement of services at each stage of the business process. According to the Commission’s report, the impact of these obstacles falls 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 two stage process was welcomed by all Member States, the EU Parliament, the Economic and Social Committee and Committee of the Regions. 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. The report showed that significant barriers exist because of authorization and registration practices that make 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. 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

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10 Ibid.
13 Ibid., 18.
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.\textsuperscript{14} The report 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 behavioural barriers that exist across different service activities “ha[d] a number of common traits in both their origins and effects.”\textsuperscript{15}

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.\textsuperscript{16} The Council proclaimed that the report provided an excellent “basis for the second stage of the Strategy.”\textsuperscript{17} 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.”\textsuperscript{18}

Then 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. In terms of scope all “services supplied by providers established in a Member State” were covered by the Proposal except for aspects of the financial, electronic and transport industries, which were covered by other community instruments. The only stipulation was that public services not open to competition, such as state-run health care and social services, would be exempt. Unless a member state held a public monopoly on the delivery of services in a particular industry, its service sector would be subject to competition from throughout the EU. The temporary provision of services would be encouraged by the ‘country of origin’ principle which is essentially a radical form of the ‘home country control’ principle. The premise is that service providers would only be subject to the rules and regulations of their country of origin. In other words, service providers offering a temporary service outside their country of origin would be 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 would be required to monitor the services offered by service providers originating from its territory. Also, member states would not be able to 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.

\textsuperscript{14} 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. See ECJ, “Opinion of AG Jacobs,” Case C-76/90, Säger v. Dennemeyer, 21 February 1991, para 27.
\textsuperscript{15} Ibid., 7.
\textsuperscript{17} Council of the European Union, “2462nd Council Meeting on Competitiveness,” 5.
The *Proposal* represented a fundamental shift in thinking with respect to how the internal market for services should be regulated and integrated. Instead of promoting liberalization on a sector by sector basis through ‘managed mutual recognition’, the *Proposal* was horizontal in scope and would have introduced a “radical form of [automatic] recognition” through the ‘country of origin’ principle. 19 How can we explain this radical shift? The primary reason is that there was clearly a consensus amongst all the actors involved that in order to complete the single market for services the appropriate way forward was through the introduction of a comprehensive framework designed to produce ‘deep’ integration. It was agreed that a vertical approach based on a sector by sector analysis of the barriers to services would take too long and in all likelihood be ineffective. Indeed, up until this point all the actors and institutions involved agreed that it was imperative that a new comprehensive approach be introduced to unleash the economic benefits of a single market for services. As Nicolaïdis and Schmidt note, the Internal Market Commissioner Bolkestein “consulted with national ministries over a period of two years and national bureaucrats seemed to be more or less on his wavelength.”20 Another reason is that it was concluded that the problems associated with the movement of service providers were common amongst different service sectors. This supported the argument that the ‘general strategy’ should be horizontal in scope. Finally, one could point to the fact that the legal precedent for service providers to operate without burdensome mechanisms restricting their freedom had certainly been established by the ECJ. 21

**The Debate and the Adoption of the Services Directive**

Interestingly, the response to the Commission’s *Proposal* was immediate, unexpected and mostly unfavourable. The most moderate response came from a number of influential Committees in the EU’s vast committee structure. For example, although the Committee of Regions (COR) welcomed the *Proposal*, its enthusiasm was mitigated by what it viewed as a lack of clarity in the *Proposal*, especially with respect to the ‘country of origin’ principle. 22 The COR 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 COR it was not clear what legal jurisdiction countries of origin would have in other member states. The COR also questioned how the *Proposal* would work in light of the large body of existing Community legislation in the areas covered by the *Proposal*. Moreover, it feared that the scope of the *Proposal* would override all national authorization schemes. The COR was unsure whether this type of interference in national procedural processes was necessary or desirable. It feared that the *Proposal* 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 COR also called for services of general economic interest to be excluded entirely from the scope of the *Proposal*, 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 *Proposal*. 23 With respect to the country of origin principle, the ESC argued that the blanket application of the principle needs

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19 Nicolaïdis and Schmidt, 721
20 Ibid., 722.
to be revisited. In particular, the ESC 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.\textsuperscript{24}

Outside normal policy channels, opposition to the 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 Proposal. The EFPSU argued that the Proposal was unclear and might take priority over collective agreements.\textsuperscript{25} The European Trade Union Federation (ETUC) issued a statement calling for drastic changes to the Proposal. The ETUC argued that the Proposal should not cover areas of general economic interest, nor should it be allowed to interfere with collective agreements, etc. The ETUC was worried that if adopted the Services Directive would strip away social protection.\textsuperscript{26} Similarly, the European Mine, Chemical and Energy Workers’ Federation (EMCEF) rejected the Proposal on the basis that the removal of national regulations with respect to the services sector would produce an unstable and unfair labour market.\textsuperscript{27}

Also, left leaning think tanks began producing reports that challenged the conclusions reached by proponents of the Proposal. 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 Proposal. 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.\textsuperscript{28} 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.”\textsuperscript{29}

However, the Proposal 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.”\textsuperscript{30} The Proposal 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

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\textsuperscript{24} \textit{Ibid.}, 3.3.6, 3.5.3.
\textsuperscript{26} 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.
\textsuperscript{28} Niklas Bruun, \textit{“Employment Issues: Memorandum,” \textsuperscript{27} Prepared for the European Parliament Public Hearing on the Proposal for a Directive on Services in the Internal Market, Brussels 11 November 2004, 5.\textsuperscript{29}}
\end{flushleft}
the Proposal would substantially increase the number of jobs in the EU, intensify competition, and add €30 billion in value to the services sector.\textsuperscript{31}

The Proposal 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 Proposal would go a long way “towards establishing a single market for services if it is implemented as proposed.”\textsuperscript{32} 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.”\textsuperscript{33} Interestingly, the paper included a warning against allowing the scope of the Proposal to be watered down. The OECD argued that any attempt to water down the Proposal through legislative amendments would only delay the achievement of a single market for services.\textsuperscript{34} Of course, it is not surprising that business groups and economic think tanks supported the Proposal. The 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 Proposal.

However, it should be made clear that the response was overwhelmingly negative and was, by every account, intense and unexpected.\textsuperscript{35} 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 (which they had supported) was not a politically viable option domestically. As a response, EU Internal Market chief Charlie McGreevy had little choice but openly confirm that the Commission would revisit the controversial Proposal. 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.”\textsuperscript{36} He also stated that he “wanted to address the country of origin concerns in an as balanced way as possible.”\textsuperscript{37}

Under the co-decision procedure, the Proposal was then sent to Parliament where the Internal Market and Consumer Protection Committee (IMCPC) was designated as the lead committee in charge of reviewing the Proposal. Meanwhile, nine other Committees were asked to review the Proposal. All ten committees called for substantial changes to the Proposal.\textsuperscript{38} By the time Parliament held a public hearing on the matter in November of 2004, opponents of the proposal were lined up at the door. Although the public hearings involved stakeholders and experts from both sides, it was becoming clear that the 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 provided a platform for those opposed to the Proposal to appeal to citizens across Europe. Moreover, protests were organized by groups opposing the Proposal and

\textsuperscript{32} Vogt, 2.
\textsuperscript{33} Ibid.
\textsuperscript{34} Ibid., 25.
\textsuperscript{35} 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 paper.
\textsuperscript{36} EU Parliament, “Public Hearing on the Proposal for a Services Directive on Services in the Internal Market.”
\textsuperscript{37} Ibid.
experts representing their position began lobbying Parliament.\(^{39}\) The debate over the Proposal 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 manoeuvred 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 Proposal down, they managed to muster enough votes to pass the legislation.\(^{40}\) A dramatically modified Proposal received 394 votes, out of a possible 732 on 16 February 2006.

In total, Parliament made 33 amendments to the Proposal. Most importantly, the scope of the Proposal was drastically diminished. Services of general economic interest “reserved to public or private entities,” were removed from the scope of the Proposal, nor would the Proposal “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.”\(^{41}\) Healthcare services and “services pursuing social welfare objectives” were totally removed from the scope of the Proposal as were postal services, broadcasting, audiovisual services, temporary employment agencies and public transport.\(^{42}\)

Not surprisingly, the main source of controversy, 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 respect the right of the service provider to supply services and to guarantee the provider "free access to and free exercise of a service activity within its territory". In addition, obstacles contrary to the principles of non-discrimination, necessity and proportionality should no longer be imposed by Member States. A list of prohibited requirements cannot be imposed either by Member States. Member States, however, will continue to apply their own rules on conditions of employment, in conformity with Community law, including those laid down through collective bargaining agreements. Furthermore, Member States may impose requirements with regard to the provision of a service activity, where they are justified for reasons of public policy, public security, environmental protection and public health.\(^{43}\)

The important point is that Member States retained the ability to regulate the provision of services on their territory for the service sectors covered by the Directive. Parliament’s modified Proposal only provided legal certainty that service providers can operate outside their country of origin. It did

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\(^{39}\) Some of the protests involved 20,000 people. These rallies were primarily organized by social groups and unions from across the EU.


\(^{42}\) Ibid., Article 1, 2.

not propose a dramatic change in the ability of Member States to control the delivery of services on their territory.

Not surprisingly, Parliament’s amended Proposal 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 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.44

On behalf of the Council Presidency, the Austrian Federal Minister for Economics and Labor welcomed the modified Proposal 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.”45 European Commission president Jose Manuel Barroso also welcomed the modified Proposal. 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.46

After years of heated debate, the compromise reached by Parliament was accepted as the best possible solution given the political sensitivity surrounding service liberalization.47 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 Services Directive at all, and for Member States like the United Kingdom with a service based economy, this would be the worst possible scenario.48 The Commission wanted a Directive that at a minimum might serve as the legal foundation a system of governance for services in the future.49

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 favour of the changes made by Parliament. Specifically, the country of origin principle was replaced by the freedom to provide services

46 Ibid.
principle and a majority of the derogations introduced by Parliament were incorporated into the Commission’s new Proposal.\(^{50}\)

When the Commission’s amended Proposal was presented to Parliament for debate, Evelyn Gedhardt, Parliament’s rapporteur on the Proposal 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.\(^{51}\)

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.”\(^ {52}\) The EPP-ED Group in the European Parliament also welcomed the Commission’s Proposal, specifically welcoming the freedom to ‘provide services principle’.\(^ {53}\)

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 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.\(^ {54}\) 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.\(^ {55}\)

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.\(^ {56}\)

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.”\(^ {57}\) 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


\(^{54}\) Council of The European Union, “Presidency Conclusions,” 7775/1/06 REV 1, Brussels, 18 May 2006.


\(^{56}\) Ibid.

delicate political compromise. Articles (16) and (17) cover the freedom to provide services and the derogations from this principle.

Two 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 “for matters excluded from the scope of application.”58 In other words, the Commission can introduce legislation that it feels are required in an area outside the scope of the Proposal. 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.59 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.60 The Council also decided to clarify the point that the Directive does not cover “labor law or social security legislation.”61 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.62 Malcolm Harbour, speaking for the EPP-ED, stated that the Common Position “keeps intact all the core political points that we agreed in Parliament.”63

Indeed, when Parliament voted to accept the Commission’s second Proposal on 12 December 2006, it was voting for the compromise it had formulated. The details were primarily determined by political actors at Parliament, not by the Commission or the Council. The compromise reflected the broad consensus that emerged amongst state and non-state actors that the Commission’s original proposal was to aggressive. This claim is supported by the fact that both the Commission and Council agreed that the compromise reached at Parliament represented the appropriate way forward given the political sensitivity surrounding services liberalization. Indeed, even though Parliament was able to reach a political compromise that allowed the Services Directive to pass, its scope was drastically reduced and its implementation remains an open question.

In summary, we can conclude that the type of services integration that the Services Directive will promote has been accepted by European Leaders who continue to make statements emphasizing how important the Service Directive is when discussing the Lisbon Strategy for Growth and Jobs. For example, following the Brussels European Council in 2007, European leaders stated that: “the recently adopted Services Directive is a key tool for unlocking the full potential of

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59 Ibid., Article 39.5.
60 Confidential Source, Interview by Author, Brussels, June 26 2006.
63 Ibid.
the European services sector.” What this statement shows is that European leaders have accepted that the type of ‘shallow’ integration that the Services Directive will promote is now in fact the accepted goal of the Lisbon Strategy for Growth and Jobs. The quest for ‘deep’ integration has been replaced with the goal of ‘shallow’ integration.

Conclusion

Instead of adopting a directive that would have fundamentally changed how the single market for services is regulated, the EU has opted to leave things essentially as they were. For sure, the Services Directive will encourage ‘shallow integration’ by introducing single points of contact and making the rules more clear. However, the goal of ‘deep’ services integration was rejected by Parliament and replaced with the goal of ‘shallow’ integration. Indeed, even though European policy-makers were able to reach a political compromise that allowed the Services Directive to pass, its scope was drastically reduced and its implementation remains an open question. At this point in time the political support does not exist in Europe for comprehensive services liberalization, which would require either the application of the ‘mutual recognition’ to trade in services, or the harmonization of regulatory regimes across the EU. To the extent that EU policy makers have been able to agree to frameworks promoting the liberalisation of services, they have insisted that integration be accomplished through ‘managed mutual recognition’ and sector specific legislation. They have not however agreed that liberalization should be promoted by the blanket application of mutual recognition. Indeed, existing institutional arrangements do not force member states to engage in widespread service market liberalisation, as member states have resisted the inclusion of deep binding restrictions on barriers to trade in services.

What is particularly interesting about how the Lisbon goal of ‘deep’ services integration was translated into the Proposal for a Services Directive is that it would appear that policy makers and member states were blissfully unaware of the fact that liberalizing trade in services requires deeper levels of policy coordination and harmonization than is the case for trade in goods. Foreign delivery of services often requires the movement of factors of production meaning that contestation of foreign markets can only occur if there are no restrictions on foreign ownership and investment and little in the way of restrictions on labour mobility. Even when service trade can be conducted without factor mobility (when services can be traded the same way goods are), differences in regulatory and professional standards in service sectors create considerable potential for liberalization to result in a significant loss of state control over basic industry standards. This means that liberalization efforts necessarily involve more complex negotiations given the different ‘varieties of capitalism’ exist in the EU. Even when states believe that services liberalization is a good idea, the differences between states in domestic regulatory structures, business-state relations and service sector policy goals makes reaching agreements very difficult. Services liberalization requires a kind of deep integration that is not easily achieved. The key point is that trade in services is different than trade in goods. Liberalizing these flows involves questions about the mobility of factors of production which require states to first remove barriers to FDI, and, second, harmonize regulatory standards on service products or recognize and accept other states’ regulatory standards. Obviously these requirements touch deeply on issues of domestic public policy (in a way that traditional tariff reductions on trade do not) and involve policy debates with a wide range of domestic economic interests, domestic service industries and regulatory agencies which may not be as supportive of liberalization as Commission officials.

Institutionally speaking, the most interesting observation related to the case of the Services Directive is that the locus of decision-making shifted to Parliament after the decision-making process became politicized. It is true that Parliament would have had the ability to affect the outcome under any circumstances because of co-decision, however co-decision in no way guarantees that Parliament will have the capacity to dramatically affect a policy outcome. In the case of the Services Directive the ability of Parliament to in effect to make the final decision, was directly related to the fact it produced a compromise that other actors had no choice but accept given the political nature of the issue. By modifying the Commission’s proposal in a manner that was viewed as legitimate by political actors and the general public, policy makers had no choice but accept the compromise formulated at Parliament.

At a theoretical level, the case study presented in this paper suggests that policy-making in the EU can become highly politicized which is a reality not captured by the existing literature on EU policy making. Plus, if Parliament’s role in shaping EU policy increases, there is the possibility that policy-making in the EU 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. While this issue is open to debate, the Services Directive at a minimum shows that there are features of policy-making in the EU that are understudied, especially the degree to which politicization affects different policy processes.
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