

To: 1. Mike Brennan
2. Andrew McCormick

From: Graeme Belshaw,
Market Access and Borders

SCS: Victor Dukelow

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Subject: The EU Single Market in Services

Issue: It is important to understand the regulatory framework that NI businesses currently operate within when selling services within the EU and how changes to that framework will impact businesses.

Summary: The creation of the EU single market in services has been slow and the market is not as integrated as the single market in goods. However, the liberalisation of the services market in the EU has, on the whole, been beneficial for UK businesses. The services sector makes a significant contribution to the Northern Ireland economy, accounting for three quarters of GVA and over 80% of employment in 2015. External sales make up a significant portion of the sector's sales. The Services Directive is the most significant piece of legislation in this area and aims to remove legal and administrative barriers to trade in services across the EU. Exiting the EU could result in NI businesses facing barriers to trade in services that they do not currently deal with. Understanding what those barriers are likely to be and the impact upon businesses is an important part of preparing for EU exit.

Recommendation: That you note the contents of this paper and the proposed next steps.

Detail

1. As a services-based economy the UK's future relationship with the EU's single market in services will be a major feature of the trade negotiation. The Northern Ireland economy also has significant interest in this space, either directly through sales to the EU or indirectly through the 'back-office' functions that support EU facing businesses in GB.
2. Negotiating the UK's access to the single market in services will be particularly complicated. The EU's services market is heavily shaped by EU legislation which can either cut across all sectors or provide detailed rules on specific sectors. This paper sets out how these 'horizontal' and 'vertical' rules currently facilitate trade in services across the EU, and begins to analyse how these negotiation variables may impact on tradable services in the Northern Ireland economy.

3. This paper is one element of work which is being taken forward in regards to the building an evidence base in regards to the NI services sector and the likely impacts of EU exit.
4. A previous submission has set out the nature and characteristics of NI's trade in services and further analytical work has been taken forward to determine trade flows and their key drivers. An engagement exercise with NI services businesses is also set to commence imminently with the aim of understanding current business practices of NI services sector businesses and the likely impacts of EU exit.
5. Work has also been taken forward in relation to migration and the access to skills and labour. This work is targeted at a sectoral level and includes services sectors.
6. The intention is that all of this activity will facilitate the development of an understanding of how changes to the regulatory framework might impact, both positively and negatively, on current and future services trade flows and the wider economy. This will be an important aspect of determining our offensive and defensive trade interests with the EU, and in Rest of the World (RoW) markets, after EU exit.
7. The EU and UK published a Joint Report following the conclusion of the first phase of negotiations. The report sets out ambitious goals regarding unfettered trade for NI within the UK internal market while avoiding a hard border between NI and the Republic of Ireland.
8. The type of deal, and its comprehensiveness, agreed between the EU and UK in relation to services may have implications for the functioning of the border as envisioned in the Joint Report. A full understanding of NI's trade in services will be important in terms of realising the ambitions set out in the Joint Report.

EU Legislation

9. The Treaty on the Function of the European Union (TEFU) contains the core principles governing the Single Market for Services. Article 49 of the TEFU provides a national of one Member State the freedom to establish a service company in another Member State and Article 56 allows for the cross-border provision of services within the Single Market.
10. Other EU legislation in this field either harmonises standards and regulations across all Member States, or ensures that Member States mutually accept each other's rules and standards as being equivalent to their own (the principle of 'mutual recognition'). The principle of mutual recognition means that individuals or businesses can provide a service in another host Member State, as long as they

meet the required standards in their own Member State (also known as the 'Country of Origin' approach).

11. Legislation can apply horizontally to most services sectors (such as the Services Directive) or target rules at specific services sectors, such as the Audiovisual Media Services Directive.
12. EU legislation also harmonises rules and standards for other potential non-tariff barriers, for instance state-aid and competition law, consumer protection law, the protection of intellectual property and the use and flow of data.
13. EU law either applies directly to Member States (under Regulations) or through national implementing legislation (such as Directives). It is enforced by national courts (which are required to give supremacy to EU law over conflicting national law), and is ultimately interpreted by the Court of Justice of the European Union (CJEU).

The Services Directive

14. The Services Directive is the most significant piece of legislation in the area of developing the EU single market in services. The purpose of the directive is to remove legal and administrative barriers to trade in services across the EU. The Directive was implemented (i.e transposed into national law) by all EU Member States, including the UK, in 2009.
15. The directive made it mandatory for each Member State to 'ensure free access to and free exercise of a service activity within its territory' and 'not make access to or exercise of a services activity in their territory subject to compliance with any requirements ... that do not respect the principles of non-discrimination, necessity and proportionality'.
16. Certain economic sectors are exempted: non-economic services of general interest, financial services, electronic communications, healthcare, temporary work agencies, audio-visual services, gambling, social services, private security, notaries and bailiffs and taxation. Nevertheless, services falling within its scope account for 46% of EU GDP.
17. A number of key sectors are regulated at EU level through sector specific regulations. They include financial services; telecommunications; transport; postal services, and; broadcasting. (*Further information on the sectors covered by the directive and those covered by sector specific regulations can be found at Annex A*).

Main Aims

18. The Services Directive has four main aims:

- i. **To help businesses establish themselves in other Member States:** under the Directive Member States are required to set up single contact points to enable businesses to access information and carry out procedures relating to their activities. They must also ensure all administrative procedures can be carried out by mail, phone or electronically, and review all authorisation schemes with a view to removing and replacing any that restrict businesses from other Member States setting up within their territory.

Additionally, Member States must:

- abolish all discriminatory requirements relating to nationality or residence;
 - abolish all 'particularly restrictive requirements' such as economic needs test that require business to demonstrate an economic demand for their services; and,
 - review all other requirements such as territorial restrictions or specifications on the minimum number of employees.
- ii. **To facilitate the cross-border provision of services:** the Directive provides for a 'principle of freedom to provide services'. The principle holds that Member States should not impose a nationality requirement on service providers. The scope of this freedom is limited, with Member States retaining the right to impose 'non-discriminatory' restrictions where it is justified on the basis of *'public policy, public scrutiny, public health or the protection of the environment'*.
 - iii. **To enhance the rights of service consumers:** the Directive places certain obligations on Member States that aim to enhance consumer rights and strengthen their confidence in the internal market. To this end, Member States are required to:
 - remove obstacles for recipients seeking to access services supplied by providers in another Member State;
 - abolish any discriminatory requirements that are based on the recipient's nationality or residence; and,
 - make information available and provide assistance on legal requirements on consumer protection rules and redress procedures applicable in other Member States.

- iv. **To facilitate administrative cooperation between Member States:** the Directive requires Member States to cooperate with each other and provide mutual assistance with respect to the supervision of service providers. To this end national authorities are required to exchange information with each other and carry out checks, inspections and investigations upon request. They are also required to alert other Member States of cases where a service activity could cause damage to health and safety, or the environment. To facilitate cooperation, the European Commission has established an electronic system for the exchange of information known as the Internal Market Information System (IMI).

Modes of Delivery for Services

19. The World Trade Organisation (WTO) General Agreement on Trade in Services defines four modes of supply in tradable services:

- **Mode 1 — Cross border trade.** This involves trade from one country into the territory of another country. For example, a consumer receives services from abroad, such as market research reports or architectural drawings, through its telecommunications or postal infrastructure.
- **Mode 2 — Consumption abroad.** This involves a consumer from one country travelling to another country. For example, a national from a country moves abroad as a tourist, student or patients to consume respective services.
- **Mode 3 — Commercial presence.** This involves a service supplier from one country establishing a commercial presence in another country. For example, a service in a country is provided within A by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and controlled bank, hotel group or construction company.
- **Mode 4 — Presence of natural persons.** This involves a service supplier from a country providing a service in another country through the presence of natural persons. For example, a foreign national provides a service within a country as an employee of a consultancy firm.

20. EU legislation, including the Services Directive, facilitates these modes of supply within the EU:

- **Mode 1 — Cross border trade.** Article 56 of the TEFU allows for the cross-border provision of services within the Single Market and the Services the Directive provides for a 'principle of freedom to provide services'.

- **Mode 2 — Consumption abroad.** The ability to trade services by having the consumer move to the location of the service provider is facilitated by the EU's fundamental freedom of movement.
- **Mode 3 — Commercial presence.** Article 49 of the TEFU provides a national of one Member State the freedom to establish a service company in another Member State. The Services Directive requires Member States to set up single contact points to enable businesses to establish themselves and to access information and carry out procedures relating to their activities.
- **Mode 4 — Presence of natural persons.** The ability to trade services by having the service supplier travel to the location of the service consumer is also facilitated by the EU's fundamental freedom of movement.

Future trade in services

21. Following the UK's exit from the European Union there will be changes to the regulatory framework set out above.
22. As the UK will no longer be a member state of the European Union it will no longer be a party to the Treaty on the Functioning of the European Union and therefore the provisions regarding cross-border trade of services and the freedom to establish a service company within a Member State will no longer apply.
23. The UK will also no longer be covered by the Services Directive and it will no longer be mandatory for EU Member States to ensure free access to and free exercise of a service activity within its territory for UK services companies.
24. The loss of this coverage will impact on all four modes of delivery and restrict access to the EU single market in services.
25. Access to the EU Single Market in services will also likely be impinged by changes to cross cutting regulations in relation to areas such as mutual recognition of professional qualifications (MRPQs), dispute resolution and data transfers.
26. The EU does not have harmonised trade policy in relation to trade in services with third countries outside the Single Market, meaning that UK businesses could face differing non-tariff barriers between Member States, which will be difficult to identify and quantify.
27. Negotiation of a UK-EU free trade agreement (FTA) will be unprecedented and unique, in that the rules and regulations in the UK and EU will be, at the point of departure, completely harmonised.

28. However, existing EU FTAs have not led to significant liberalisation in trade in services. If the UK and EU were to conclude negotiations on an FTA with terms similar to the EU and Canada's FTA (CETA) this would represent a significant deterioration of trading conditions for UK services businesses.
29. A deal which did not provide market access for all services sectors, or no deal at all, would result in the UK trading services with the EU on the basis of WTO rules.
30. This would result in less favourable trading conditions than membership of the Single Market or a FTA. WTO terms would require the UK and the EU to comply with the 'Most Favoured Nation' principle: the UK would not be able to trade on more preferential terms with the EU, unless it applied those same terms to all other WTO member countries.
31. Whilst the focus of this paper is on the EU it is nonetheless deemed prudent to undertake some initial work in relation to RoW trade in services which accounts for £0.6bn or 37.5% of service exports.
32. A geographic split of RoW trade exports is not available however, similar to goods, it is anticipated that the USA is a key market for NI service exporters. It is also a priority market for the UK in terms of negotiating a future FTA. A meeting with DIT is provisionally scheduled for February to discuss a future US FTA and it would therefore be beneficial to include the USA within the scope of this work.
33. Similarly Australia is a priority country for a future FTA and from a goods perspective is a fast growing export market. Whilst data is not available on service exports to Australia a number of NI companies are active in the market including First Derivatives and Cirdan. Engagement with DIT will follow the US team meeting and there is benefit to carrying out this work also.

Next Steps

34. This paper provides an overview and understanding of the aims of the Services Directive and how it facilitates the removal of legal and administrative barriers to the trade in services across the EU.
35. The next stage of this work will be to develop an understanding of the specific sectoral regulations which govern and facilitate trade in sectors including financial services, transport, audiovisual media services and broadcasting.
36. Further work will also be taken forward to understand how the EU single market in services is supported by EU rules on issues including freedom of movement, mutual recognition of professional qualifications (MRPQs) and data transfer.

37. A full understanding of these 'vertical' and "horizontal' rules will be important in developing a baseline position to understand the regulatory framework NI services businesses currently operate within and determine the likely impacts of various negotiated outcomes on the NI services sector. (*Further information on the NI services sector and possible future trade scenarios can be found at Annex B and C respectively*).
38. In this regard, it will be useful to utilise the OECD's Services Trade Restrictiveness Index (STRI). The OECD STRI presents an up-to-date snapshot of services regulatory regimes in 22 sectors across 44 countries, accounting for over 80% of global services trade.
39. The STRI consists of a database of laws and regulations in force, updated annually (currently covering 2014-2016) and verified and peer-reviewed by regulators and trade officials.
40. Composite STRI indices are also used to quantify restrictions on foreign entry and the movement of people, barriers to competition, regulatory transparency and other discriminatory measures that impact the ease of doing business.
41. An interactive tool also allows users to compare regulatory regimes across countries and to simulate the impact of policy reforms.
42. In theory, once an understanding of the current regulatory regime in which NI services business operate is developed, the impacts of changes to that regime could be modelled using the interactive tool.
43. A research specification is currently being drawn up to engage external expertise to take forward this aspect of work.

Annex A

Services included in the Directive	Services excluded from the Directive with sectoral specific regulations
Distributive trades including retail and the wholesale of goods and services	Financial services;
activities of most regulated professions such as legal and tax advisers, architects, engineers, accountants or surveyors	Electronic communications services with respect to matters covered by other EU instruments;
Construction services and crafts	Transport services falling within the scope of Title VI of the Treaty on the Functioning of the European Union (TFEU) ¹
Business-related services such as office maintenance, management consultancy, event organisation, debt recovery, advertising and recruitment services	Postal Services
Tourism services such as travel agents	Broadcasting
Leisure services such as sports centres and amusement parks	Audio-visual services
Installation and maintenance of equipment	Gambling
Information society services such as publishing for print and web, news agencies, computer programming	
Accommodation and food services such as hotels, restaurants and caterers	
Training and education services	
Rentals and leasing services including car rentals	
Real estate services	
Household support services such as cleaning, gardening and private nannies	

¹ Title VI of the TEFU refers to transport by rail, road and inland waterway.

Annex B

NI Services Sector

1. The services sector makes a significant contribution to the Northern Ireland economy, accounting for three quarters of GVA² and over 80% of employment in 2015³. External sales of 'tradable services' make up a significant part of this picture. The vast majority of external sales of non-financial services were to GB (£3.1bn of £4.7bn) in 2015, with a further £1bn into Ireland and the EU26. The total sale of financial services to external markets totalled £1bn in 2015. As such, understanding the nature and characteristics of NI's trade in services will be essential to support the UK's preparation for exiting the EU, but also important in framing NI's interests in future trade deals.
2. Trade in services is different to, and more complicated than, trade in goods. The sector's exposure to non-tariff barriers is the primary difference. However, trade frictions in goods and services are related i.e. frictions at borders for the movement of goods can impact on the ability of businesses to offer services related to these goods, such as maintenance and repairs.
3. While NI businesses will retain certain advantages, e.g. English speaking and geographic location between American and Eastern markets, divergence from the 'level playing field' standards and regulations is likely to increase non-tariff barriers in trade with the EU. Research estimates that a 1% increase in the 'restrictiveness' of the services sector reduces exports by around 2.5% and reduces imports by around 2%.⁴
4. Businesses purchased and imported services from outside of NI to the value of £3.2bn in 2015.⁵ The primary external market for the purchase of NI services is GB, which accounted for £2.6bn (81%) of the £3.2bn external purchases and imports in 2015. A further £290m of services were imported from Ireland (IE), £100m from the EU26 and £210m from the rest of the world.⁶

² Regional gross value added (income approach), ONS, December 2016

³ Quarterly Employment Survey, NISRA, June 2017

⁴ [Leaving the EU: An Assessment of its Impact on Services and Trade, London First, June 2016](#)

⁵ [NISRA Broad Economy Purchases and Imports of Goods and Services Data Tables 2011-2015, 2017](#)

⁶ [NISRA Broad Economy Purchases and Imports of Goods and Services Data Tables 2011-2015, 2017](#)

Annex C

Trade scenarios

1. A number of possible post-Exit scenarios and their implications for services sector restrictiveness are outlined below.

Harmonisation with EU acquis (EEA Membership)

2. Under this scenario restrictiveness is not likely to change significantly and therefore the impact on trade flows with the EU is likely to be negligible.
3. The UK could in principle join the European Free Trade Area (EFTA) and become a signatory to the EEA Agreement, becoming a non-EU EEA member. It would then join the current non-EU members of the EEA, Norway, Liechtenstein and Iceland.
4. An EEA Agreement would provide not only full access to, but membership of, the internal market in services. While free movement of services within the Single Market is still developing, the EU has increasingly focused on reducing non-tariff barriers over the last two decades and this focus is likely to continue, in particular in relation to the Digital Markets Strategy.
5. The substance of EEA law is largely aligned to EU single market law, free movement of people would continue and mutual recognition of qualifications would also continue to be facilitated. This would allow 'passporting' to continue and operators to provide cross-border services.
6. There is also an established dispute resolution mechanism utilising the EFTA court. Membership of the EEA would therefore provide legal clarity for firms engaging in cross-border service provision.
7. The advantage of the EEA option is that it is a system that already exists and functions.
8. In terms of limiting the increase in restrictiveness of services trade as a result of EU exit, EEA membership is likely to be most successful. However, the UK Government has all but ruled out this option for a future UK-EU relationship.

Equivalence of outcomes (UK-EU Free Trade Agreement)

9. Instead of remaining in the EEA or the EU's customs union, the Government could seek to negotiate a free trade agreement (FTA) with the EU. The Prime Minister has indicated that the UK will pursue a "bold and ambitious" FTA with the EU that

would “aim for the freest possible trade in goods and services” between the UK and EU.

10. Negotiation of an FTA between the UK and EU would be unprecedented. These negotiations are normally predicated on the desire to increase market integration and access between both sides. However, the UK will be in a position of starting with full integration with the prospect of reduced integration in some areas.
11. A UK-EU FTA would also need to be broader in scope than existing EU FTAs. Previous FTAs signed by the EU, such as those with Canada or South Korea, which include services are some distance short of the access the UK currently has as an EU Member State.
12. The Canada-EU FTA (CETA) agreement includes some form of mutual recognition of qualifications, some rights of establishment, and the ability to set up subsidiaries and entities in the EU but it falls short of providing for ‘passporting’ and being able to provide a service from a provider’s home base in Canada.
13. Any FTA would also require the establishment of some form of mechanism to resolve disputes. The establishment of an EU-UK court may not be politically acceptable as it may be regarded as an indirect way of imposing decisions made by the European Court of Justice.
14. It is likely that restrictions will increase for the services sector in the event of an FTA with the EU. The curtailing of the freedom of movement of people, changes to recognition of professional qualifications and a new dispute resolution mechanism are likely to contribute to that increase.
15. An FTA of unprecedented scope will be required to mitigate these restrictions and the impact on services trade. Further work needs to be done to determine which NI services sectors rely most heavily on external sales to the EU and therefore need to be highlighted in UK-EU FTA negotiations.

Disorderly Exit (WTO trading)

16. A ‘no deal’ scenario would result in UK-EU services trade being governed by WTO rules. This is likely to lead to the most significant increase in restrictiveness of the services sector and in turn of the largest impact on external sales of NI service providers.
17. The WTO legal order consists of a number of agreements that are annexed to the WTO Agreement. The General Agreement on Trade in Services (GATS) came into force in 1995 and applies to all WTO members.

18. The GATS applies to all but two service sectors: first, those sectors where services are supplied by a Government authority neither on a commercial basis nor in competition with other suppliers (such as education or health services); and second, all air traffic rights.
19. Trading under WTO rules would also provide limited commitments on services. Members must extend immediately and unconditionally to services or services suppliers of all other Members "treatment no less favourable than that accorded to like services and services suppliers of any other country". Trading under GATS rules would not provide the UK with any preferential access to the Single Market.
20. The GATS also expressly recognises the right of Members to regulate the supply of services in pursuit of their own policy objectives. Various limitations can be imposed on the number of suppliers, employees in the sector, value of transactions and the legal form of the supplier.
21. The extent of market access in services provided by WTO agreements is therefore not uniform. Rather, it varies sector by sector and a body of work would have to be taken forward to determine the access available to NI service sector industries and the likely impact on their external sales and trade.
22. The GATS also contains no mechanism or approach to facilitate mutual recognition of qualifications, hindering movement of people and the provision of cross-border services.
23. There is also a significant difference between dispute resolution within the Single Market and under WTO rules. Single Market rules are part of domestic law so businesses in the Single Market can use domestic courts to enforce any rights they have. In contrast, complaints to the WTO can only be brought by governments.
24. Trading under WTO rules would likely result in significant increases in restrictiveness of the services trade. Freedom of movement of people and mutual recognition of qualifications would not continue as they currently operate, potentially hindering the right of establishment and the continuation of 'passportable rights' for cross-border service providers. The dispute resolution mechanism within WTO is also deficient in comparison to the mechanism within the EU Single Market and decisions are not automatically enforceable.