NEW DIRECTION

THE FOUNDATION FOR EUROPEAN REFORM

Serving Europe

Making the Services Directive work

Manuel Dierickx Visschers

June 2012

LIBERA!

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Table of Contents

Executive summary

Twenty years after its establishment, the idea of an internal market where professionals and service workers, from accountants to plumbers and hairdressers, can freely offer their services anywhere in the EU without protectionist obstacles remains largely an unfulfilled vision.

One of the flagships of the European liberalisation efforts of the last decade, the Services Directive, risks becoming a hugely missed opportunity to develop a well-functioning Single Market and make Europe more competitive.

Two years after the deadline for implementing the Services Directive, European businesses still face legal uncertainty if they decide to cross borders. This will clearly not improve the fact that in 2009 only seven to 39%, dependent on the specific service sector, of European SMEs exported their services to other Member States, compared to 56% in the manufacturing sector.

Contrary to the initial objective of the Directive, complex and unclear conditions still allow EU Member States to keep trade distorting regulations in place. On 27 October 2011, the European Commission referred Germany, Austria and Greece to the European Court of Justice over incomplete transposition of the Directive. Lack of exact guidelines on why and which regulations should be abolished could therefore lead to serious legal and political disputes and extra costs for businesses that are already under a heavy burden.

The complexity of the Services Directive is one of the reasons why the implementation process has been slow and will take years to complete. The original simple 'country of origin' principle was replaced by an obligation to screen an enormous amount and variety of national regulations based on 'necessity and proportionality'. Additionally, there are no clear guidelines on how to provide proof that EU Member States have checked their laws and removed all unnecessary and disproportionate regulations.

More transparency and legal certainty of the screening process is urgently needed.

This study presents a new approach to screening national regulations more thoroughly by recommending the use of the 'Services Impact Test' (SIT), which has recently been developed by the Flemish Government, to filter national legislation and to test its necessity, suitability and proportionality. Based on the methodology of the Impact Assessment (IA), SIT integrates some perspectives and methodologies from the scientific discipline of "Law & Economics". It focuses on the screening of regulations in relation to their possible internal market and trade distortions.

A case study, namely the Belgian "IKEA-regulation", highlights the danger that without profound judicial review and enforcement, market- and trade-distorting regulations may remain in place as a result of EU Member States' underlying protectionist policies. Due to insufficient screening, the unnecessary and disproportionate IKEA-regulation is still in place and continuously prevents large retail centres from conducting their business on a proper basis.

1. Introduction

The European economy momentarily finds itself in a coma-like state. For 2012 the Commission expects a GDP growth of a meagre 0.5%; the OECD predicts only 0.3%. The European Commission's latest report on the economic forecast looks very grim:

> "The outlook for the European economy has taken a turn for the worse. Sharply deteriorating confidence and intensified financial turmoil is affecting investment and consumption, while urgent fiscal consolidation is weighing on domestic demand and weakening global economic conditions are holding back exports. Real GDP growth in the EU is now expected to come to a standstill around the end of this year, turning negative in some Member States. Only after some quarters of zero or close-to-zero GDP growth, a gradual and feeble return of growth is projected in the second half of 2012."[1]

One might expect that this is all due to the heavy disturbances on the financial market. But even when the immediate financial turmoil lessens, the economic problems for the EU are far from over:

> "The uncertainty related to the sovereign-debt crisis is expected to gradually fade over the forecast horizon, provided the necessary policy measures are implemented. Nevertheless, growth is likely to be held back by more difficult financing conditions, ongoing deleveraging and sectoral adjustment. Growth will be insufficient to deliver an overall reduction of unemployment within the forecast period."[2]

Budgetary constraints and fiscal austerity are needed and have to be implemented in the short term in order to regain trust and confidence in the financial markets. More than anything, however, the European economies need strong growth. To put it briefly, many economies in the EU have to overcome their continuing lack of competitiveness and productivity. Structural reforms of our economies are needed and this can only be obtained by completing the internal market which is, as the European Commission correctly puts it, "the real growth engine within the European economy"[3].

Or in other words: "The creation of a Single Market for services – an area without internal frontiers in which the free movement of services is ensured – has been one of the cornerstones of the European project from its origin. […] We need to use the enormous potential it offers as a lever for creating sustainable growth and jobs, widening choice for consumers and opening new opportunities for businesses."[4]

But the development and implementation of the internal market is unfinished and incomplete, as acknowledged by the European Commission: "Nevertheless, the internal market has shortcomings, which were highlighted by Mario Monti in his report 'A New Strategy for the Single Market' and by the European Parliament in Louis Grech's report 'Delivering a single market to consumers and citizens'."[5]

How to develop its full potential? The European Commission is planning to adopt a 'proactive and cross-cutting strategy': "This means putting an end to market fragmentation and eliminating barriers and obstacles to the movement of services, innovation and creativity." The Commission rightfully understands its importance in order to strengthen Europe's competitiveness: "A better integrated market which fully

plays its role as a platform on which to build European competitiveness for its peoples, businesses and regions, including the remotest and least developed. There is an urgent need to act."

The Commission, quite rightly, goes further on this point: "A well-functioning Single Market for services is even more urgently needed in light of the current economic crisis. Today, services are the main driver of the EU economy and economic activity has been shifting markedly to knowledge-intensive services over the last decades. Services amount for over two-thirds of EU GDP and employment, and have been the source of all net job creation in recent years. Furthermore, approximately 75% of services trade concerns the supply of services to other businesses in almost any sector of the European economy, in particular industry. More integrated and better functioning services markets should therefore enhance the competitiveness of the EU economy as a whole. […] In short, the EU economy urgently needs a more integrate, deepened Single Market for services. This is necessary to help business – in services and industry – to grow, create more jobs and better position themselves globally. It is also key to leading the EU economy onto the path of recovery. Additional growth in services should also help accompanying structural changes in the EU economy and compensate for employment adjustments in other sectors."[6]

The Commission stresses the importance of using the full potential of an integrated European market for services and the role of the Services Directive in achieving this: "More generally, a Single Market in services which functions well is a prerequisite for generating growth and employment in Europe. Whereas the growth of the European economy was on average 2.1% per annum between 1998 and 2008, the services sector grew on average by 2.8% per annum. Employment in this sector increased by 2% per annum, compared with 1% for the economy as a whole. To create a Single Market in services, the immediate priority is the full and complete implementation of the Services Directive in all Member States […]."

The question now is what exactly the full and complete implementation of the Services Directive will take or require from the Member States. This paper will focus on one of the most difficult and sensitive parts of transposing the Services Directive: the screening of legal requirements and permit schemes on their necessity, suitability and proportionality.

2. The content and rationale of the Services Directive

2.1. The legal obligations of the Services Directive

Let us begin by summarising and explaining in short the main issues and legal obligations of the Services Directive[7] (SD). This will provide us with the necessary framework to focus on and comprehend our research topic.

In essence, the SD is crucial in enforcing our basic rights to provide cross-border services and to establish service providers in other Member States, as set out in Articles 49 and 56 of the Treaty on the Functioning of the European Union (TFEU), formerly Articles 43 and 49 of the EC Treaty EU Treaties. At the very least, the SD will provide extra stimulus for the "in the field" application and use of these rights by removing many existing barriers to them. Because, according to the SD, "those barriers cannot be removed solely by relying on the direct application of the Articles 43 and 49 of the Treaty"[8], due to the limitations of the case-by-case approach and complex and expensive proceedings of the European Court of Justice (ECJ).

Essentially, the SD obligates the Member States to get rid of all legal and administrative barriers to the free cross-border movement of (or trade in) services by improving the quality of national regulations (cf. "Better Regulation") and the administrative functioning of the Member States.[9] This approach is clearly reflected in the structure of the SD. Chapter II of the SD deals with the overall need for administrative simplification in order to lower the bureaucratic barriers to the cross-border provision of services. Chapter III of the SD emphasises the freedom of establishment for service providers, while Chapter IV tries to improve the free movement of services.

More specifically, the SD raises nine major issues, each having its own rationales and policy aims, as explained in the recitals:

A. The administrative simplification in Article 5 of the SD aims for "the reduction of the number of procedures and formalities applicable to service activities and the restriction of such procedures and formalities to those which are essential in order to achieve a general interest objective and which do not duplicate each other in terms of content or purpose"[10]. This is the general policy aim which is expanded upon in subsequent articles and provides some "minor" individual rights (to the citizenry), such as lower "red tape" costs caused by useless and overzealous administrative paperwork.
B. "In order to further simplify administrative procedures"[11], Articles 6 to 8 of the SD require the development of 'single points of contact' through which the service provider can complete all procedures and formalities which are necessary for its establishment and actual functioning. This will lower substantially the information and transaction costs for the service providers when dealing with the governments of other MS in which they want to provide services.
C. Articles 9 to 13 of the SD require the Member States to analyse the necessity and proportionality of their authorisation schemes and criteria. "That means, in particular, that authorisation schemes should be permissible only where an *a posteriori* inspection would not be effective because of the impossibility of ascertaining the defects of the services concerned *a posteriori*, due account being taken of the risks and dangers which could arise in the absence of a prior inspection."[12] In other words, authorisation schemes are considered as the most restrictive policy measure. They must be avoided when possible.

D. Article 14 of the SD focuses on what are outright forbidden requirements for the establishment of service providers. There are two distinct rulings: "Access to a service activity or the exercise thereof in a Member State, either as a principle or secondary activity, should not be made subject to criteria such as place of establishment, residence, domicile or principle provision of the service activity."[13] And "Access to or the exercise of a service activity in the territory of a Member State should not be subject to an economic test."[14] There is no longer any place for economic planning in regulations. It is also important to realise that not only is the direct discrimination on grounds of nationality forbidden, but "also any indirect discrimination based on other grounds but capable of producing the same result."[15] All these kinds of national regulations are on the "blacklist".

E. Articles 15 and 16 of the SD obligate Member States to analyse the necessity, appropriateness and proportionality of requirements for the cross-border establishment of service providers and for the free movement of services. The reason for these requirements is clear: "In order to coordinate the modernisation of national rules and regulations in a manner consistent with the requirements of the internal market, it is necessary to evaluate certain non-discriminatory national requirements which, by their very nature, could severely restrict or even prevent access to an activity or the exercise thereof under the freedom of establishment. [...] Where such requirements are discriminatory or not objectively justified by an overriding reason relating to the public interest, or where they are disproportionate, they must be abolished or amended."[16] Contrary to the previous Article 14 of the SD, these kinds of national regulations are in the "grey zone" and can be allowed if they are necessary, suitable and proportionate.

F. The Services Directive also zooms in on the rights of recipients of services in Articles 19 to 21 of the SD. Many barriers to the use of services by recipients, especially consumers, may also restrict the free cross-border trade in services. "This also includes cases where recipients of a service are under an obligation to obtain authorisation from or to make a declaration to their competent authorities in order to receive a service from a provider established in another Member State."[17] What is also prohibited is direct or indirect discrimination on grounds of nationality or local/national residence of the recipient (also by service providers). These requirements fit in with the general policy aim of consumer protection and the free movement of persons (consumers).

G. The aim of improving the quality of services is addressed in Articles 22 to 27 of the SD. "It is necessary to provide in this Directive for certain rules on high quality of services, ensuring in particular information and transparency requirements."[18] One way to do this is to ensure "that information on the meaning of quality labels and other distinctive marks relating to these services are easily accessible, in order to increase transparency and promote assessments based on comparable criteria with regard to the quality of the services offered and supplied to recipients."[19] This ruling aims to enhance the confidence of consumers in cross-border service provision and therefore strengthen the functioning of the internal market.

H. The SD also deals with the need for administrative cooperation between Member States in Articles 28 to 36. The reason for this is quite obvious: "Administrative cooperation is essential to make the internal market in services function properly. Lack of cooperation between Member States results in proliferation of rules applicable to providers or duplication of controls for cross-border activities, and can also be used by rogue traders to avoid supervision or to circumvent applicable national rules on services. It is, therefore, essential to provide for clear, legally binding obligations for Member States to cooperate effectively."[20] The internal market information system plays a key role in this administrative cooperation by providing an online information and communication system between the governments of the Member States and their smaller subdivisions (regional and local governments).

I. Finally, in Articles 37 to 41 the SD puts a lot of emphasis on the convergence programme, including the required reporting and mutual evaluation by the Member States in order to enforce the obligations of this Directive. The mutual evaluation in particular is very important in this respect: "At the latest by the end of the transposition period, Member States should draw up a report on the results of this screening. Each report will be submitted to all other Member States and interested parties. Member States will then have six months in which to submit their observations on these reports. At the latest by one year after the date of transposition of this Directive, the Commission should draw up a summary report, accompanied where appropriate by proposals for further initiatives. If necessary the Commission, in cooperation with the Member States, could assist them to design a common method."[21] Point 9 establishes the working method for the future implementation of the SD.

This study will focus solely on points 3, 5 and 9 because they deal with the screening of the content or specific behavioural norms of national requirements which (may) impede cross-border trade flows in services. While points 3 and 5 focus on the actual screening of national regulations, point 9 deals with adequate reporting of the screening results to the European Commission and the other Member States. This reporting will prove to be necessary to make an ex post and external quality control ("peer review") of these screening results possible. In this respect, point 9 represents the way in which the obligations for the Member States as described in points 3 and 5 could be enforced, and is therefore the final piece – or 'capstone' – of points 3 and 5.

But before we can explain this further, we first have to understand the rationales and background of the SD. The SD emphasises two main reasons for its existence. First, the conclusions of the European Council meeting held in Lisbon in March 2000 launched the "Lisbon process" to strengthen competitiveness and economic growth in the EU (now succeeded by the "Europe2020" process of which the "Single Market Act" is an important part and tool). The completion of the internal market is crucial for the further European integration and for the support of the euro. Second, there is an intention to specify and complement the basic rights of Articles 43 and 49 of the EC Treaty on the free establishment of service providers and the free movement of services respectively, now Articles 49 and 56 of the TFEU. Both of these *raisons d'êtres* complement each other because, in essence, the EC Treaty is an 'economic' treaty to facilitate or even stimulate "interstate commerce" between the MS and therefore to foster economic growth within the European Union as a whole.

2.2. The Services Directive (SD) and the "Lisbon Process"

The "Lisbon process", as an ambitious policy road map towards the goal of becoming the most competitive economic region in the world by 2010 and not to be confused with the later "Lisbon Treaty", is clearly reflected in the SD when it states: "A competitive market in services is essential in order to promote economic growth and create jobs in the European Union. At present, numerous barriers within the internal market prevent providers, particularly small- and medium-sized enterprises (SMEs), from extending their operations beyond their national borders and from taking full advantage of the internal market. This weakens the worldwide competitiveness of providers in the EU. A free market which compels the Member States to eliminate restrictions on cross-border provision of services while at the same time increasing transparency and information for consumers would give consumers wider choice and better services at lower prices."[22] In this respect, the SD clearly recognises the importance of supply-side economics: through enhancing the production possibilities of the supply side (the service providers), the demand side (the consumers) will prosper as a result of greater consumer surplus (better quality and lower prices of the products and services).

In order to carry out the "Lisbon process", the European Commission initiated a study on the "numerous barriers within the internal market" in services, as mentioned earlier. The SD refers to this study when it reads: "The report from the Commission on 'The State of Internal Market for Services' drew up an inventory of a large number of barriers which are preventing or slowing down the development of services between Member States, in particular those provided by SMEs, which are predominant in the field of services. The report concludes that a decade after the envisaged completion of the internal market, there is still a huge gap between the vision of an integrated European Union economy and the reality as experienced by European citizens and providers. The barriers affect a wide variety of service activities across all stages of the provider's activity and have a number of common features, including the fact that they often arise from administrative burdens, the legal uncertainty associated with cross-border activity and the lack of mutual trust between Member States."[23] On closer inspection, the SD clearly acknowledges the fact that the regulatory costs for service providers (administrative burdens, information costs and uncertainty due to foreign regulations, and compliance costs) lead to higher production costs and are an entry barrier for newcomers, finally resulting in more expensive products and services of lower quality for the consumers.

2.3. The Services Directive and the Completion of the Internal Market

The SD formulates its second main political objective by focusing on the freedoms of establishment and free movement of services, and by making the link with the relevant and appropriate freedoms in the EC Treaty: "It is therefore necessary to remove barriers to the freedom of establishment for providers in Member States and barriers to the free movement of services as between Member States and to guarantee recipients and providers the legal certainty necessary for the exercise in practice of those fundamental freedoms of the Treaty. Since the barriers in the internal market for services affect operators who wish to become established in other Member States as well as those who provide a service in another Member State without being established there, it is necessary to enable providers to develop their service activities within the internal market either by becoming established in a Member State or by making use of the free movement of services. Providers should be able to choose between those two freedoms, depending on their strategy for growth in each Member State."[24] This shows clearly not only a political will to complete the internal market for economic reasons, but also that the economic liberties deriving from the internal market are safeguarded by the EC Treaty (now the TFEU), and therefore have become unalienable rights for the legal subjects of the EU, enforceable through the European Court of Justice (ECJ).

A last important note concerns the relationship between the EC Treaty, now the TFEU, and the SD: "Those barriers [to interstate commerce in services] cannot be removed *solely* by relying on direct application of Articles 43 and 49 of the Treaty, since, on the one hand, addressing them on a case-by-case basis through infringement procedures against the Member States concerned would, especially following enlargement, be extremely complicated for national and Community institutions, and, on the other hand, the lifting of many barriers requires prior coordination of national legal schemes, including the setting up of administrative cooperation. As the European Parliament and the Council have recognised, a Community legislative instrument makes it possible to achieve a genuine internal market for services."[25] Having the law on your side is one matter, but you also need to *get* the law on your side. The SD may prove to be very crucial in this respect, as we will show later on.

The SD as secondary law can be seen not only to *be based on*, but also as *a logical culmination of* the EC Treaty (now the TFEU). So, while the EC Treaty provides general freedoms and rights to its legal subjects, which are enforceable before courts on an individual, case-by-case basis, the SD imposes general rules of

conduct for the Member States, in order to facilitate the application of these rights and freedoms to the aforementioned subjects. It is surely better to avoid as many infringements of the EC Treaty by Member States as possible, than to correct them afterwards by way of court rulings; prevention is better than cure. Unfortunately, some Member States, for example Belgium on occasions, "forget" in reality this essential principle of "Bundestreue" or "federal loyalty" and try to comply as little as possible with the requirements of the internal market.

Because the European Court of Justice (ECJ) has already developed extensive case law, based on the EC treaty, the SD regularly refers to ECJ jurisprudence and should be interpreted in accordance with the body of ECJ case law. Conversely, the ECJ will in the (near) future probably refine and redefine its interpretations of Articles 43 and 49 of the EC Treaty on the basis of the eventual implementation of the SD provisions. We will therefore analyse the ECJ jurisprudence in its relation to the issue of the screening of the national regulations later on in this study.

But it is also important to realise that the ECJ is not alone in clarifying the meaning and importance of directives as policy instruments in the legal order of the EU and that of the Member States: "The Member States' obligation arising from a Directive to achieve the result envisaged by the Directive and their duty under Article 10 EC to take all appropriate measures whether general or particular, to ensure the fulfilment of that obligation is binding on all authorities of Member States including, for matters within their jurisdiction, the courts."[26] When we look more closely at the role of the national courts in enforcing EU directives, such as the SD, they have to follow the following ruling of the ECJ: "When it applies domestic law, and in particular legislative provisions specifically adopted for the purpose of implementing the requirements of a directive, the national court is bound to interpret national law, as far as possible, in the light of the wording and the purpose of the directive concerned in order to achieve the result sought by the directive and consequently comply with the third paragraph of Article 249 of the EC."[27]

The ECJ continues: "The requirement for national law to be interpreted in conformity with Community law is inherent in the system of the Treaty, since it permits the national court, for matters within its jurisdiction, to ensure the *full effectiveness* of Community law when it determines the dispute before it. Although the principle that national law must be interpreted in conformity with Community law concerns chiefly domestic provisions enacted in order to implement the directive in question, it *does not entail an interpretation merely* of those provisions but requires the national court *to consider national law as a whole* in order to assess to what extent it may be applied *so as not to produce a result contrary to that sought by the directive*."[28] It is therefore important to have a clear understanding of the policy aims and the reasons for existence of the SD, in order to explore new ways of "law-finding" by the courts, in striving for the policy aims of the SD. More specifically, the aims of the Lisbon Process and the completion of the internal market have to be taken into account when national courts enforce and interpret the SD.

In short, the European Treaty and the ECJ, in its wake, accept no hesitance from the national courts of Member States in attempting to complete the internal market. They will simply apply European supranational law in specific cases and situations. The specific facts and situations seem always to be interpreted in the light and policy aims of the European law on the internal market, an approach that has already proven very useful in forcing national governments to comply with the legal requirements of the internal market, and has removed a huge workload from the shoulders of the ECJ.

So, the legal discussions as to whether or not a national regulation is necessary and proportionate (and must therefore not be removed) boil down not as much to legal matters, but to facts. As mentioned previously, it is the suggestion of this paper that the Services Impact Test (SIT) is able to facilitate and

improve the "fact finding" process necessary in order to perform the necessity and proportionality tests more seriously and thoroughly, and to encourage more "evidence-based" rulings from the courts.

3. The principles of necessity, suitability and proportionality

3.1. The principles of necessity, suitability and proportionality in the Services Directive (SD)

The principles of necessity, suitability and proportionality are mentioned four times in the SD: firstly and secondly, pertaining to the authorisations in Articles 9 and 10 of the SD[29]; thirdly in conjunction with the requirements for the establishment of service providers in Article 15 of the SD[30]; and finally, in relation to the requirements for free cross-border movement of services in Article 16 of the SD[31]. It is important to note here that the wording of these principles differs slightly across the four occurrences (see endnotes below for the exact wording). The question then arises as to whether these small differences in wording might end up in divergent legal interpretations and, potentially therefore, substantially different economic consequences.

Upon closer analysis we may notice that the four articles all have the necessity principle in common, with "the justification by overriding reasons relating to the general interest". The SD does not, however, explain what this "justification" exactly means or how this can be proven in an unambiguous, objective and transparent way. Additionally, Articles 9 and 10 can be read and interpreted in a cumulative way, with Article 10 building on and clarifying Article 9. Article 9 deals with authorisation schemes *'per se',* as policy instruments to steer human behaviour while Article 10 focuses on the conditions for granting such authorisations. So firstly, Article 9 addresses the question of which policy instrument to choose, and opts for authorisation. As a second step, Article 10 then tackles the question of regulatory design: the specific content of that authorisation scheme, most notably the conditions and criteria for granting the authorisation. This means, of course, that the necessity and proportionality tests in Articles 9 and 10 pertain to different subjects.

Put more precisely, Article 9 requires an efficiency analysis of (and between) alternative policy instruments, more specifically between the authorisation schemes and the requirements of an *a posteriori* inspection. The question now is whether other policy instruments, such as taxation and subsidies, private law instruments such as contracts or insurance systems, communication campaigns, etc., can also be taken into account. The least burdensome policy instruments, such as communication campaigns or voluntary contracts between the government and a private party, are in European law surely preferable to the more burdensome ones, as long as they attain the policy goals which have to be justified by an overriding reason of general interest. The screening demanded in Article 10 does not deal with these questions but instead tackles issues about the severity or gravity of the required conditions. Minor societal problems, for which a permit system is needed, only call for "easier" conditions to achieve the authorisation.

A second point to note is that the "overriding reason relating to the public interest" clause for the establishment of service providers in Articles 9, 10 and 15 has a much broader scope than the combined remit of the four reasons (public policy, public security, public health or the protection of the environment)

for possible restrictions of the free movement of services in Article 16. This seems to suggest that the protection of the free movement of services is much stronger for the cross-border trade in services than for the free cross-border establishment of service providers. But Article 17 of the SD[32] also states that "Article 16 shall not apply to services of general economic interest" – precisely those services which are usually regulated (or subsidised) by government for 'overriding reasons relating to the public interest'. Unfortunately, the "crowding out" of the private sector will not be stopped by the SD so easily.

Thirdly, although only two principles, necessity and proportionality, are explicitly mentioned in the SD, a third is also in play implicitly, namely the principle of suitability or effectiveness. This third principle is included in the principle of proportionality as it is defined in Articles 15 and 16 of the SD regarding the screening of requirements: "the requirement must be suitable for attaining the objective pursued". In this respect, we may say that the proportionality principle in the broad sense of Articles 15 and 16 contains two principles: suitability on one hand and proportionality (in a narrow sense) on the other. This last concept of proportionality focuses more on indirect impacts which are not related to the pursued policy aims but which may create unwanted results, such as too many restrictions on cross-border trade that go beyond what is necessary for attaining the objective.

Finally, we may raise the question as to whether the omission in Article 16 of the phrase "and it must not be possible to replace those requirements with other, less restrictive measures which attain the same result" is deliberate or not, and is therefore legally relevant or not. In this respect, we need to ask whether the two phrases "must not go beyond what is necessary to attain that objective" and "must not be possible to replace those requirements with other, less restrictive measures which attain the same result" are similar or different in their legal meaning. In order to solve these questions partially, we must now analyse the current jurisprudence of the European Court of Justice (ECJ).

3.2. The principles of necessity, suitability and proportionality in current jurisprudence of the European Court of Justice

As was mentioned earlier, there exists a substantial corpus of ECJ case law on Articles 43 and 49 of the EC Treaty. As a result of this, the SD is essentially based on, or even codifies, this case law and therefore refers to it on a regular basis. Many important topics of the SD are already explained or interpreted by the ECJ in a rudimentary, case-by-case manner. Moreover, the SD itself refers frequently to the ECJ case law.

First, it is important to point to the "dynamic" or time-related and ever evolving interpretation of the necessity principle, because the 'overriding reasons relating to the public interest' are not defined once and for all. Article 4 of the SD stipulates: "For the purposes of this Directive, the following definitions shall apply: […] 8) 'overriding reasons relating to the public interest' means reasons recognised as such *in the case law of the Court of Justice*, *including* the following grounds: […]" It is self-evident that the case law of the ECJ will evolve in time.

Several recitals of the SD also refer to this case law of the ECJ:

- "The concept of 'overriding reasons relating to the public interest' to which reference is made in certain provisions of this Directive has been developed by the Court of Justice in its case law in relation to Articles 43 en 49 of the [former EC] Treaty and may continue to evolve. The notion as recognised in the case law of the Court of Justice covers *at least* the following grounds."[33]
- "The concept of 'public policy', as interpreted by the Court of Justice…"[34]

- "The provisions of this Directive should not preclude the application by a Member State of rules on employment conditions. Rules laid down by law, regulation or administrative provisions should, in accordance with the Treaty, be justified for reasons relating to the protection of workers and be non-discriminatory, necessary and proportionate, as interpreted by the Court of Justice, and comply with other relevant Community law."[35]

In the current ECJ jurisprudence on the free establishment of service providers and the free (cross-border) flow of services, the principles of necessity and proportionality are broadly defined as follows: "National measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions:

- they must be applied in a non-discriminatory manner;
- they must be justified by imperative requirements in the general interest;
- they must be suitable for securing the attainment of the objective which they pursue; and
- they must not go to beyond what is necessary in order to attain it."[36]

Some legal scholars[37] see two crucial elements when applying the proportionality principle: the criterion of suitability or effectiveness on the one hand and on the other the criterion of indispensability. Let us now focus on this last criterion. The indispensability principle of the sentence "it must not be possible to replace those requirements with other, less restrictive measures which attain the same result" means that government intervention cannot be replaced by an alternative that has the same positive effect (achieving of the policy aims) but has less negative consequence for other policy aims or interests. An interesting case[38] to illustrate this was the complaint against the Swedish direct import ban on alcoholic beverages for private persons. The ECJ ruled that this import ban went further than the policy aim to protect youngsters against alcohol because there was no age limit for the import ban. Moreover, alternative measures were possible which offered adequate protection but caused less drastic impacts on the free movement of goods, for example, a written declaration that the importer is over the age of 20, in combination with penalties.

Finally, it is important here to look at the topic of cross-border trade when evaluating the impacts of national regulations on grounds of necessity, adequacy and proportionality: "Furthermore, the Court has already held that Article [49 EC] precludes the application of any national rules which have the effect of making the provision of services between Member States *more* difficult than the provision of services purely within one Member State. […] By contrast, measures, the only effect of which is to create additional costs in respect of the service in question and which affect in the *same way* the provision of services between Member States and that within one Member State do not fall within the scope of Article [49 EC]."[39] This suggests that there must always be a negative impact on cross-border trade when invoking Articles 43 and 49 of the EC and therefore also when invoking the SD.

We may conclude that in a certain manner of speaking, the SD is almost nothing more than a generalisation of ECJ case law. But the "law" or legal order is always alive and evolving. The SD's case law, based on the articles 43 and 49 of the EC Treaty, has been codified in the SD. But now, as the SD starts 'to live its own life' (with its own case law and other legal rulings), will this development eventually change the original case law of the ECJ? More specifically, it will therefore be interesting to find out in future legal research:

- Will there be two kinds of protection: one for services which fall under the SD, and one for services which don't but remain under the overall umbrella of the EC Treaty, now the TFEU?

- How will the existing ECJ case law evolve over time and what impact will it have on the meaning and consequences of the SD?
- How will the general content, policy aims and *raisons d'être* of the SD impact on the existing body of case law related to Articles 49 and 56 of the TFEU? Will the specific characteristics of the SD change the generalising and abstractive characteristics of the ECJ's case law?

4. The Services Impact Test (SIT)

4.1. What is the SIT?

The Services Impact Test (SIT) has recently been developed by the Flemish Government to perform the required *necessity*, *suitability* and *proportionality* tests, or 'screenings' of Flemish regulation, and is based on the (Regulatory) Impact Assessment (RIA) methodology. Like the (R)IA, the SIT has four distinct qualities: it is a logical *process* of analysis; it will result in an official evaluation *document*; it may require a legislative *procedure* to be followed within the administration; and all combined it amounts to a system to manage the life cycle of regulation.

The main goal of the (R)IA is to develop "better regulation", that is, regulation which conforms to the general principles of good regulation. Necessity, suitability and proportionality are precisely three important elements of these general principles. In the next chapter, we will explain this topic in more detail.

Like the (R)IA, the SIT contains several subsequent chapters or points of interest. More specifically, it deals with the following questions and topics:

- Pre-phase or chapter 0: Determining the scope
  - What is the legal scope? Do forbidden requirements (discriminatory or of economic nature) exist for which there is no need of screening?
  - How 'important' is the regulation and what is the magnitude of its impacts at first glance, in order to avoid disproportional screening efforts?
- Chapter 1: The problem analysis
  - Describe the societal problems and their mutual causal links.
  - What are the characteristics of the societal groups involved?
  - How serious or important are the potential risks for society?
  - What specific human behaviour causes the problem?
- Chapter 2: Defining the policy aims
  - Are the policy goals related to changing human behaviour?
  - Do the policy aims provide a solution for the societal problems?
  - Can the policy goals be formulated in SMART terms?
- Chapter 3: The policy options or the alternative policy instruments
  - To which alternative policy instruments is the regulation that needs to be screened, compared?
  - To what extent do these options (the regulation and its alternatives) reach the policy aims? Are they effective in achieving the policy aims?
- Chapter 4: The impacts of each of the options on cross-border trade in services
  - Provide an oversight of the direct, indirect and distributional effects/impacts.

        - What is the (relative) cost effectiveness per option?
            - Calculate the compliance costs for the service providers and analyse its impacts on the competitiveness and functioning of the service provider.
            - Calculate the impact on the Lisbon objectives such as economic growth, employment and price stability.
        - Make a comparison of the results for all the options.
    - Chapter 5: Issues of application and enforcement
        - What measures are taken by the government to apply the regulation?
        - What is the administrative burden of the regulation in question?
        - What are the spontaneous compliance and the enforcement costs?
    - Chapter 6: Data collection and consultation
        - What responses and remarks did consulted stakeholders provide and were they used in the SIT analysis? Why were they used or not used?
        - What are the interests and backgrounds of the stakeholders?
        - Are the used data and its sources reliable and of good quality?
    - Chapter 7: (Executive) Summary

Although chapter 0 is not part of the actual analysis in the SIT methodology, it is quite crucial to answer these two questions in a thorough manner. Firstly, the SD has several meanings attached to the principles of necessity, adequacy and proportionality, depending on whether it is an authorisation scheme, requirements for the establishment of service providers, or for cross-border flows of services. Secondly, because there are also forbidden requirements which must be detected and removed before the screening of the regulation as to its necessity, suitability and proportionality can start, it is necessary to define properly from the beginning what the regulation in question is actually regulating. Besides this, it is also important from a practical point of view to balance the efforts we put into the actual analysis and make them proportionate in relation to the actual gravity of the regulatory impacts in question. Having done this, we are then ready to start the SIT properly.

Chapter 1 is very crucial in the SIT because it potentially determines the value of the rest of the analysis. When starting out on the wrong foot, the SIT analysis will never be able to provide valuable answers. There are four elementary questions or tasks which must be dealt with: constructing an overview of the problem in order to determine its underlying causes and mutual links; the assessment of the seriousness of societal risks in terms of probability and actual damages; the screening of the features of the societal groups which are involved; and finally, the analysis of the specific characteristics of human behaviour which are causing the problem or risk. These four elements will reappear in the next two chapters as we deal with the policy aims and policy options.

Chapter 2 attempts to define the policy aims, and raises the question as to whether the problem will actually be solved, in terms of the risks involved and the desired human behaviour, when the aims have been reached. There have to be identifiable links between the policy goals and the underlying societal problems, if those policy goals are developed with a view to changing the underlying problematic human behaviour. It is also important to formulate the policy goals in SMART terms: Specific, Measurable, Actual, Result-oriented, and Timely. This SMART formulation allows for monitoring, and also determines whether the policy instruments can actually achieve the policy goals.

Chapter 3 raises the issue of how effective the particular regulation may be in fulfilling the policy goals, compared with its alternatives. In this respect, we need to draw a distinction between *the selection of different policy instruments (the regulation and its alternatives) which is the first step, and the differences in*

possible contents for the regulation in question. So, in Chapter 3, we need not only to answer whether or to what extent the regulation in question meets its policy goals, but also to compare these results with the possible alternatives. Only then will we be able to address the proportionality test of the next chapter, as to whether it goes beyond what is necessary *to attain that objective*, or whether it can be replaced with other less restrictive measures which *attain the same result*.

Chapter 4 endeavours to define such terms as "less restrictive measures" and "goes beyond what is necessary", in order to answer the questions on proportionality. Therefore it is essential to assess the direct (static), indirect (dynamic) and distributional effects of each option or measure and focus must be given to the distortions of the cross-border trade flows or investments which these measures create. In this respect, there are two central issues that we need to analyse: (1) the compliance costs of the policy instruments for the service providers, and their impact on the competitiveness and specific functioning of the service providers; and (2) the impact on the objectives of the Lisbon process: economic growth, employment and price stability. The results of this analysis will provide us with the cost effectiveness of each option. Finally, we have to compare these results in order to find out whether or not the regulation in question is the least restrictive measure and does not go beyond what is necessary.

These questions of necessity, suitability and proportionality must be applied not only to the actual *content*, or specific obligations of the regulation in question, but also to *the way in which the regulation is applied* and enforced. The latter could also lead to unnecessary and disproportionate costs for the legal subjects. The implementation may be too burdensome, creating excessive administrative costs, excessively severe punishments, or excessively strict inspections. Remember that in this respect Article 5 of the SD requires that procedures and formalities are as simple as possible. Another important element to consider is *spontaneous compliance* (and its roots or causes), as compared to the extent (and costs) of the enforcement. The greater the degree to which people comply spontaneously with a regulation, the less enforcement is required. The SD looks at the implications of the regulation on the practical side and not just in theory.

Finally, after completing these analyses, further explanations are still needed. We need to prove that our data collection, from interviews ("HUMINT" or human intelligence) or from databanks ("DIGINT" or digital intelligence) is sound. Without the correct empirical foundations and proper fact finding it is impossible to make the right analyses. Therefore, the interests and backgrounds of the people who were consulted should be screened, and any findings compared with the remarks they made, whether these were used in the analysis or not. The data sources used must be checked for quality and reliability.

To conclude, we may compare the SIT methodology with a filtering system, in which multiple treatments are used to clean water. The "dirt in the water" comes from multiple sources and is analogous with the sum of the elements in a given regulation that are contradictory to the SD. You need therefore several different filters to remove all of the different types of dirt in the water. Forbidden requirements are filtered out during the scoping process, some other requirements or permits can be removed by the necessity test and others by the adequacy and proportionality test and, finally, there is the administrative simplification check. This system of several subsequent filters is also very useful for comparing and choosing between different options in the *ex-ante* SIT for new regulations.

4.2. The link of the SD and the SIT with "Better Regulation" and Impact Assessment methodology

The SD focuses on the policy aims of the Lisbon programme, as we have seen when we quoted the recitals on the reasons for the SD's existence. But it also seems that the SIT has the same place within the broader framework and policy goals of the SD as that of the Impact Assessment (IA) methodology within the framework and aims of the European "Better Regulation Action Programme", which was an important part of the Lisbon programme and now of the "Europe2020" action plan. In short, we may state that the SD and the SIT are more or less the legally binding versions or variants of the "Better Regulation Action Plan" and the IA methodology, specifically focusing on the economic sector of cross-border trade in services.

In order to gain a better understanding of the SD and the SIT, in particular how the SIT fits in with the overall policy goals of the SD, it is useful to take a closer look at the Better Regulation Action Programme and more particularly the role of the Impact Assessment in it. The executive summary of the strategic review of Better Regulation Action Programme[40] provides some interesting clues: "Laws and regulations are fundamental to ensuring a fair and competitive market place, citizens' welfare and the effective protection of public health and the environment. Better Regulation is about doing this in ways that maximise the benefits whilst minimising costs. Better Regulation can significantly boost productivity and employment, thus contributing to growth and jobs. In Europe, the regulatory environment is developed both by the European Union and the Member States in an international context; Better Regulation is, therefore, a joint responsibility. […] Better Regulation covers policy-making, from its initial conception through to implementation and enforcement starting with the careful application of the principle of subsidiarity." The EU clearly linked the Better Regulation to the objectives of the Lisbon process (to become the most competitive economy in the world) and now to the Europe2020 action plan.

Other international organisations have also scrutinised this regulatory process. Observe the recommendations of the OECD Council of 9 March 1995 where statements were made indicating a focus on "improving the quality of government regulation"[41]. Here it was acknowledged "that the regulatory instrument is among the most important tools of government in OECD countries and that consequently high quality regulation is crucial for government effectiveness". The importance of the link between good regulation and the proper functioning of the economy and of companies is highlighted because "the environment in which private enterprises are born and compete is substantially determined by the framework of responsibilities and constraints established by government regulation, and that economic growth and the efficient use of economic resources are promoted by high-quality regulations". Thanks to the OECD, the microeconomic causal link between high quality regulation, low or at least proportionate compliance costs for companies, and the overall competitiveness of national economies is now common knowledge and practiced at all levels of policy-making within the OECD Member States, and even beyond.

It is also important to note here that the full potential of the IA methodology can only be unleashed when additional management measures are taken within the functioning and structure of the government. The use of roadmaps and the current cooperation arrangements between Commission services and between the three EU Institutions can be put to use in better implementing the IA methodology in greater depth. That is why the implementation of the IA methodology must be part of an integrated regulatory management order within the governmental system. This will probably also prove to be the case with the SIT. In order to have a more result-oriented and effective application of the SIT when performing the necessity and proportionality tests, additional measures must be taken. We come back to this issue in the concluding remarks.

It is even more crucial at this point to explain the definition that the OECD gave as the 8 principles of "good regulation". "Good regulation should: (i) be needed to serve clearly identified policy goals, and effective in achieving those goals; (ii) have a sound legal basis; (iii) produce benefits that justify costs, considering the distribution of effects across society; (iv) minimise costs and market distortions; (v) promote innovation through market incentives and goal-based applications; (vi) be clear, simple and practical for users; (vii) be consistent with other regulations and policies and (viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels".[42] Without this definition of good regulation, the use of techniques to aim for or to work on better regulation, such as the IA methodology, would be pointless.

The "Mandelkern" report is the central foundation of the Better Regulation Action Programme. The report starts correctly by defining the seven "common principles" of good regulation. We cite here the most important or relevant ones:

- "Necessity – This would for example involve comparing the relative effectiveness and legitimacy of several instruments of public action (regulation, but also the provision of information for users, financial incentives and contracts between public authorities and economic and social partners) in the light of the aims they wish to achieve.
- Proportionality – Any regulation must strike a balance between the advantages that it provides and the constraints it imposes.
- Simplicity – The aim should be to make any regulation simple to use and to understand, as this is an essential prerequisite if citizens are to make effective use of the rights granted to them – regulation should be as necessary and as simple as possible."[43]

The other four common principles mentioned in the "Mandelkern" report are: subsidiarity, transparency, accountability and accessibility.

In its brochure outlining the "Better Regulation" guidelines, the EU Commission translates these principles of good regulation into simple phrases warning of what bad regulation can lead to (the links with the specific principles in brackets): "But poorly conceived and ill-considered regulation can prove to be excessive and go beyond what is strictly necessary. Some regulation can be overly prescriptive, unjustifiably expensive or counterproductive. Layers of overlapping regulation can develop over time […]. Regulation can also become quickly outdated. Rapid technological developments, open and expanding global markets and ever-increasing access to information mean that regulation has to be kept under constant review and adapted to keep pace with the fast moving world." Or put in more positive phrasing: "to make sure that [laws and regulations] are using the right tools to get the job done; that benefits are maximised, while negative effects are minimised; that the voices of those affected are being heard."[44]

The important difference between these principles of good regulation and the principles of necessity and proportionality is that the latter are legally binding and enforceable by courts, whereas the former can only be characterised as policy goals of good governance. Being legally binding also brings with it the difficulty of defining precisely what is meant by necessity, suitability and proportionality if these principles are to be applied fully and coherently. That is the reason why the SIT methodology clearly establishes the link with these three principles, while the link between the IA methodology and the general principles of good regulation has not fully been elaborated. If the SIT is going to work properly, it must establish that link fully and unambiguously.

5. The use of the Services Impact Test (SIT) as a necessary proof in the screening requirements

This paper suggests that there are two main reasons why the use of the SIT in the screening requirements of the SD is recommended or even necessary as the central furnishing of proof:

- The SIT is a valid analysis method to define in a concise, objective and coherent manner whether or not regulation is *necessary, suitable and proportionate*.
- The content of the SIT (summary) is also the only way to fulfil the reporting requirements of the SD in a sufficient way.

5.1. The screening of the national regulations

The SIT is a suitable and sufficient analysis methodology for two principal reasons. The SIT provides an opportunity

- to perform the screening in a logic sequence of steps which may lead to insights that could not have been reached before;
- to integrate varying approaches to "Law & Economics" in these successive steps of analysis, which will improve the depth and gravitas of the screening.

We will explain these two statements more in detail below but we start by analysing the legal status of the methodology of the Impact Assessment.

5.1.1. The legal status of the methodology of the Impact Assessment

A very important factor in determining whether or not the Services Impact Test (SIT) will be accepted in the future as an appropriate methodology will be the European Court of Justice (ECJ). To date there have been no rulings of the ECJ on possible violations of the SD, due to the very recent implementation deadline of the SD. But we may find some answers to the question in the way the ECJ deals with the requirement in the European Commission (EC) to develop Impact Assessments when analysing the added value (the necessity and proportionality) of the European regulations and directives which it proposes. If IAs are accepted as a basis for legal scrutiny, then, *mutatis mutandis*, this also may become the case for screening national regulations and their compliance with the SD.

For the moment, the legal status of the Impact Assessment (IA) methodology when developing European legislation remains unclear. Initially, the EC avoided any reference to a legally binding context, especially any judicial scrutiny by the ECJ. The EC saw only trouble in a legal approach, leading to rigid and slow decision-making processes. More potential was seen in non-binding codes of conduct, guidelines, etc. The specific content of Better Regulation was being developed through means of "soft law", such as communications and official guidelines. This approach also had the advantage of putting the users at ease: no legally binding character and no judicial scrutiny.

But this is not the end of the story: there is indeed a need for more "hard law" measures in order for the Impact Assessment to be used in court, but this process is evolving gradually. First, the EC puts a great deal of effort into improving regulatory quality by means of the IA, for example, through the establishment and

functioning of the Impact Assessment Board. Now some scholars claim that the more institutionalised the IA instruments become, the more likely it is that judicial scrutiny will follow. The judicial scrutiny of the quality of IAs is a slow but growing and inevitable process.

In its screening of the legal activity of the EU institutions, the ECJ has always strived towards an optimal judicial protection of the citizens against low quality regulations. In this respect, it is logical that the ECJ, which sees itself as a constitutional court, follows the evolutions in the legal communities of the European Member States. When the EC (as part of the European government) develops regulatory policies in which the proper activity is ever more rationalised (such as with the IA methodology), the ECJ cannot turn a blind eye towards this development. Other judicial courts are also aware of the duty to safeguard regulatory quality. The European Court of Human Rights, for example, highly values the *ex-ante* evaluation in order to motivate and justify regulation.

There is a possible angle of approach in which *ex ante* analysis, IAs and consultations may be considered a substantial feature of European policy- and rulemaking. In the past, the ECJ has already recognised that the failure to comply with the motivation principle may lead to the invalidity of the legal act. In this respect, an intrinsic link is made between the use of the IA and the motivation principle. It needs to be made absolutely clear on which grounds or motives a European regulation was developed. Advocate General Sharpston wrote in an opinion piece: "In the absence of any impact study, certain choices made by the Commission, and the Council appear arbitrary."[45] The lack of an impact assessment was treated as a self-standing and decisive factor in concluding that there had been a breach of proportionality.

All principles of good regulation flow from the general principle of good care. In recent years, this principle has gained a firm grasp over all aspects of government activity and EU institutions need to behave with great care. In the jurisprudence of the ECJ, there is no explicit reference to the general care principle, but it may be deduced implicitly from the application of other principles such as justification and proportionality. When the legislator is expected to behave carefully, and therefore to consult and the develop IAs, then it will be impossible to be satisfied merely with the formal presence of these instruments. In turn, consultations and IA must be drafted carefully; otherwise they make carefully drafted regulations difficult or even impossible. It may be useful, therefore, to consider general principles, facts and behaviours during the preparatory processes.

By way of conclusion, it is safe to assume that a proper *ex ante* evaluation of the impacts and alternatives of every proposed regulation is an obligation for the rule maker. The *exante* evaluation not only begins with the gathering of information but also requires proper processing and thorough analysis of the collected data afterwards. This must lead eventually to a proper balancing of interests and decision-making. In the end, the formal motivation or publication of the results of this evaluation ensures that the government justifies its policy choices and avoids random exercise of power.

5.1.2. The logical sequence of the SIT analysis

As we have seen earlier, the SD requires answers to three questions: Is the regulation (1) necessary (or justified), (2) suitable (or effective), and (3) proportionate (or efficient)? The sequence of these questions is not accidental, but logical and even necessary. It is not useful or relevant in terms of policy-making to claim that regulation is proportionate if you cannot prove beforehand that this regulation is firstly necessary and secondly suitable. In other words, the necessity and suitability tests of a specific regulation are necessary conditions to perform an analysis of proportionality properly.

The necessity test requires the justification that overriding reasons of general interest really do exist. This issue is tackled in the first two SIT chapters of *problem description* and the *definition of the policy aims*. The third chapter (on the options in policy instruments) deals with the issue of the suitability or effectiveness of the regulation in question. *i.e.* – Which of the different options attain the policy goals that are defined in the previous chapter? The proportionality test flows from this and poses the efficiency question in chapter 4 on the impacts. For each option, it must be established whether or not they are efficient. This means that the balance between the benefits and costs that the regulation produces, has to be optimal (cost benefit analysis), or that, given the benefit, the chosen option generates less cost than the other options (cost effectiveness). When this is not the case, then the regulation is not proportionate.

Therefore, we need to integrate explicitly the three partial questions of screenings of the SD in the SIT methodology, in the light of the answers on the following questions:

- As the conclusion of chapters 1 and 2: is the regulation necessary?
- As the conclusion of chapter 3: is the regulation suitable (or even indispensable)?
- As the conclusion of chapter 4: is the regulation proportionate?
- As the conclusion of chapter 5: is the implementation and enforcement of the regulation necessary, suitable and proportionate, and is the regulatory design simple enough?

Finally, the SIT process of analysis also provides the opportunity to integrate in a sensible way the empirical data in the screening process because they are presented in a logic and coherent way. The empirical data are always "rough" from the start, and only make sense when used within a proper framework of analysis. Only then do "naked" data become meaningful information. Only then too do the added values and shortcomings of the data become clear. Some data may at first sight provide clear answers or findings, but when used in a sound framework of analysis, are shown to contain more flaws and uncertainties than presumed from the beginning. In other words, one must ask the right questions to get the right answers, but one will never get the right answers with wrong questions, however empirically-based these answers may be.

5.1.3. The integration of the views and tools of Law & Economics in the SIT

Besides being a logical and necessary sequence to be used in the furnishing of proof, the SIT is also a way of incorporating additional useful methods of analysis, interesting insights and scientific conclusions from different schools of Law & Economics. The essence of Law & Economics is the economic analysis of the legal order and legislation, based on the criterion of efficiency (the link between the highest outputs and the lowest inputs) and the *homo oeconomicus*, striving towards this efficiency. Based on this "cost benefit analysis", Law & Economics may explain (to some degree) why human behaviour is altered by a certain regulation, and to what extent there is a change in general welfare within society. In an introductory and non-exhaustive way, we will show in this study how this incorporation of the Law & Economics in the SIT methodology may be useful.

Law and legislations influence human behaviour. It is therefore important to know whether this influence has the right effect or whether a change in the law will lead to greater efficiency. Law & Economics assumes that the individual will abide by the law because they will always choose the option which will yield the most utility or prosperity (utility maximising). By studying the law in an economic manner, the effects or impacts of the law are analysed. As well as on the individual, Law & Economics also studies the impact of the law on society and the general welfare, based on the Pareto-optimum or the Kaldor-Hicks criterion (the welfare which is being lost must be compensated by the newly created welfare). Efficiency, as the ratio

between benefits (outputs) and costs (inputs) of regulation, plays a crucial part in all this, not just the distribution of the general welfare.

We examine four approaches to economic analysis of legislation, each with different analytical techniques and different starting points; each detecting divergent societal problems; and each focusing on different aspects of the regulation. Each approach or school provides a specific added value to the quality of the analysis. These four schools are: the school of Behavioural Economics, the Austrian School, the Chicago School and finally the Public Choice School. To keep things simple and illustrative, each time we shall allocate one particular school to one specific test of regulatory quality, though it is very well possible that each test can contain views or analysis techniques from more than one school. Let us briefly explain the main characteristics of these four schools of economic thought.

The Chicago School of economics builds on the neoclassical price theory and on the view that regulations and other government intervention may distort the normal functioning of the price mechanism. Due to the higher production costs of complying with regulation, the supply side curve will shift leftwards, leading to a higher price and lower quantity, and will therefore result in wealth losses for society (or "dead weight losses"). In terms of methodology, the stress is on 'positive economics', that is, empirically based studies using statistics to prove theory. Normatively speaking, many regulations are considered to be breaches on efficiency and are therefore unwelcome.

The second relevant economic school is the Austrian School, which attributes a lot of importance to the spontaneous organising power of the price mechanism and claims that the complexity of subjective human choices makes mathematical modelling of the evolving market extremely difficult or even impossible. As a result of this, the Austrian School stands for a '*laissez faire*' approach to the economy, with the strict enforcement of voluntary contractual agreements between economic agents and a maximum openness to individual choice (including free choice) and to the voluntary means of exchange. This approach has some consequences in the field of policy-making: entrepreneurship is considered to be the driver of economic development; private property and the protection of it are central in the efficient use of scarce resources; and direct government interference is usually viewed as harmful and unnecessary for economic development.

Although the Austrian School and the Chicago School favour the same policy options, wary of government measures and regulations as intrusions in market processes, their methodology (deductive vs. inductive, axiomatic vs. statistical) differs quite substantially. The Chicago School claims that it can measure precisely the welfare losses of regulation, based on the changing demand and supply curves in the general equilibrium model. The Austrian School would acknowledge that there is indeed a welfare loss, due to the violation of individual free choices, but would argue it is impossible to measure it because of too many unknown preferences and constantly changing variables. What many "Austrians" also claim is that this ability to measure may eventually lead to policy instruments of command and control because, when you are able to measure something, you will inevitably want to control and to master. To the Austrian School, society is far too complex to measure, let alone to control it.

Behavioural Economics combines economics and psychology in analysing market events in which some market players are characterised by human incapacities, failings and confusions. Scholars see two crucial reasons why humans deviate from the standard economic model of the purely rational, even mathematical, *homo oeconomicus*. The jury is still out on how large these deviations are, and what their economic impacts or consequences are. "Bounded rationality" incorporates the limited knowledge or cognitive abilities that sometimes constrain rational choices and adequate problem-solving. "Bounded willpower" illustrates the

fact that some people make choices that are not in their long-term interest because they are guided by their emotions. Some scholars also point to the "bounded self interest" which reflects the fact that humans are often willing to sacrifice their own interests to help others. However, many other economists claim that this is a discussion of the ends, not of the means, and that only the latter is subject to economic analysis.

Finally, Public Choice in economic theory is the use of modern economic tools to analyse topics that were always considered as falling within the realm of political science. More particularly, it studies the behaviour of pressure groups, politicians and government officials (civil servants and their bureaucracies) who are (mostly) self-interested agents wanting to maximise the return on their investment. These can be represented in a number of ways, including by price theory, by the concept of utility maximisation, and by game theory. We may define three important groups to be studied: the special interest groups who want to 'capture' regulations for their own purposes; the politicians who want to get elected; and government officials and bureaucrats who want to maximise their budgets and political influences. The self-interest of these three groups may therefore influence government intervention, and the content of particular regulations, quite heavily.

We will now start to integrate these four schools of Law & Economics into the SIT methodology by amalgamating Behavioural Economics into the first two chapters on problem determination, the definition of policy goals in order to solve the societal problems and finally which policy options will attain the policy aims. It is a given that problems within society which are caused by *non-human* events cannot be solved by regulation. These problems cannot be forbidden from 'turning up'; one cannot command them to just disappear. Therefore, in order to define whether or not a specific regulation is necessary or justified by overriding reasons of general interest, it must first be established which instance of human behaviour creates the societal problem, and what the specific characteristics of that human behaviour are (and they are not always rational or logical, quite on the contrary).

In this respect, it is no surprise that in 1994 the Canadian Government developed their own guide to regulatory impact analysis, called "Assessing Regulatory Alternatives"[46], where the issues of mutual links between human behaviour and regulations are placed centre-stage. Several of the 13 points of interest within the Canadian analysis deal very specifically with human behaviour and its characteristics (especially in the definition of the problems related to the necessity test), and with how the views and analysis methods of Behavioural Economics can be integrated, such as game theory and its suboptimal decision-making or cognitive imperfections of humans.

Specific questions are raised like:

- What behaviour is causing or contributing to the problem?
- Which external factors influence the behaviour?
- What behaviour, or change of behaviour, is desired and to what extent?

The question as to which (and to what extent) external factors influence the behaviour can be further broken down into several sub-questions such as:

- Do people understand and accept that a problem exists and that they contribute to it (to some extent)?
- Do people understand and accept the policy goals and their role in achieving these?
- Are they capable of changing their behaviour?
- Are economic, social or psychological factors involved?

In order to test whether a regulation is suitable or not, it is useful to consider the views of the Austrian School when developing possible alternatives to regulation. The advantage of the Austrian approach is not only that it respects the subsidiarity principle fully (meaning that government intrusion is only allowed when it is absolutely necessary), it also starts its analysis "*ex nihilo*", because the methodology of the Austrian School is based on the logical deduction from self-evident and undeniable facts about human action. The first and most important fact is that humans take *conscious* action toward chosen goals. This factor is very useful when developing possible alternatives to regulation. The Austrian School starts from the logic of human action and analyses whether (and to what extent) the preferred policy outcome can be achieved through voluntary actions, instead of using coercion. The impact of the transaction costs on these voluntary actions is crucial in this respect (see below).

The techniques of the Chicago School are very advantageous for the proportionality test in the SIT analysis. Measuring the economic effects of regulation such as efficiency issues or "dead weight losses" is based on the analysis of price changes. This makes it possible to calculate the costs and benefits of regulation for all kinds of markets and their participants, and therefore to know whether (and to what degree) a particular regulation may cause so many costs for certain service providers that it actually hinders cross-border trade in services. An easier approach lies in the measurement of compliance costs and production costs, and a calculation of how much loss in profit this will mean for companies involved. The Chicago approach is one of the best known among economists, but also requires the most empirical data in order to perform the analysis well.

Finally, Public Choice theory provides many interesting views for assessing the issues of implementation, enforcement and evaluation of the regulation. The sting is always in the tail, which means that many policy objectives, policy instruments and *ex ante* assessments of all kinds of effects can be thwarted by politicians, bureaucrats and pressure groups when applying, implementing and enforcing government intervention. Alongside this, all kinds of special interests attach themselves to particular legislation, which might severely hinder the objective evaluation of that legislation. The Public Choice School specialises in analysing such interests, processes and policy outcomes that may lead again to societal problems, taking the scenario full circle.

5.2. The legal obligations of the SD to accurately report

The Services Directive not only stipulates the need to analyse whether or not the relevant national regulations are necessary and proportionate, but also to report sufficiently on the results of assessments of existing and new regulations.[47] This means that the reports should not contain gaps or errors in the reasoning process, or obvious falsities in empirical data (used in the furnishing of proof when performing the screening). The lack of adequate reporting alone, even when the regulation in itself is necessary and proportionate, may constitute a violation of the legal obligations of the SD. The question now is what the legal consequences in terms of liability are. Another question is whether (and to what extent) private legal subjects can draw individual rights to sue.

As mentioned earlier, the reporting obligation in the SD seems only to have been issued in order to enable the mutual evaluation of the regulations in question by the Member States. It seems that no individual rights flow from this reporting obligation. Is it therefore only possible for Member States and the Commission to make use of Article 39 of the SD when requesting other Member States to render account of their reporting obligations? Do private legal subjects have no recourse should they wish to invoke the violation of this reporting obligation? Though all this seems to be the case, in the opinion of this paper it is too soon to answer these questions definitively.

The basis of the SD is to be found in Articles 43 and 49 of the EC Treaty. These articles have direct legal consequences and may be used by private legal subjects to safeguard their interests pertaining to the free cross-border trade of services. But the services sector is a special case because, according to the SD, "(t)hose barriers cannot be removed solely by relying on the direct application of Articles 43 and 49 of the Treaty, since, on the one hand, addressing them on a case-by-case basis through infringement procedures against the Member States concerned would, especially following enlargement, be extremely complicated for national and Community institutions, and, on the other hand, the lifting of many barriers requires prior coordination of national legal schemes, including the setting up of administrative cooperation."[48]

Because the main goal of the SD is to make the policy aims of the Treaty easier to achieve, the SD provides no clearly elaborated commands, bans or rules on what behaviour is allowed or forbidden, but "establishes a general legal framework which benefits a wide variety of services while taking into account the distinctive features of each type of activity or profession and its system of regulation. This framework is based on a dynamic and selective approach consisting in the removal, as a matter of priority, of barriers which may be dismantled quickly and, for the others, the launching of a process of evaluation, consultation and complementary harmonisation of specific issues, which will make possible the progressive and coordinated modernisation of national regulatory systems for service activities which is vital in order to achieve a genuine internal market for services by 2010."[49] In other words, the legal implications of the SD will evolve or be developed gradually.

That explains why the screening and reporting obligations in the SD are so important for the full implementation possibilities of Articles 43 and 49 of the EC Treaty for private legal subjects. The individual rights they draw from Articles 43 and 49 are defined by the successful implementation of the screening obligation. The duty of the Member States to report properly is a necessary condition in enforcing this screening obligation. Without this reporting, it is not possible to determine whether the screening has been performed sufficiently and, subsequently, whether the hampering of individual rights, which stem from Articles 43 and 49 of the EC Treaty, is necessary and proportionate. That is why private legal subjects should be able, whenever they have a private interest, to invoke the violation of Article 39 of the SD before court, because this seems to me the only way to safeguard the rights which stem from Articles 43 and 49 of the EC Treaty.

Considering the importance of the necessity and proportionality tests as required by the Services Directive, it is quite remarkable (and slightly unfortunate) that the European Commission for the moment offers no specific guidelines on how to furnish proof when performing the screenings. Not only would this be important for the Member States to carry out their implementation of the screening obligations well, but also to avoid political discussions and legal disputes with other Member States and with the Commission later on. The unofficial handbook on the implementation of the SD already recognises this issue stating: "Moreover, to ensure coherence in the scope of the review and the assessments of identified provisions, it would appear advisable for Member States to consider internal guidelines together with standard forms for identification and assessment of the different types of authorisation schemes and requirements. In addition, and in order to assist Member States in reporting the results of their review and assessment of legislation, the Commission services will develop and propose to Member States a methodology and structure for the national reports and will also put in place arrangements for online reporting."[50]

As already mentioned earlier, the previous Flemish Government issued, in the form of the SIT, its own internal guidelines in 2008 for the assessment of the different types of authorisation schemes and requirements. In this respect, it is important to note in advance that the SD only requires reports on the reasons why any given piece of legislation is compatible with the required necessity, appropriateness and

proportionality. This means that not every SIT analysis needs to be reported to the Commission, especially when it shows that a particular regulation is not compatible with the SD. But when this is the case, the legislation needs to be changed until it is proven compatible (by the SIT analysis).

The EU Commission for its part has developed the Interactive Policy Making (IPM) system, the method chosen for the online processing of national reports. The following points are important for the Commission, and therefore compulsory to report:

- the actual regulatory texts (or at least their references),
- what the obligation consists of,
- what reason of general interest seems to be at stake and the reasons why the requirement is justified by an overriding reasons of general interest,
- why the requirement is suitable for attaining the objective pursued and why the objective cannot be attained by a less restrictive measure.

The Commission provides no additional explanation on how to deliver, let alone how to prove, this reasoning. Because of the limited space for giving answers (only two pages) the final question is therefore how to integrate the Flemish SIT analysis into the European IPM reporting system. Because the SIT analysis will most of the time lead to extensive reports, it is rather impossible to submit the whole SIT report to the Commission. The 'executive summary' of the SIT report will have to suffice. But this raises another question: how can a summary be short, concise and complete at the same time?

In an additional study[51] for the Flemish Government, following the previous SIT study, a solution for this reporting problem was proposed which is based on two crucial elements:

- the use of key indicators that capture the crucial SIT questions
- the attribution of simple values (--, -, 0, +, ++) as answers to these questions.

Based on these two elements, answers can be developed for the central questions of the screening process as to whether the regulation at stake is necessary, suitable and proportionate. This solution would also make it possible for the Flemish Government to monitor these values over time and to make sure that the Flemish regulations remain necessary, suitable and proportionate.

6. A case study: the application of the SIT on the Belgian (federal) "IKEA-regulation"

6.1. An overview of the Belgian "IKEA-regulation"

In 2009, the Flemish Government issued a study[52] to analyse, using the SIT method, whether (and to what extent) the "IKEA-regulation" is compatible with the SD. The correct or full title of the legislation in question is the Law of 13 August 2004 'concerning the permit for distribution establishments' and the Royal Decree of 22 February 2005 'in order to clarify the criteria to take into consideration in the examination of drafts of distribution establishment and the composition of the socio-economic dossier'. But because major distribution centres or stores (such as IKEA) are its focus group, the particular legislation acquired this memorable nickname.

Central to this legislation is the obligation of Article 3 of the Law which states that the establishment of retail stores of more than 400 m² is subject to an *ex ante* permit, to be granted by the local authorities of the location where the establishment will be situated. When considering the permit, the authorities need to take several criteria into consideration: the spatial location of the establishment; the interest of consumers; and the effects on employment and on existing businesses. The IKEA legislation does not provide clear rules or criteria on what basis to grant the permit or otherwise. But these criteria are further elaborated upon in the Royal Decree and in its 'memory of explanation'.

Article 2 of the Royal Decree clarifies the concept of spatial location as the fitting of the establishment into local development projects or city patterns. Article 3 does the same thing with the concept of consumer interests, further defined as: the demographic dynamics; the impact of the new establishment in terms of product diversity and price level; the area of the service provision in relation to other existing areas; the accessibility of the new establishment by public transport or individual means. Article 4 develops the criterion of employment to encompass: the expectations of the creation of new employment in the short and long term; the impact on the overall employment; and the net gains and impact on quality. Finally, Article 5 deals with issues such as the market position of existing companies, the impact on the attraction of (neighbouring) city centres and the equilibrium and complementary nature of small and big distribution establishments.

The criteria, mentioned and set out in the Royal Decree, seem to be a mixture of economic criteria on the one hand and related to overriding reasons relating to the public interest on the other. The possible negative impacts on existing businesses in order to refuse a permit can clearly only be determined by "the case-by-case application of an economic test making the granting of authorisation subject to proof of the existence of an economic need or market demand, an assessment of the potential or current economic effects of the activity or an assessment of the appropriateness of the activity in relationship to the economic planning objectives set by the competent authority"[53], which is clearly prohibited by Article 14 of the SD.

The other criteria are not strictly forbidden and fall in the grey zone of the overriding reasons relating to the public interest, which may be used to constrain the freedom of establishment for service providers. To their advantage, the list of these overriding reasons of public interest is quite extensive: "overriding reasons relating to the public interest means reasons recognised as such in the case law of the Court of Justice, including the following grounds: public policy; public security; public safety; public health; preserving the financial equilibrium of the social security system; the protection of consumers, recipients of services and workers; fairness of trade transactions; combating fraud; the protection of the environment and the urban environment; the health of animals; intellectual property; the conservation of the national historic and artistic heritage; social policy objectives and cultural policy objectives."[54] Moreover, the ECJ stated that this list is not even exhaustive and that in the future new overriding reasons may arise.

6.2. The application of the SIT to the "IKEA-legislation"

The application of the SIT to the IKEA legislation has several levels of analysis. First, the forbidden elements are filtered out during the scoping process. The SIT primarily focuses on the necessity, suitability and proportionality tests and therefore does not have to be applied on forbidden (because of economic criteria or discrimination) sections of the IKEA legislation. Therefore, the criterion of the impacts on existing companies were viewed as forbidden by the SD and thus left out in the further SIT application. Additionally, because it appeared at first hand that the impacts of the IKEA-regulation on the distribution sector as a whole were important, it was decided that a more thorough analysis was needed.

As described before, the SIT can be viewed as a filtering system which has four different levels of filters. The elements of the legislation in question that are not compatible with the SD are filtered out by one of the tests. Three tests are already explained earlier on, the fourth test deals with administrative simplification, and although a screening of the regulation on this basis is not explicitly required by the SD, it may stem from Article 5 of the SD[55]. It is, however, not legally required to report the results of this last test.

Let us now see whether the case of the IKEA-regulation can survive these four filters or tests. For the purpose of this study, the results are conveniently arranged in a matrix (see below). We start the actual SIT analysis by stating that only four overriding reasons of general interest are indeed valid from the outset: employment; (sustainable) mobility; urban renewal; and inner city regeneration and spatial planning. But are they justified by hard facts?

When performing the necessity test, it quickly appeared to us that the "employment criterion" in the IKEA-regulation is in the long run not justified by the overriding reason relating to the public interest, more specifically the reduction or prevention of unemployment. This criterion claims to try to protect employment in the distribution sector. But the general economic theory clearly indicates that new and more efficient distribution centres will enhance competition and therefore better product choices, more innovation and labour productivity. As a result of this, though in the short run, this increased competition may indeed lead to temporary unemployment in some failing stores, the long-term employment opportunities in the distribution sector will grow more than the initial loss of jobs. The three remaining criteria on the contrary were able to withstand the necessity test and are therefore justified and valid. We may reasonably assume that sustainable mobility, urban renewal and inner city regeneration may face negative consequences of an uncontrolled location of large retail centres.

As we mentioned earlier in this paper, the suitability and proportionality tests require the comparison of the regulation at stake with other possible policy instruments. Is the regulation really both suitable and indispensable? In this respect, the Flemish study has also identified alternative policy instruments which incorporate several of the policy aims of the IKEA legislation, and represent better suitability and proportionality. If they withstand these two tests, they are able to make the IKEA legislation invalid, without sacrificing its policy goals.

Three different alternatives were identified and put to the compatibility test:

- the same requirements as the criteria of the permit system, but combined with an *a posteriori* inspection system, as required by Article 9 1. (c);
- the current Flemish regulation on spatial planning and construction permits;
- supportive, but non-coercive, policy measures, like subsidies and communication campaigns to promote the specific policy aims.

	Employment criterion	Sustainable mobility criterion	Urban renewal criterion	Spatial planning criterion
Necessity test ⇒ Conclusion: the IKEA-regulation is only necessary for 3 reasons, so no employment criterion	Not justified by an overriding reason of public interest because there is no risk of massive unemployment	Necessary because the overriding reason of public interest at stake really does exist	Necessary because the overriding reason of public interest at stake really does exist	Necessary because the overriding reason of public interest at stake really does exist
Suitability test ⇒ Conclusion: the IKEA-regulation is not the only appropriate policy instrument to tackle the three remaining overriding reasons of public interest	/	Can be covered partially by supportive policy measures, partly by the integration of a mobility impact test in the already existing building permit scheme	Can be covered mainly by supportive policy measures, and to a small degree by the integration of a mobility impact test in the already existing building permit scheme	Can be almost totally covered or tackled by the existing Flemish spatial planning regulations and building permits scheme
Proportionality test ⇒ Conclusion: the IKEA-regulation causes a lot of additional costs without much additional added value and is therefore not proportional	/	Causes a lot of *additional* compliance costs for the service providers and welfare losses for society, compared to the costs of the already existing Flemish policies and regulations	Causes a lot of *additional* compliance costs for the service providers and welfare losses for society, compared to the costs of the already existing Flemish policies and regulations	Causes a lot of *additional* compliance costs for the service providers and welfare losses for society, compared to the costs of the already existing Flemish policies and regulations
Administrative simplification ⇒ Conclusion: The combination of the existing scheme of building permits and the supportive subsidy systems is the best choice of policy instrument	/	Supportive policies create no coercive administrative costs	Supportive policies create no coercive administrative costs	A slimmed down IKEA permit scheme brings too much additional administrative costs compared to the existing permit scheme

Conclusion: the existing Flemish regulation on spatial planning, which cannot be subject of a screening because it does not fall in the application field of the SD, is now already capable of largely tackling the justified reasons of general interest (sustainable mobility, urban renewal and spatial planning). If modified slightly (e.g. through the integration of the requirement to conduct a mobility impact test when applying for a building permit for a major distribution centre), it could even deal with the issue completely. Therefore, the federal IKEA-regulation can and should be totally abolished:

- without creating or adding to (new) societal problems; and
- resulting in major reductions of compliance and administrative costs for service providers and of the welfare losses for the economy as a whole.

6.3. A "Law & Economics" evaluation of the SIT-application in the "IKEA-case study"

The final question this case study raises is whether (and to what extent) the useful tools of the additional Law & Economics perspectives used in the SIT analysis made actually a difference in the final conclusions. If not, would or should that be the case? Due to the limited framework in which this case study was utilised, to show what the potential added value of the SIT methodology can offer in practice (especially in illustrating the logical structure of the SIT), the application and integration of Law & Economics views and tools was not initially perceived as crucial.

Therefore, the IKEA case study contains only limited references to the tools and views of Law & Economics, mainly those of the Chicago School. More precisely, the welfare losses were calculated using the higher compliance costs for the distribution sector as a result of the IKEA-regulation. These higher costs lead to higher prices for the distributed goods and services. The upward shift of the supply curve leads inevitably to lower distributed quantities, and therefore results in dead weight losses or welfare losses.

The views of the other three Law & Economics schools, the Austrian School and the analysis of the transaction costs, the Public Choice School and the School of Behavioural Economics are not used in the IKEA case study. Maybe this was not considered as necessary because the use of the views of the Chicago School already provided enough proof that the IKEA legislation was not compatible with the proportionality principle of the SD (because the costs of this legislation are clearly not proportional in comparison to the possible alternatives). The SIT analysis in the end requires only those efforts which are necessary to make the case. On closer inspection, however, we may detect several opportunities to enhance the quality of the SIT by integrating the views of the other three Law & Economics schools.

Firstly, Behavioural Economics can be brought into the SIT analysis when analysing the perception of risks by policymakers (or by stakeholders) and how this perception may lead to bounded rationality and risk adverse behaviour. Usually, societal problems are exaggerated (sometimes unwillingly) because decision-makers want to justify the regulation by highlighting its problem-solving nature; this is why they tend to focus solely on the societal problem and "forget" to put the problem into perspective.

It is also possible to use concepts from Behavioural Economics when examining the underlying human behaviours which cause societal problems, where these are affected by decisions that are framed by bounded willpower. Behavioural Economics can also be very helpful when analysing spontaneous compliance and the enforcement of regulation. The use of the concepts of bounded rationality may lead to the conclusion that some societal problems, mentioned by the government as justification, are in fact a result of processes of economic adjustment (as a result of "creative destruction" processes) which happen too abruptly or are misjudged by stakeholders, but that in the long run, the spontaneous market processes will tend to the most optimal (but not perfect) situation.

The Austrian School would argue that free interactions between market players always lead to the most optimal transactions or allocations of resources. Ronald Coase, though considered to be part of the Chicago School tradition because of his focus on the measurement of transaction costs and its crucial link with the

central price mechanism, may also have been influenced by this Austrian standpoint when he issued the Coase Theorem. The theorem states that whatever the initial distribution, in the absence of transaction costs the market parties will always reach the most optimal allocation of resources. Therefore, government interference is only necessary or required if the transaction costs are so high that private negotiations will not be able to solve the allocation problem in the most optimal way.

The issue of the transaction costs was not raised in the IKEA case study. A possible reason why it was left aside may be that the policy aims of the IKEA legislation are clearly not related to possible market structure failures, information asymmetries, lack of consumer trust or other transaction costs which might have become too high. But are there no possible links at all with the issue of transaction costs? In fact, there are opportunities to integrate transaction costs into the IKEA case study because the topic of transaction costs can be used in all kinds of human interactions within society. In this respect, it would have been possible to investigate whether (and to what extent) some issues of spatial planning or mobility could be solved through negotiations and voluntary agreements between the service provider and the service provider's neighbours.

Another way to use the concept of transaction costs in the SIT pertains to the claim that the rise in compliance costs for the distribution centres may lead to cuts in distributors' budgets aimed at lowering transaction costs for consumers. Examples of potential outcomes could be: lower communication or publicity budgets, smaller car parks, or lower availability of personnel; some of which might hamper the transactions. So, the higher the compliance costs (as a result of the IKEA-regulation), the higher the transaction costs and eventually the higher the welfare losses as a result of missed of failed transactions. On the other hand, some may take the view that urban renewal and sustainable mobility will lead to perceived lower transaction costs because it makes the market transactions in some case more pleasant and therefore easier.

Finally, the Public Choice School provides many opportunities to dissect the IKEA-regulation, but none of them are actually used in the IKEA case study. Of course, this kind of analysis is politically very sensitive. Claiming the presence of regulatory capture by pressure groups and lobbyists, not only during the development of the regulation, but during application and enforcement, is quite a delicate statement. This may be thought but never openly said in public. It is therefore not uncommon that the views and analyses of the Public Choice School are only used by academics, from their removed position, far away from the political playing field.

A further use of the Public Choice theory would have been to analyse whether (and to what extent) certain economic criteria, or even overriding reasons of public interest, are used to block investments by large distribution chains, because some of these investments may harm the business of local independent merchants. A useful approach might be to focus on the aspect of distributional effects: who wins and who loses, and how might these groups react when the IKEA-regulation is applied or enforced in particular cases.

A second application of Public Choice theory relates to the question of who is the best suited to apply and enforce the regulation, bureaucrats or politicians? "What is the socially optimal allocation of policy responsibilities between elected representatives (politicians) and independent bureaucrats? And how does this optimal task allocation differ from what would be chosen by the politicians themselves? [...] More generally, what normative criteria should guide the allocation of responsibilities amongst politicians and bureaucrats? And, if politicians choose whether or not to delegate policy tasks to independent bureaucrats, should we expect systematic deviations from optimality, and if so in which direction?"[56] From this point of view, the general public interest is clearly not always optimally served by either politicians or bureaucrats; a

view which has only recently become widely accepted. In fact, it is apparent that politicians and bureaucrats are usually driven by self-interest.

Economists Alberto Alesina and Guido Tebellini have stressed the fundamental differences in motives and self-interests between politicians and bureaucrats: "To address these questions, we study a principal-agent model of public choice, where the voters are the principals and the policymakers (the agents) are motivated by a 'career concern'. But the career concern differs for politicians and bureaucrats. The former wants to win elections, by pleasing the voters. Top bureaucrats want to fulfil the goals of their organisation, so as to appear competent in the eyes of their professional peers. […] In a companion paper, we use this same analytical framework to study how bureaucrats and politicians differ in their performance of a single policy task. There we show that bureaucrats are preferable to politicians in technical tasks for which ability is more important than effort, and in purely redistributive tasks provided that the bureaucrat can be instructed to be 'fair', i.e. to fulfil some social goals specified *ex ante* behind a 'veil of ignorance'."[57]

When applying this reasoning to the IKEA-regulation, we may conclude that due to the vague and uncertain nature of the criteria of the IKEA authorisation scheme, it is unwise ("economically not optimal") for the decision-makers in these matters to be politicians or those representing political interests. This is the case at a local level where local politicians decide; or at a national level where representatives of ministers grant the authorisation or not. In this respect, it is no surprise that Article 10 of the SD actually prohibits vague and ambiguous criteria for the authorisation scheme.

6.4. What eventually happened to the IKEA-regulation?

The Belgian IKEA-regulation was never fully abolished, only changed. The forbidden authorisation criteria were abolished, but they were replaced by new requirements, such as "to be in compliance with labour law and with social security regulations". They do not seem to be additional criteria, everybody needs to comply with existing legislation, but they actually imply new sanctions or punishments for non-compliance of these labour and social security rules, by the retail businesses, and so add no regulatory burdens for them. The other requirements, or authorisation criteria, were not abolished or changed because they were considered to be necessary and proportionate. The justification of this claim remains vague and unsubstantiated. In essence very little has changed[58].

Of even greater concern is the current policy development at the Flemish level whereby the government plans to introduce a "societal disturbance (disruption) test" for each application to locate a large retail store. The following logic or reasoning is followed:

"Larger distribution centres locate at the city edge where there is more space and where the grounds are cheaper ⇒ they attract consumers from the city (with more careful use) ⇒ the local retail businesses in the city lose customers ⇒ there are less retail businesses in the city ⇒ there are less consumption possibilities in the city ⇒ the city loses attraction and vividness ⇒ the city is struck by an exodus and decay."[59]

There are two main objections which can be made against the logic of this causal link. Firstly, it may contradict Article 14's prohibition of "the case-by-case application of an economic test making the granting of authorisation subject to proof of the existence of an economic need or market demand, an assessment of the potential or current economic effects of the activity or an assessment of the appropriateness of the activity in relation to the economic planning objectives set by the competent authority". The direct aim of the Flemish Government, clearly, is to avoid the bankruptcy of local retail businesses by preventing the local

establishment of bigger retail stores, and hereby preventing their competition. Preventing an exodus from the city and city decay is only an indirect aim which is built on the achievement of the direct aim.

Secondly the causal chain as mentioned above is not empirically and irrefutably proven. In this respect we may argue that none of the necessity (the city decay being caused by the location of larger distribution centres at the city edge), nor the suitability (the introduction of the "societal disturbance test"), nor the proportionality (the economic costs and trade distortions caused by the prohibition of locating larger distribution centres at the city edge) have been considered explicitly, let alone proven.

It remains unclear what the eventual outcome of these policy intentions will be. But this case is symptomatic of the apparent lack of consideration by the Flemish (and Belgian) Governments (and probably many other Member States in the EU) of these crucial principles for the completion of the internal market. It also shows that goodwill on the part of the Member States does not seem to be enough. A big judicial stick behind the door (the ECJ) may eventually prove to be useful and welcome…

7. Some conclusions and policy recommendations

Let us now turn back to the starting point of this paper: the need for structural reform of the European economies, i.e. through the completion of the internal market for services and the complete transposition of the Services Directive more specifically.

The screening of the enormous amount and wide variety of national regulations (permits and behavioural norms), based on the necessity, suitability and proportionality principles, is indeed a very complex task and demands significant effort. This complexity is partly due to the fact that neither the Commission nor the SD itself provide much clarification of what exactly these principles mean and how the Member States have to prove whether (and to what extent) their regulations conform to these SD principles. Additionally, the screening requires both a profound screening methodology and a great deal of empirical evidence (sufficient data collection and analysis), which are not always well understood or available. Last but not least, the screening results may reveal that many national regulations reflect intrinsic protectionist tendencies to protect the "insiders" and to keep out the outsiders, especially foreign competitors. In the eyes of many national governments, a profound screening may indeed open Pandora's Box, full of political problems.

Yet without a thorough screening the SD risks becoming meaningless. Unnecessary and disproportional regulations will then remain a major source of impediments for the free and cross-border flow of services within the EU, and therefore a serious nuisance for the European Union. In turn, this will result in serious legal uncertainties and substantial missed opportunities for businesses in the services sector and beyond. This risk of insufficient screening also constitutes a major problem for the European Commission and the Member States and may result in serious political and legal conflicts. Fierce political discussions will remain whether or not some particular regulations of some Member States are necessary, suitable and proportionate, and therefore allowed to stay in force. In order to avoid these fruitless ideological discussions between supporters and opponents of the SD, a sound, objective and commonly shared methodology and good practice guidelines for the use of empirical data remain necessary.

This study has made an attempt to show, in theory and in practice, that the SIT provides an opportunity to improve the quality and thoroughness of the required screenings of regulation on the basis of necessity,

suitability and proportionality. It can do this not only because of its logical structure and its ability to turn raw empirical data into meaningful and consistent information, but also by allowing the various analytical tools of Law & Economics to be used in practice.

When the reports of many Member States turn out to be of poor quality and the Commission asks for additional information on the screening results, as required by Article 39 of the SD, then the Commission might suggest that the Member States furnish these required answers based on the SIT methodology. SIT would also be a useful supporting instrument for the Better Regulation Action Programme because the Member States could become accustomed to the Impact Assessment methodology. It would show how the SD and the Better Regulation Action Programme can be a case of 'two hands washing the other'.

A good practical way to promote the SIT would be to develop a second 'handbook for the implementation of the Services Directive – screening requirements' in which the use of the SIT is explained when performing the screening. In short, this handbook may be seen as similar to the Impact Assessment Guidelines (which have recently been updated). This handbook, like its predecessor, does not need to have any official or legally binding force but it can provide clear indications on how to screen national regulations in a legally sufficient manner.

The central question for the Commission and the Member States remains how to proceed in practice with the screening process from now on. The EC has shed some light on its intentions and has launched several major initiatives towards a full transposition of the SD in all Member States. Firstly, and "[a]s a matter of priority, the Commission will continue and step up work with Member States on an individual basis so as to achieve a complete and correct transposition and implementation of the Services Directive in all Member States."[60] In the first half of 2011, the Commission carried out a series of bilateral meetings with those Member States where there were strong indications of incorrect or incomplete implementation of the Services Directive. The Commission clearly stated from the beginning that "[w]hen needed, formal enforcement measures will be taken."[61]

Next to this and "[b]eyond the implementation of the Directive, and in accordance with the European Council conclusions of 24/25 March 2011 the Commission, together with the Member States, will carry out 'performance checks' aimed at closer scrutiny of the practical functioning of the EU regulatory framework applicable to certain growth sectors such as business services, construction and tourism. It will carry out further assessments on reserved activities, requirements as regards capital ownership and legal form, and insurance obligations, all of which are persistent obstacles to better integration of the markets in services. On the basis of the outcome of these various initiatives, the Commission will decide in 2012 on the subsequent steps."[62]

The European Commission explains this new approach: "The aim here will be to assess the situation from the perspective of the users of the Single Market, such as the company that wants to open a subsidiary in another Member State, the self-employed person who wants to provide services across borders, the SME or the consumer seeking to use services provided by someone established in another Member State. The 'performance check' should provide an assessment of how different pieces of EU legislation are applied and how they work on the ground. […] The 'performance check' should allow the formulation of sector-specific conclusions on the functioning of the Single Market for services and, where necessary, identify the need for other actions, including legislative intervention if required. [Finally, i]n order to ensure that the freedom to provide services clause in Article 16 of the Services Directive is applied properly and consistently in all Member States, the Commission will closely monitor its application and discuss its findings with all Member States. This process can be built upon the Services Directive itself, which already foresees that the

Commission reports on the functioning of this clause. The monitoring should, to a large extent, be based on the collection of information and views from Member States and stakeholders."[63]

In summary, the Commission seems to be taking steps in the near future in a gradually growing but cautiously implemented evaluation process. Firstly, it will probably tackle the easiest screening results or the "low hanging fruit" (a clear lack of new legislation which transposes the SD or existing national regulations which are clearly in dispute with the SD or cause extensive economic damage), and then (very) carefully move towards the more complex issues during the following ten years. An important evaluation tool will be the market monitoring which stems from the Internal Market Review. Through this market monitoring, the Commission will be able to focus on these national regulations which have the biggest (negative) impacts on the cross-border flows in services.

We may therefore conclude that the deadline of 28 December 2009 was not the end of the transposition process of the SD, but actually the start of it. The SD and the further development of a true internal market for services need further development of liberalisation tools. From now on the Commission has to enter the playing field and the real work on the screening of national regulations must start. Central in this "real work" will be the "mutual evaluation" or quality check of the reported or submitted screening results on a continuous basis, by the Commission and the pioneering Member States.

In addition to this, the Commission needs strong support from "pulling and pushing" or pioneering Member States, e.g. the UK, Ireland, the Netherlands and Sweden, who want to open up the markets in neighbouring Member States for their service providers, if necessary through the ECJ and national courts. This support should take the shape of two kinds or tracks of initiatives:

- First, the "pioneering" Member States must vigorously monitor the effective removal of trade-distorting regulations in other more reluctant Member States and, if necessary, by suing before court these protectionist Member States. The Netherlands, for example, could question those screening results, which are even considered to be (severely) biased, from its most important trading partners within the EU such as Belgium (Flanders). These trading partners will then be asked to provide detailed answers as to why they came to the conclusion that their regulations are considered to be necessary, suitable and proportionate, and are therefore being kept in place.
- In addition to this, there is newly launched initiative of the Dutch Prime Minister Mark Rutte in which at least nine Member States could work together more closely in establishing the internal market for services.[64] They could do so by recognising each other's regulations, and therefore by re-introducing "the country of origin" principle (as initially removed in the current Article 16 of the SD). In the light of this study, this approach seems to be much more effective and efficient in lifting trade distorting regulations.

This two-track approach, using both carrot and stick, will eventually lead to higher economic growth in the EU, a highly desirable policy aim in these economically troubled times, with huge but necessary budget cuts. Eventually, economic growth can only be achieved through micro-economic reform, not by way of using macro-economic sorcery such as deficit spending and monetary loosening which will eventually lead to a bigger economic mess than the one we see today.

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Endnotes

[1] European Economic Forecast, Autumn 2011, European Economy Series 6/2011, European Commission, p.1.

[2]Ibidem

[3] Communication from the Commission, *Single Market Act – Twelve levers to boost growth and strengthen confidence*, COM(2011) 206 final, Brussels, 13.4.2011, p. 3

[4]Communication from the Commission, *Towards a better functioning Single Market for services, building on the results of the mutual evaluation process of the Services Directive*, COM (2011) 20 final, Brussels, 21.1.2011,, p. 2.

[5]*Single Market Act*, o.c., p. 3

[6]Towards a better functioning Single Market for services, o.c., p. 2-3

[7] Official Journal of the European Union L 376, 27.12.2006, pp. 36-68.

[8]Recital 6 of the SD.

[9]Recital 7 of the SD: "This Directive establishes a general legal framework which benefits a wide variety of services while taking into account the distinctive features of each type of activity or profession and its system of regulation. That framework is based on a dynamic and selective approach consisting in the removal –as a matter of priority – of barriers that can be dismantled quickly; and for others, the launching of a process of evaluation, consultation and complementary harmonisation of specific issues, which makes possible the progressive and coordinated modernisation of national regulatory systems for service activities – vital in order to achieve a genuine internal market for services by 2010. Provision should be made for a balanced mixture of measures involving targeted harmonisation, administrative cooperation, the improvement of freedom for service provision and encouragement of the development of codes of conduct on certain issues."

[10]Recital 46 of the SD.

[11]Recital 48 of the SD.

[12]Recital 54 of the SD.

[13]Recital 65 of the SD.

[14]Recital 66 of the SD.

[15]Recital 65 of the SD.

[16]Recital 69 of the SD.

[17]Recital 92 of the SD.

[18]Recital 97 of the SD.

[19]Recital 102 of the SD.

[20]Recital 105 of the SD.

[21]Recital 74 of the SD.

[22]Recital 2 of the SD.

[23]Recital 3 of the SD.

[24]Recital 5 of the SD.

[25]Recital 6 of the SD.

[26] See, i.a, Case C106/89 Marleasing [1990] ECR I-4135, paragraph 8; Case C126/96 Inter-Environnement Wallonie [1997] ECR I-7411, paragraph 40; Case C131/97 Carbonari and Other [1999] ECR II 103, paragraph 48.

[27]Case C106/89 Marleasing [1990] ECR I-4135, paragraph 8; Joined Cases C240/98 to C244/98 Océano Grupo Editorial and Salvat Editores [2000] ECR I-4941, paragraph 30.

[28]Case C-397/01 Bernhard Pfeiffer [2004], in joined Cases C-397/01 to C-403/01, ECR I-08835.

[29] Article 9 of the SD:

"1. Member States shall not make access to a service activity or the exercise thereof subject to an authorisation scheme unless the following conditions are satisfied: […]

(b) the need for an authorisation scheme is justified by an overriding reason relating to the public interest;

(c) the objective pursued cannot be attained by means of a less restrictive measure, in particular because an a posteriori inspection would take place too late to be genuinely effective."

Article 10 of the SD:

"1. Authorisation schemes shall be based on criteria which preclude the competent authorities from exercising their power of assessment in an arbitrary manner.

2. The criteria referred to in paragraph 1 shall be: […]

(b) justified by an overriding reason relating to the public interest;

(c) proportionate to that public interest objective; […]".

[30] Article 15 of the SD:

"3. Member States shall verify that the requirements referred to in paragraph 2 satisfy the following conditions: […]

(b) necessity: requirements must be justified by an overriding reason relating to the public interest;

(c) proportionality: requirements must be suitable for securing the attainment of the objective pursued; they must not go beyond what is necessary to attain that objective and it must not be possible to replace those requirements with other, less restrictive measures which attain the same result."

[31] Article 16 of the SD:

"1. [...] Member States shall not make access to or exercise of a service activity in their territory subject to compliance with any requirements which do not respect the following principles: […]

(b) necessity: the requirement must be justified for reasons of public policy, public security, public health or the protection of the environment;

(c) proportionality: the requirement must be suitable for attaining the objective pursued, and must not go beyond what is necessary to attain that objective."

[32] Article 18 of the SD provides another exemption to Article 16: the case-by-case derogations: "By way of derogation from Article 16, and in exceptional circumstances only, a Member State may, in respect of a provider established in another Member State, take measures relating to the safety of services. The measures […] may be taken only if […] the following conditions are fulfilled […] d. the measures are proportionate."

[33]Recital 40 of the SD.

[34]Recital 41 of the SD.

[35]Recital 82 of the SD.

[36] See Case C-19/92 Kraus v. Land Baden-Württemberg [1993] ECR I-1663, paragraph 32; Case C-55/94 Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, [1995] ECR I-4165, paragraph 37.

[37]Keyaerts, D 2008, ,'Behoorlijke wetgeving in de rechtspraak van het Hof van Justitie 2006 – 2007', *Tijdschrift voor Wetgeving*, no. 2, pp. 46-74.

[38] Case C-170/04 Rosengren v. Riksaklagaren [2007] EUR-Lex; 62004J0170.

[39]Joined cases C-544/03 and C-545/03 Mobistar and Belgacom Mobile [2005] ECR I-7723, paragraphs 30 - 31.

[40] Communication from the Commission, *A strategic review of Better Regulation in the European Union*, COM(2006) 689 final, Brussels, 14.11.2006.

[41]OECD [1995], *Recommendations on improving the quality of government regulation*, (Also see OECD [1997], *Report on regulatory reform - summary*, and OECD [1997], *Report on regulatory reform – synthesis report*,

[42] OECD [1997], *Report on regulatory reform – synthesis report*, p. 28.

[43]Mandelkern D [2001] *Mandelkern Group on Better Regulation, Final Report*, European Commission, Brussels, <http://ec.europa.eu/governance/better_regulation/documents/mandelkern_report.pdf>, pp. 9-10.

[44]*Better Regulation – simply explained*[2006], European Communities, Luxembourg, <http://,ec.europa.eu/governance/better_regulation/brochure_en.htm>, pp. 3-4.

[45]Opinion of Advocate General Sharpston of March 16th 2006, C-310/04, Spain vs Council, paragraphs 80-81.

[46] Government of Canada [1994], *Assessing Regulatory Alternatives*, <http://dpac.tas.gov.au/_data/assets/pdf_file/0015/121137/18_Canadaassessing_reg_alternatives_e.PDF

[47] Article 9 of the SD:

"2. In the report referred to in Article 39(1), Member States shall identify their authorisation schemes and give reasons showing their compatibility with paragraph 1 of this Article."

Article 15 of the SD:

"5. In the mutual evaluation report provided for in Article 39(1), Member States shall specify the following:

the requirements that they intend to maintain and the reasons why they consider that those requirements comply with the conditions set out in paragraph 3."

Article 39 of the SD on mutual evaluation:

"1. By 28 December 2009 at the latest, Member States shall present a report to the Commission, containing the information specified in the following provisions:

Article 9(2), on authorisation schemes;

Article 15(5), on requirements to be evaluated; […]

5. By 28 December 2009 at the latest, Member States shall present a report to the Commission on the national requirements whose application could fall under the third subparagraph of Article 16(1) […], providing reasons why they consider that the application of those requirements fulfil the criteria referred to in the third subparagraph of Article 16(1).

Thereafter, Member States shall transmit to the Commission any changes in their requirements, including new requirements, as referred to above, together with the reasons for them."

[48]Recital 6 of the SD.

[49]Recital 7 of the SD.

[50] Internal Market and Services DG [2007], *Handbook for the implementation of the Services Directive*, Commission of the European Communities, Brussels, p. 76.

[51] This study in Dutch has not been published yet.

[52] This study in Dutch has not been published yet.

[53]Article 14, 5) of the SD.

[54]Article 4 (8) of the SD.

[55] Article 5 (1) of the SD:

"Member States shall examine the procedures and formalities applicable to access to a service activity and to the exercise thereof. Where procedures and formalities examined under this paragraph are not sufficiently simple, Member States shall simplify them."

[56]Alesina, A, Tabellini, G [2008], 'Bureaucrats or politicians? Part II: multiple policy tasks, *Journal of Public Economics,* vol. 92, pp. 426-427.

[57]Ibidem, p. 427.

[58]See the recitals and parliamentary deliberations of the Belgian law of 22 December 2009 ("Wet van 22 december 2009 tot aanpassing van sommige wetgevingen aan de Richtlijn 2006/123/EG van het Europees Parlement en de Raad betreffende diensten op de interne markt") which changed the original the permit criteria for commercial establishments,and the Royal Decree of 13 January 2010 which implements this changed law ("Koninklijk besluit van 13 januari 2010 tot wijziging van het koninklijk besluit van 22 februari 2005 tot verduidelijking van de criteria waarmede rekening moet worden gehouden bij het onderzoek van ontwerpen van handelsvestiging en de samenstelling van het social-economisch dossier"). <http://www.ejustice.just.fgov.be>

[59]Flemish Government, "Startnota Winkelen in Vlaanderen" (translation: "Startnote Shopping in Flanders"), VR 2010 2307 DOC.0674BIS,http://www.vvsg.be/economie_en_werk/economie/detailhandel/winkelnota/Pages/Winkelnota.aspx, p. 8.

[60]Communication from the Commission, *Towards a better functioning Single Market for services, building on the results of the mutual evaluation process of the Services Directive*, COM (2011) 20 final, Brussels, 21.1.2011,, p. 8.

[61]Ibidem

[62] Communication from the Commission, *Single Market Act – Twelve levers to boost growth and strengthen confidence*, COM(2011) 206 final, Brussels, 13.4.2011, p. 11

[63] Communication from the Commission, Towards a better functioning Single Market for services, building on the results of the mutual evaluation process of the Services Directive, COM (2011) 20 final, Brussels, 21.1.2011, pp. 8-10.

[64]Editorial, 'A new Hanseatic League', Wall Street Journal, 28 January 2011, p. 12.

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