econPOL
POLICY REPORT

52
2024

November
Vol. 8

Building a Stronger Single Market: Potential for Deeper Integration of the Services Sector within the EU

Florian Dorn, Lisandra Flach and Isabella Gourevich

CESifo ifo INSTITUTE

The study was conducted on behalf of the Chamber of Industry and Commerce for Munich and Upper Bavaria, previously published in German (Dorn, F., Flach, L. and Gourevich, I., 2024: "*Die EU und der Binnenmarkt – Potenziale eines vertieften Dienstleistungshandels*").

All rights reserved, in particular the right of reproduction, distribution, and translation. No part of this work may be reproduced in any form (by photocopy, microfilm, or any other process) or stored, processed, duplicated, or distributed using electronic systems without written permission.

EconPol Europe is CESifo's economic policy platform. With key support from the ifo Institute, it seeks to leverage CESifo's globe-spanning network of more than 2,000 high-ranked economists – at least a dozen of whom have won the Nobel Prize – and ifo's decades-deep research expertise to provide well-founded advice to European policymakers and to facilitate informed decisions. Drawing on the wide range of specializations of its members, EconPol's mission is to contribute to the crafting of evidence-based, effective economic policy in the face of the rapidly evolving challenges faced by the European economies and their global partners.

EconPol POLICY REPORT
A publication of the CESifo Research Network

Publisher and distributor: CESifo GmbH
Poschingerstr. 5, 81679 Munich, Germany
Telephone +49 89 9224-0, Email office@cesifo.de
Shipping not included
Editor of this issue: Clemens Fuest, Florian Dorn
Reproduction permitted only if source is stated and copy is sent to CESifo.

EconPol Europe: www.econpol.eu

Building a Stronger Single Market: Potential for Deeper Integration of the Services Sector within the EU

Florian Dorn, Lisandra Flach and Isabella Gourevich

ifo Institute, Munich, November 2024

Abstract

The service sector has been a key driver of growth in the European Union (EU) over the past two decades. However, despite the principle of free movement of services, the single market still faces significant national barriers and remains a patchwork of 27 systems across member states. Administrative hurdles are the most significant obstacles. These barriers significantly hinder cross-border trade in services.

Our quantitative analysis shows that reducing barriers and better harmonizing regulations within the EU would deepen the integration of the EU internal market for trade in services. This would lead to gains in value added across all sectors, strengthening Europe's economy and competitiveness and generating substantial welfare gains.

Table of Contents

Executive Summary **3**

1 Introduction **6**

2 Service Sector as a Driver of Growth **8**

3 Intra-European Barriers to Trade in Services **12**

4 Policy Scenarios and Results **16**

4.1 Gains in Value Added by Reducing Trade Barriers by 10% 17

4.2 Sectoral Value-Added Gains 18

4.3 Gains in Added Value by Reducing Trade Barriers by 25% 21

5 Conclusion and Recommendations **23**

References **25**

Appendix **27**

List of Figures **29**

List of Tables **29**

Executive Summary

This study analyzes the service sector in the European Union (EU), by examining the extent to which the integration of this sector, which contributes significantly to the gross domestic product of the EU member states, can be strengthened and its untapped potential unleashed. The first part of the study describes how trade in services has evolved in recent years. The second part describes intra-European barriers to trade in services. The third part analyzes policy scenarios to unlock the potential of deeper integration in services trade in the EU. The final chapter outlines policy measures.

The results of the descriptive analysis of the evolution of trade in services can be grouped as follows:

- **Stagnation in trade in goods, growth in trade in services:** While trade in goods has stagnated in the EU, trade in services has gained importance in relation to GDP.
- **Services as a growth driver:** Services, particularly in tradable sectors such as IT and financial services, have established themselves as dynamic growth drivers in the EU, accounting for 81.9% of European economic growth between 2000 and 2023. In recent years, this growth has mainly taken place within the member states. This points to significant growth potential that could go hand in hand with deeper EU integration.
- **The EU's trade in services has grown at an annual rate of 4.5% over the past 13 years.** The EU mainly trades in business-related services, with the strongest growth recorded in information and communication, intellectual property and manufacturing services.
- **Services are an essential input in all industries:** The growing demand for customized products and machinery is leading to a greater integration of the service sector with other sectors of the economy. The manufacturing industry obtains 32.6% of its inputs from the services sector, and agriculture and forestry 42.2%. This suggests that the liberalization of trade in services will have a positive impact on the economy as a whole.

In order to gain a more comprehensive understanding of the nature of existing barriers to trade in services in the EU, the second chapter analyzes trade barriers. The key results can be summarized as follows:

- **Despite the principle of free movement of services in the EU, the reality is a patchwork of 27 separate systems:** Within the European Union, there are still different regulations and market access barriers to intra-EU trade in services. While these barriers are lower than the barriers to extra-EU trade, they significantly hamper the flow of services.
- **There are marked differences between EU member states and between the various sectors:** The Netherlands, Lithuania, Sweden, Denmark, and Estonia have particularly open markets, while Luxembourg, Belgium, Austria, and France have the most restrictive trade barriers. On average, sectors such as air transport, sales, and legal advice are among the most heavily regulated sectors not only in the EU, bus also in the European Economic Area (EEA), which also includes non-EU members such as Iceland, Lichtenstein and Norway. Barriers in all sectors vary greatly from country to country, leading in practice to 27 different national systems within the EU.
- **Administrative barriers are the main obstacle to the smooth provision of services abroad:** Most member states impose various requirements on foreign service providers. These are mainly administrative requirements such as the need for prior authorization, additional insurance, or the recognition of qualifications. The fragmentation of regulations, combined with non-transparent and difficult access to information on the respective requirements, makes it difficult to provide services smoothly in other countries.

The third part of the study uses the ifo trade simulation model to quantify the economic effects of increased trade in services within the EU. In particular, we simulate a 10% and a 25% reduction in non-tariff barriers to trade in services within the EU. The results can be summarized as follows:

- **The removal of non-tariff barriers to trade in services within the EU leads to gains in value added for all member states:** While in absolute terms Germany, Ireland, France, Belgium, and Italy would benefit the most from a reduction in barriers, it is smaller countries, such as Ireland, Luxembourg, and Malta, that would benefit the most in relative terms. A 10% (25%) reduction in non-tariff barriers could increase value added by 0.5% (2.3%) in the EU and by 0.4% (1.8%) in Germany, its largest economy. At 2023 prices, this corresponds

to an annual increase in gross value added of EUR 77 billion (EUR 355 billion) in the EU in the medium term.

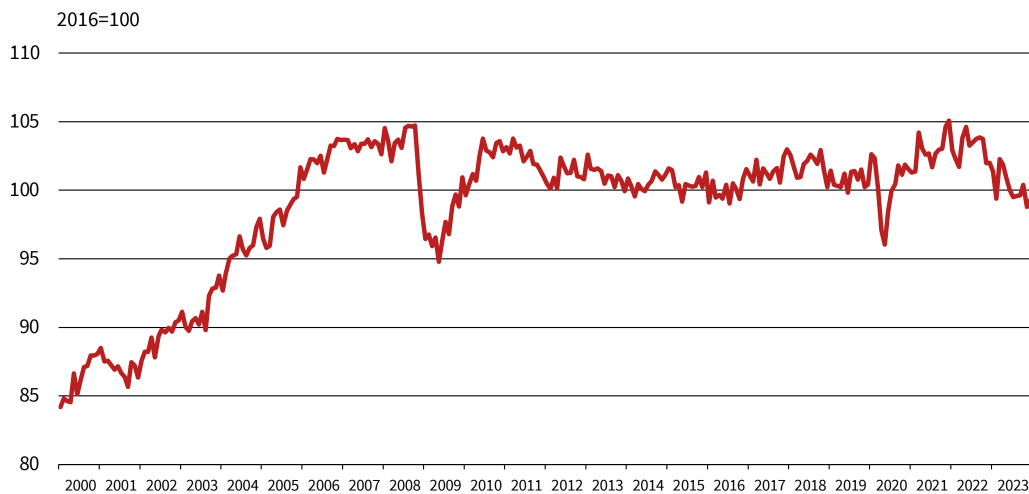
- **The removal of non-tariff barriers to trade in services within the EU leads to gains in value added in all sectors:** Financial services, insurance, transport, and leisure would observe the largest percentage increases, but the industry would also significantly benefit from the liberalization of trade in services.
- **German industry could benefit significantly from the synergies between trade in services and trade in goods:** In Germany, the manufacturing industry would benefit significantly from the liberalization of European trade in services, while transportation, warehousing, and tourism and leisure are expected to experience smaller increases.

The last chapter of the study summarizes policy recommendations.

1 Introduction

Globalization and the international division of labor were important drivers of welfare gains in the EU. Until the global financial crisis, trade in goods was one of the key drivers of economic growth. However, the rapid globalization of goods markets has entered a phase of stagnation since the global financial crisis (see Figure 1). In view of these developments, it is important to explore additional sources of economic growth.

Figure 1: Index of Goods Market Globalization

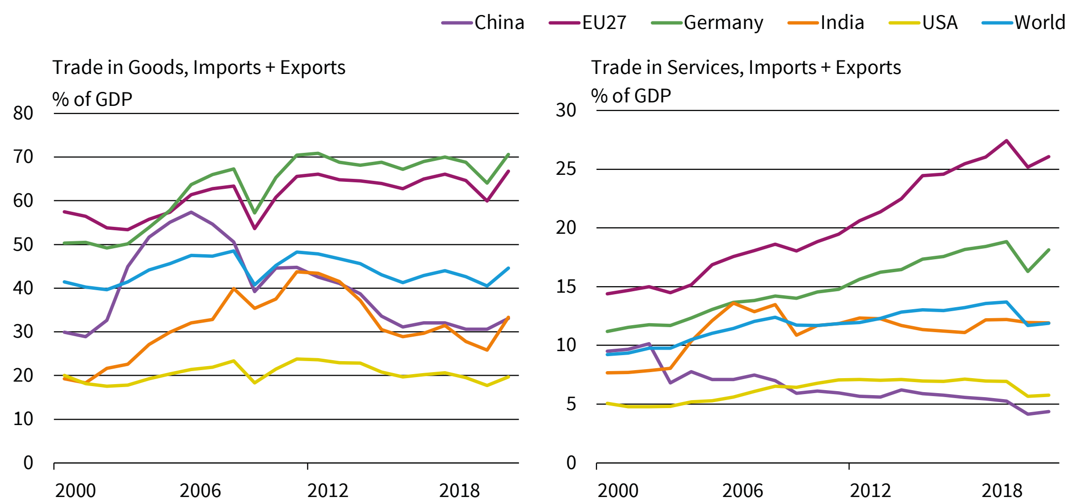


Note: The index shows how the global trade in goods has performed in comparison to global industrial produc-tion. The volume index of global trade is divided by the volume index of global industrial production. Since the financial crisis, global trade in goods has not expanded any faster than industrial production.
Source: CPB 2024; calculations by the ifo Institute.

© ifo Institute

While the GDP share of foreign trade in goods has always been low in the United States, at around 20%, in the expanding emerging markets of China and India it has fallen significantly since the financial crisis, most recently stabilizing at around 30% (Figure 2). Relative to their economic output, these economies are exporting or importing less and less, partly because domestic demand is increasingly being met by domestic production. In the EU27 the ratio of foreign trade in goods to economic output has stabilised at a relatively high level since 2012, at around 65% (70% in Germany's heavily export-oriented economy). Although Europe continues to benefit significantly from global trade in the goods it produces, it remains more dependent on functioning global value chains. Figure 2 also shows that the share of trade in services in the EU, although at a low level, has risen steadily since the financial crisis; it is now close to 20%, while trade in goods is moving sideways. That said, trade in services has grown despite significant barriers, which suggests the potential for further integration and expansion of such trade in the EU.

Figure 2: Development of Trade in Goods and Services in Relation to GDP



Source: World Bank; calculationy by the ifo Institute.

© ifo Institute

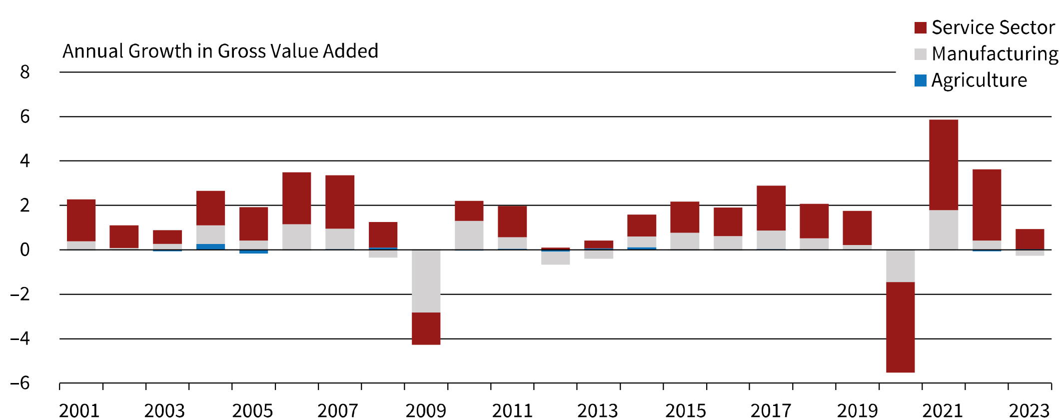
Recent crises have shown how geopolitical challenges and structural upheavals can quickly become risks to the competitiveness of the European Union's economy. In order to boost prosperity and competitiveness, risks must be reduced without sacrificing the welfare gains and benefits of the international division of labor. The focus must therefore be on strengthening the EU's internal market and identifying untapped growth potential rather than on reshoring production. Despite the freedom of the single market, there are still considerable barriers in the EU, especially in the services sector, which mean that many (service) firms are unable to take full advantage of the size of the EU market. This puts in particular small and medium-sized enterprises (SMEs) and digital and innovative start-ups at a competitive disadvantage in Europe compared to large integrated markets such as those in the United States or China. The growth potential of trade in services could be further enhanced by the dynamics of digitalization, the increasing demand for customized products and the interlinkages with other sectors of the economy. Removing barriers and creating a coherent internal market for services can therefore strengthen Europe's economic power, increase its resilience and boost its global competitiveness.

By focusing on the untapped potential of trade in services in the EU, the extent of existing trade barriers and the impact of reducing trade costs on welfare and value-added creation across sectors, our study identifies the most important barriers to trade for EU businesses. The results clearly show that there is considerable untapped potential for all countries in the European Union, particularly in the service sector.

2 Service Sector as a Driver of Growth

Over the past two decades, the service sector has made a significant contribution to EU's economic growth (Figure 3). Adjusted for price changes, gross value added in the EU27 increased by 37.1% between 2000 and 2023. Services alone accounted for 30.4% of this growth, dwarfing the increase in gross value added in manufacturing (6.4%) and in the agricultural sector (0.2%). This means that the services sector alone contributed almost 82% to the overall growth in gross value added (Figure 4).

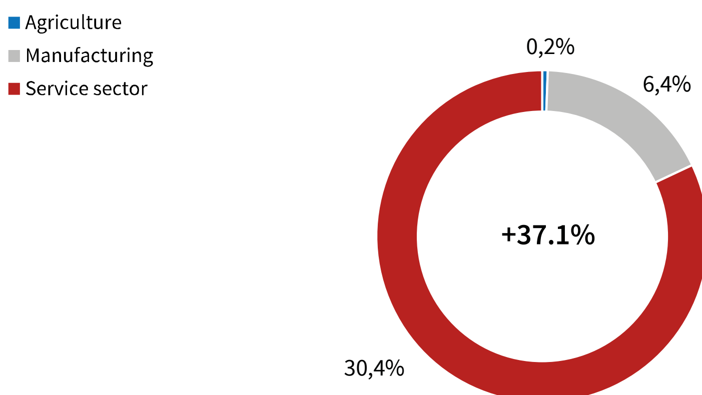
Figure 3: Sectoral Contribution to Growth in Gross Value Added in the EU27



Source: Eurostat; calculations by th ifo Institute. © ifo Institute

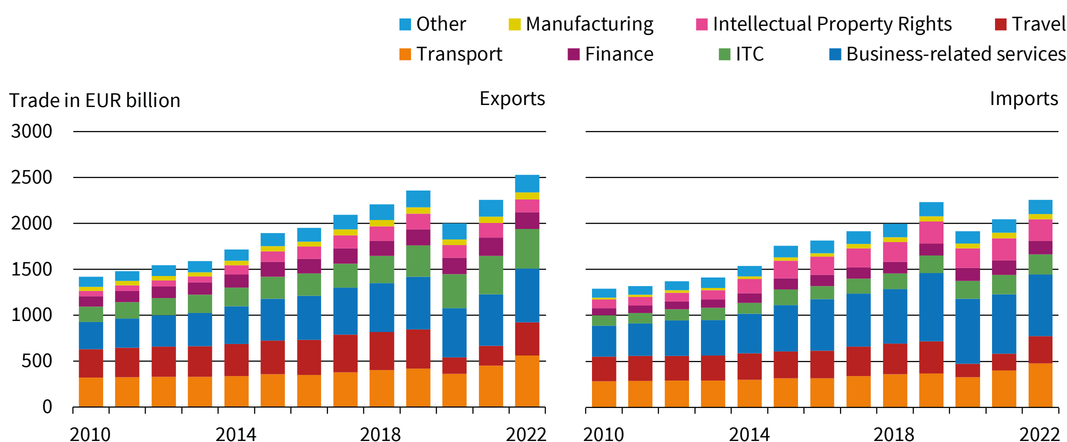
These figures highlight the service sector's considerable growth potential and show that it has already established itself as a key driver of the European economy, despite being still predominantly provided within national borders. Despite barriers, the trend is steadily positive in the EU, including in trade in services (Figure 5). Between 2010 and 2023, trade in services recorded a 4.5% annual growth rate. The composition of traded services is similar for both exports and imports, with business-related services playing a dominant role. The fastest-growing export sectors in services include information and communication, property rights (e.g., licenses), and manufacturing services.

Figure 4: Sectoral Contribution to Growth in EU27, 2000-2023



Source: Eurostat; calculations by the ifo Institute. © ifo Institute

Figure 5: EU27 Trade in Services



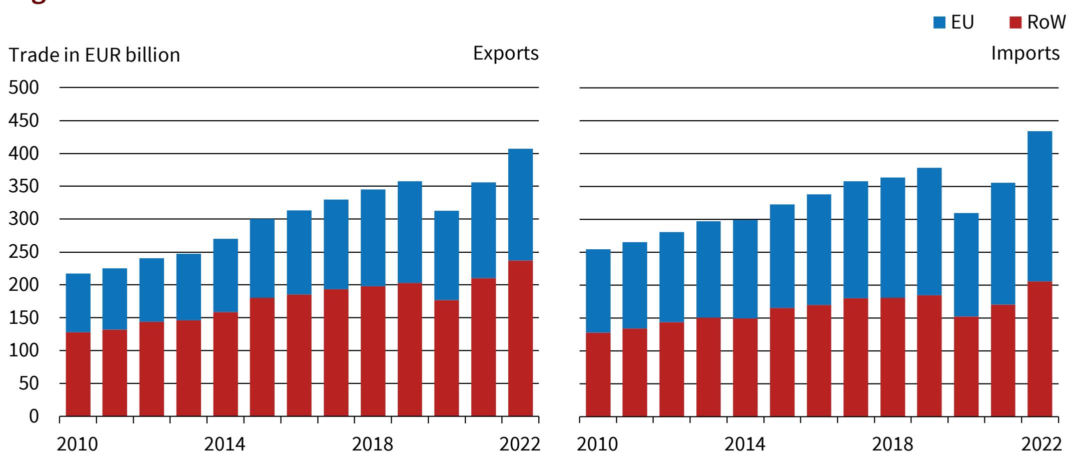
Note: The volumes are the sum up of intra- and extra-EU international trade in services. The prices shown have been adjusted as of 2022.
Source: Eurostat; calculations by the ifo Institute. © ifo Institute

To exemplify the role of trade in services, we have a closer look at Germany, the largest economy in the European Union. Despite the growth in exports (4.9% p.a.) and imports (4.2% p.a.), Germany has recorded a slight trade deficit in services (Figure 6). The EU is one of Germany's most important trading partners, which underlines the importance of lowering trade barriers within the EU. The US, the United Kingdom, and Switzerland are also important trading partners for services, differing somewhat from the group of most important trading partners for goods. China, in particular, plays an important role for trade in goods but less so in services trade (Table 1).

Germany is also an interesting case to investigate interdependencies between the service sector and other sectors of the economy, as illustrated by the sectoral

interdependencies shown in Figure 7. These interdependencies reveal that the manufacturing sector obtains 32.6% of its inputs directly from the service sector. This dependence is even more pronounced for agriculture, forestry, and fisheries, where 42.2% of inputs come from the services sector. These interdependencies suggest that a liberalization of trade in services could have far-reaching positive effects on the German economy.

Figure 6: German Trade in Services



Note: The prices shown have been adjusted as of 2022. "RoW" denotes Rest of world.
Source: Eurostat; calculations by the ifo Institute.

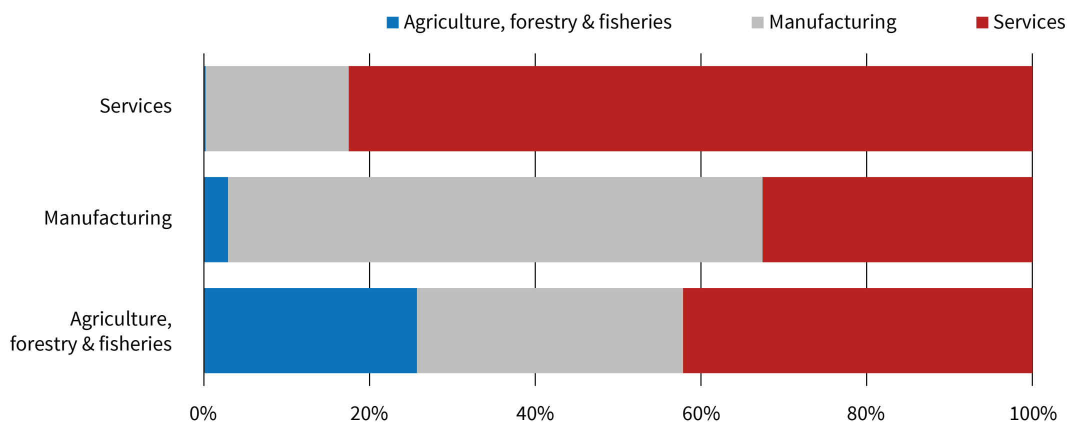
© ifo Institute

Table 1: Germany's Most Important Trading Partners

Services				Goods			
Partner	Exports in %	Partner	Imports in %	Partner	Exports in %	Partner	Imports in %
EU	37.9	EU	43.2	EU	48.8	EU	45.3
US	18.5	US	12.4	US	8.9	CN	8.2
UK	8.3	UK	8.8	CN	7.6	US	4.5
CH	8.2	CH	4.4	UK	4.8	CH	3.7
JP	1.7	JP	1.7	CH	4.4	UK	2.4
SG	1.4	SG	1.5	RU	1.9	RU	2.0
IN	1.1	IN	1.5	TR	1.6	JP	1.4

Source: Eurostat; calculations by the ifo Institute.

Figure 7: Sectoral Interdependencies in Germany, 2019



Source: Destatis; calculations by the ifo Institute. © ifo Institute

Reducing trade barriers in the service sector could therefore also act as a catalyst for efficiency gains and cost reductions in other sectors. For example, improved logistics services or more efficient consultancy services could also directly increase the manufacturing sector's productivity and competitiveness. In addition, many industrial companies also provide services for their products, for example by offering leasing and financing for cars, which could lead to an increase in automotive production. These effects are reinforced by the growing preference for customized products and machinery, which leads to an even closer integration of the service sector with other sectors of the economy — a phenomenon that is often referred to as the "*servitization*" of the manufacturing industry. Additional services such as maintenance, special adaptations, or support services are offered together with physical products. This increasing integration of services into the manufacturing sector emphasizes the importance of improving the efficiency in service provision, as this might generate important spillover effects to other sectors of the economy.

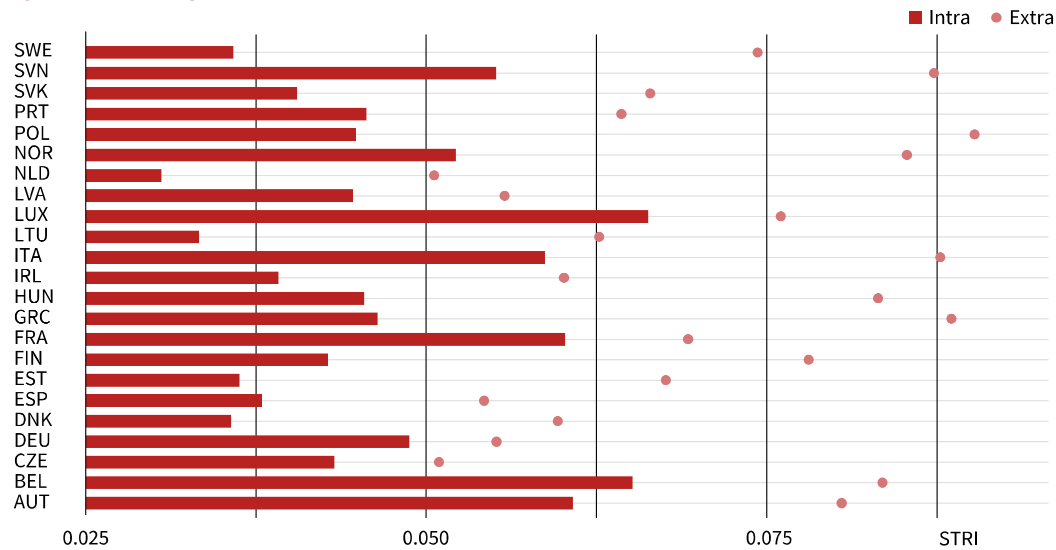
3 Intra-European Barriers to Trade in Services

The principle of free movement of services is fundamentally anchored in the EU and was implemented in EU law with the adoption of the Services Directive back in 2006. The core principles of the single market for services include the freedom to establish a company or business in another EU country (Article 49 TFEU) and to provide or receive services in an EU country other than the one in which the company is established (Article 56 TFEU). In theory, there should therefore be no barriers to the provision of services within the European single market, and the EU has already attempted to reduce existing barriers in the member states with various packages of measures (including the 2017 services package).

However, the practical implementation of the free movement of services in the EU single market is still patchy. The discrepancy becomes particularly clear when looking at the OECD Service Trade Restrictiveness Index (STRI),[1] which quantifies non-tariff trade barriers in the service sector. Figure 8 shows the average level of these barriers in the countries of the European Economic Area (EEA), distinguishing between barriers for service providers from other EEA countries (intra-EEA STRI) and for service providers from third countries (extra-EEA STRI). Although the barriers to market access for non-EEA countries are generally more restrictive, firms from the EEA continue to face considerable obstacles when providing services in other EEA countries. The average strength of barriers to cross-border trade in services for firms in the EEA is often even closer to the obstacles faced by furns outside the EEA. As a result, market access to other member states is only possible to a limited extent, and there is no free and fair competition. Countries such as Luxembourg, Belgium, Austria, Italy, and France have particularly restrictive regulations on cross-border trade in services, while the Netherlands, Lithuania, Sweden, Denmark, and Estonia have comparatively more open markets for service providers in the EEA.

[1] The OECD Services Trade Restrictiveness Index (STRI) is an evidence-based tool that provides information on regulations affecting trade in services in 22 sectors in all OECD member countries and 11 other countries. These countries and sectors account for more than 80% of the global trade in services. For the EEA countries, the restrictions measured are directed against other member states of the internal market (intra-EEA index), as well as an index that measures the restrictions against third countries (extra-EEA index).

Figure 8: Average Intra- and Extra-EEA STRI by Country, 2022

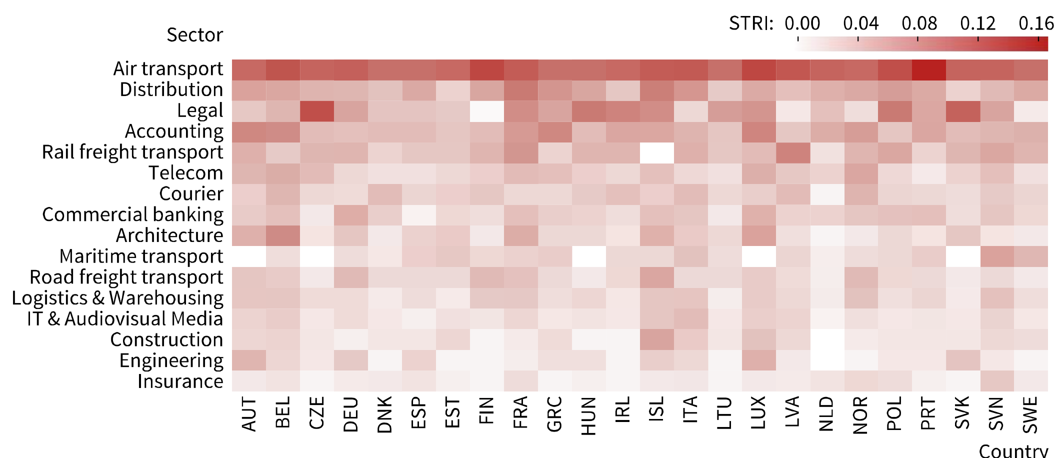


Note: The STRI quantifies the non-tariff barriers to trade in services in an index ranging from 0 – open to 1 – very restrictive.
Source: OECD; calculations by the ifo Institute.

© ifo Institute

Not only do EU firms face a patchwork of varying degrees of regulation and non-tariff barriers to cross-border trade in services between member countries, but a closer look reveals that restrictions vary considerably across sectors. On average, sectors such as air transportation, distribution, and legal services are among the most heavily regulated sectors in the EEA member states (Figure 9). Above all, however, barriers in all sectors vary considerably from country to country. Hence, in practice, firms from different sectors do not face a coherent single market but 27 different national systems within the EU. As a result, there are 27 different sets of laws and regulations for each economic sector, each regulating access for the provision of services, instead of a harmonized single market across the common economic area. This makes it particularly difficult for small and medium-sized enterprises (SMEs) to comply with the regulations of all member states, to operate in the single market with legal certainty, and to offer their services without having to incur large costs. As a result, the size and strength of the EU market, with almost 450 million people, cannot be fully exploited.

Figure 9: Intra-EEA STRI, 2022



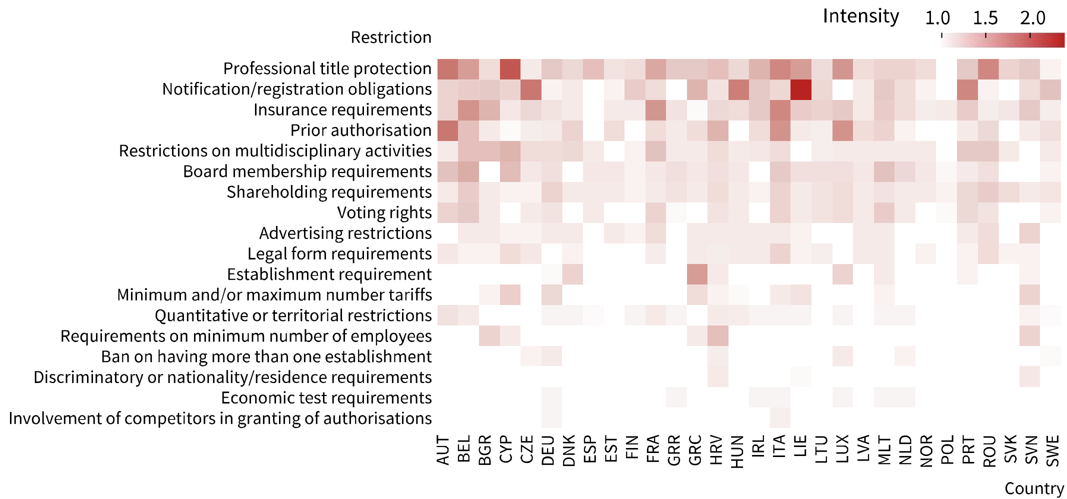
Note: The STRI quantifies the non-tariff barriers to trade in services in an index ranging from 0 – open to 1 – very restrictive. The sectors are sorted by average strength of the restrictions.
Data: OECD; calculations by the ifo Institute.
© ifo Institute

Firms are exposed to numerous forms of non-tariff barriers that can make the cross-border provision of services within the EU more difficult. A detailed understanding of these barriers is crucial for effective regulation, its possible harmonization, and the reduction of bureaucratic burdens in order to better exploit the potential of the EU single market. As part of the implementation of the Services Directive, the European Commission has therefore launched a detailed assessment of barriers in the member states. The analysis of the data collected shows that administrative hurdles pose the biggest obstacle to the seamless provision of cross-border services (Figure 10). Through national regulations, many member states impose different requirements on foreign companies before allowing them to provide services in their country. These administrative hurdles of national states include, for example, reporting obligations, prior authorization, additional insurance requirements, or the protection of professional titles and the non-recognition of professional qualifications, which make the seamless provision of services from other EU countries more difficult.[2] The regulatory fragmentation of the individual nation states, frequent lack of transparency and access to information on the specific requirements on market access, language barriers and bureaucratic costs due to fees and delays caused by authorization procedures all hinder the integration of the

[2] In company surveys, companies also report significant barriers to trade in services in the EU single market. The most common barriers cited are (see Appendix, Figure 15; Eurochambres Single Market Survey 2024; Association of German Chambers of Commerce and Industry (DIHK) survey "Going International" 2024): (1) Fragmentation of rules (e.g., different national service and product rules; contractual and legal practices, and tax law differences); (2) Difficult access to information on rules or general conditions and requirements (including language barriers, lack of transparency, public procurement; some reports of discrimination against foreign companies by national authorities); (3) Cost of bureaucracy and regulation (e.g., fees, conditions, certification, and security requirements); (4) Restrictions on the free movement of services in the EU single market (including time delays due to extensive and increasing reporting and notification obligations as well as administrative and approval procedures, e.g., on the basis of delegation guidelines for business trips, licensing and recognition procedures, etc.).

EU single market for services. Clearly, there is much to be done to achieve a free movement of services in the EU.

Figure 10: Intra-European Restrictions on Trade in Services



Note: The restrictions are sorted according to the average strength of the restrictions. Restriction: 1 – open & 3 – very restrictive.
Source: EU Services Directive; calculations by the ifo Institute.

© ifo Institute

4 Policy Scenarios and Results

To assess the potential for building a stronger single market by removing barriers to the provision of services within the EU, we used the ifo trade model to evaluate and simulate the gains in value-added from reducing non-tariff barriers in services. The study simulates and discusses two trade policy scenarios: (1) a 10% reduction in barriers for services trade between members of the EU and (2) a more ambitious 25% reduction in these barriers. The latter represents the goal set by the European Commission.

The ifo trade model allows for general equilibrium effects to be simulated for a large number of different trade policy scenarios, providing insights into the effects of such policies on trade flows, sectoral value added, and real income. The model covers more than 120 countries and 65 economic sectors, which account for over 90 percent of global value added. Simulations can be used to derive trade and production effects for all 65 sectors at a disaggregated level, and for the sectoral effects to be analyzed for all countries in the data. The data required for the simulation (e.g., international value chain interdependence) come from the global input-output database GTAP 10, which contains comprehensive information on the agriculture, manufacturing and service sectors.[3]

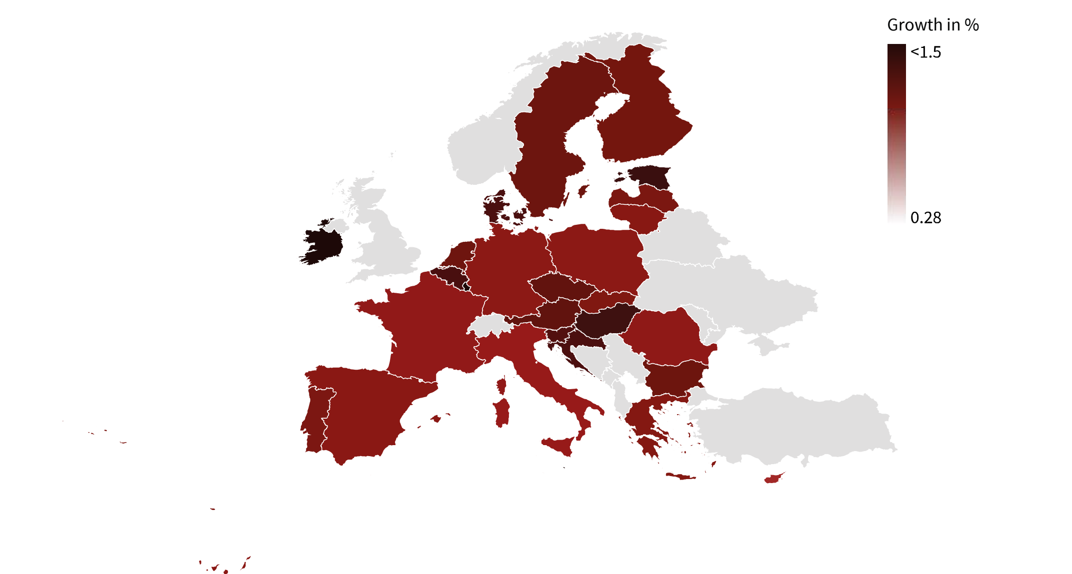
The model is based on the general equilibrium model by Caliendo and Parro (2015) and builds on the work of Eaton and Kortum (2002). The technical and complex details of the model have been described in a number of academic studies (see Aichele et al. 2016, Sforza and Steininger 2020, Flach et al. 2023). The simulated results show a static level effect, meaning that, with a static gain in value added in the medium term, future economic growth would start from a higher level. The results are likely to underestimate the long-term changes in welfare, as dynamic effects such as further investment in the EU single market resulting from better and more attractive market integration are not included in the simulation.

[3] See Flach et al. (2021) and Aichele et al. (2016) for a more detailed description and application of the ifo trade model.

4.1 Gains in Value Added by Reducing Trade Barriers by 10%

The first scenario considers a 10% reduction in non-tariff barriers to services trade. The result shows that all economies in the European Union would benefit from liberalization and the removal of barriers and that a considerable increase in welfare could be expected in the EU in the medium term (Figure 11). According to the model calculations, even a 10% reduction in barriers would increase gross value added in the EU by 0.5%, or almost EUR 77 billion (at 2023 prices). As Figure 11 shows, smaller EU economies such as Luxembourg (+4.0%) and Ireland (+2.8%) would have the largest gains – firms from smaller EU member states would particularly benefit from easier access to the markets of the major European economies. Germany and France, on the other hand, would observe the largest gains in absolute terms, as the breakdown of EU gains shown in Figure 12 illustrates. Germany's share of overall European growth in gross value added in response to better integration of trade in services is by far the largest, at 16.5%. This would increase welfare in Germany by 0.4%, or around EUR 15 billion (at 2023 prices). In France, the increase would be around 0.3% or EUR 9 billion. Among the other countries with the largest gains would be Ireland (EUR 13.5 billion), Italy (EUR 5 billion), and Belgium (EUR 6 billion).

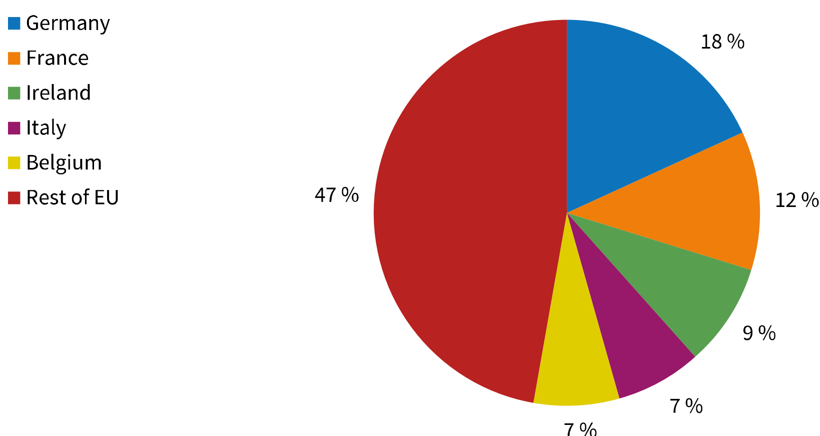
Figure 11: Change in Welfare from a 10% Reduction in Non-Tariff Barriers to Services Trade



Source: ifo trade model; calculations by the ifo Institute.

© ifo Institute

Figure 12: Share of EU Growth after a 10% Reduction in Barriers



Source: ifo trade model; calculations by the ifo Institute.

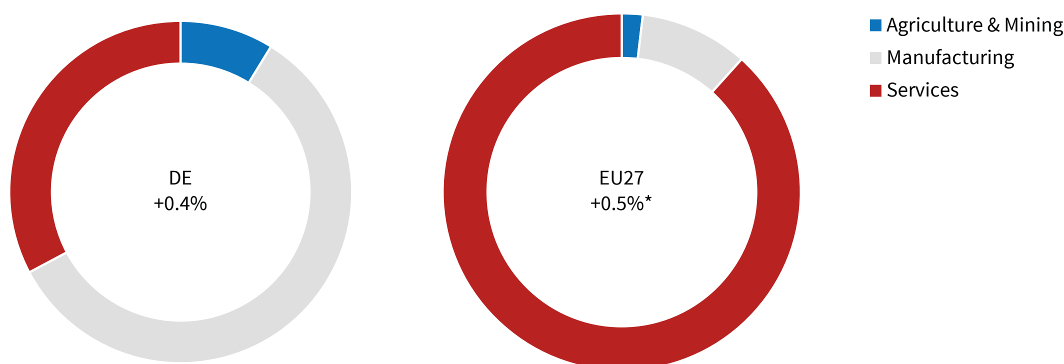
© ifo Institute

4.2 Sectoral Value-Added Gains

A detailed examination of the sectoral breakdown of growth in value added due to the liberalization of trade in services in the EU reveals interesting patterns. The results shown refer to a 10% reduction in non-tariff barriers for services trade within the EU.

For the EU as a whole, the service sector itself accounts for the largest share (88%) of the growth in value added resulting from lower trade barriers in services. However, manufacturing and agriculture would also gain from the liberalization in services, with an increase in value added of 10% and 2%, respectively. Among the services sectors in the EU, business services (+0.8% increase in value added), insurance (+1.0%), retail trade (+0.6%) and transportation (+1.3%) are among the sectors that would benefit most from a 10% reduction in barriers (Table 2). The German case underlines the close sectoral interdependence and the macroeconomic benefits of liberalizing trade in services in the EU. The distribution of the gains would be somewhat different from other member states, given Germany's heavy reliance on manufacturing: the manufacturing sector would observe a +1.1% increase in value added and service firms would gain 0.2% (Tables 2 and 3). Thus, Germany's service sector accounts for 33% of the increase in gross value added, while manufacturing would contribute a remarkable 58% share (Figure 13).

Figure 13: Change in the Level of Value Added after a 10% Reduction in Barriers



* The level of gross value added is EUR 77 billion higher (relative to 2023).
Source: ifo trade model; calculations by the ifo Institute.

© ifo Institute

Table 2: Change in Value Added in the Service Sector after a 10% Reduction in Barriers

	Germany		**EU27**	
	Change	Share of the service sector	Change	Share of the service sector
Service sector (total)	**0.2%**		**0.6%**	
Business services	0.8%	16.4%	0.8%	14.5%
Communications	-0.1%	8.7%	0.6%	8.0%
Financial services	0.5%	5.0%	0.4%	5.5%
Insurance	0.5%	1.3%	1.0%	1.3%
Construction	0.6%	6.3%	0.5%	7.5%
Real estate	0.0%	6.5%	0.5%	6.0%
Electricity	2.0%	1.5%	0.8%	2.1%
Water	0.4%	1.7%	0.5%	1.4%
Education	0.3%	7.1%	0.4%	6.3%
Health and social services	0.2%	9.5%	0.5%	9.5%
Public administration	0.3%	8.7%	0.5%	8.8%
Retail	0.2%	12.1%	0.6%	13.8%
Transport	-1.8%	3.7%	1.3%	4.6%
Warehousing	-1.3%	2.0%	0.6%	1.9%
Accommodation and meals	-0.4%	4.0%	0.5%	4.2%
Leisure and other services	-0.9%	5.4%	0.6%	4.6%

Source: ifo trade model; calculations by the ifo Institute.

However, it should be noted that not all economic sectors or firms in the individual member states would benefit equally from the removal of barriers and increased competition. While highly internationally competitive sectors would benefit, smaller, less competitive sectors could lose. Taking a German example to illustrate this point, the simulation results suggest that the areas of transportation and warehousing as well as tourism and leisure would be expected to see a decline in value added, to the benefit of other EU countries (Figure 8), whereas business-related services and construction-related services would have the strongest growth in the country's service sector. In manufacturing, all industry segments would benefit from the liberalization, partly because this sector increasingly offers services, such as automotive leases, which lead to an increase in automotive production. Overall, however, all countries and all sectors across Europe would benefit from the efficiency gains.

Table 3: Change in Value Added in Manufacturing after a 10% Reduction in Barriers

	Germany		**EU27**	
	Change	Share of manufacturing	Change	Share of manufacturing
Manufacturing (total)	**1.1%**		**0.3%**	
Textiles & clothing	1.2%	2.7%	0.2%	5.5%
Wood products	1.2%	1.2%	0.3%	1.9%
Paper products and publishing	1.0%	5.5%	0.4%	6.5%
Basic pharmaceuticals	1.4%	4.3%	-0.5%	5.8%
Chemical products	1.2%	8.9%	0.4%	9.6%
Rubber and plastic products	1.1%	6.4%	0.4%	6.2%
Metal and minerals	1.1%	8.3%	0.4%	9.7%
Metal products	1.0%	9.1%	0.4%	9.1%
Computers & electronic products	0.9%	8.3%	0.4%	7.3%
Electrical equipment	1.1%	7.5%	0.4%	6.8%
Machinery and equipment	1.1%	15.8%	0.4%	13.7%
Assemblies	0.9%	5.0%	0.2%	6.5%
Motor vehicles and motor vehicle parts	1.1%	12.9%	0.5%	8.3%
Vehicle manufacturing	0.8%	3.9%	0.4%	3.2%

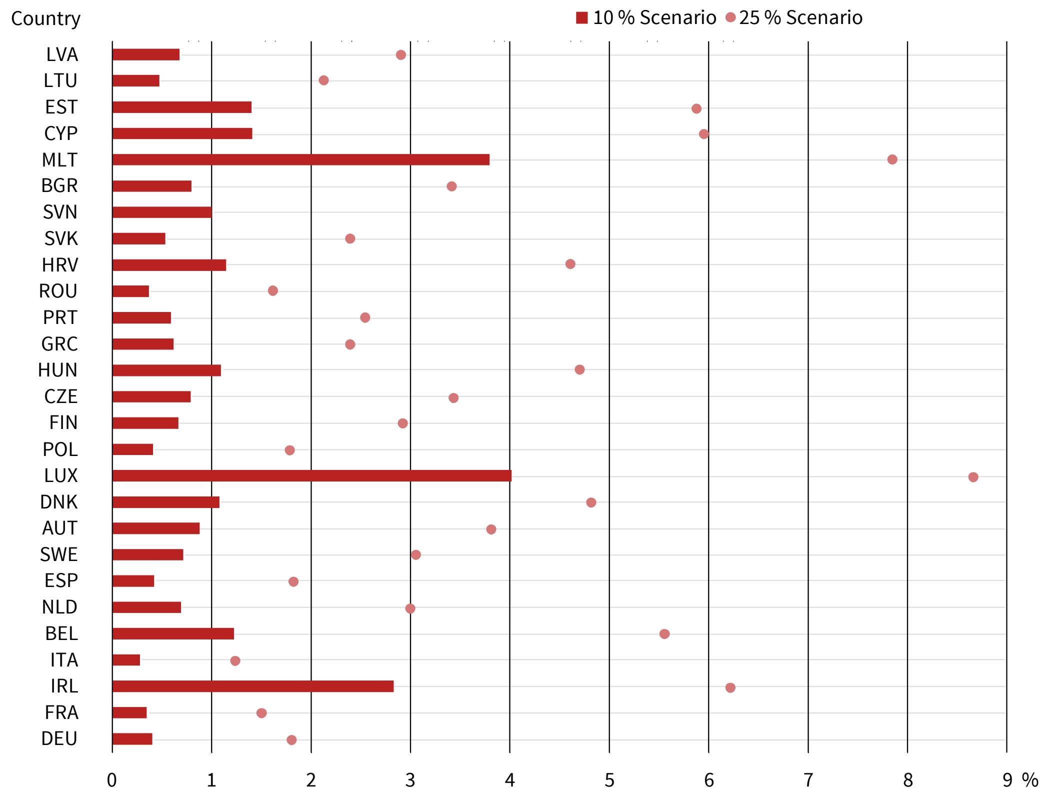
Source: ifo trade model; calculations by the ifo Institute.

4.3 Gains in Added Value by Reducing Trade Barriers by 25%

If the EU were to achieve a more ambitious target of a 25% reduction in red tape and barriers to trade in services within the single market, the gains in value added would be disproportionately greater, as Figure 14 shows. According to the model's calculations, a comprehensive 25% reduction in trade barriers would increase gross value added in the EU by as much as 2.3%, or around EUR 353 billion (at 2023 prices), in the long term. In general, all EU countries would benefit from a comprehensive lowering of national trade barriers for services in the single market. Some examples: Germany would benefit with an increase in value added of 1.8%, or around EUR 68 billion, Italy would gain 1.3 percent, or almost EUR 24 billion, while France's value added would rise by 1.5 percent, or around EUR 38 billion. Countries with the largest relative gains include Ireland, with 6.2% or EUR 30 billion, and Belgium, with 5.5% or EUR 29 billion.

Compared to the scenario with a 10% reduction in barriers, the results show that a more aggressive reduction in the bureaucratic burden and liberalization of the EU single market for trade in services would lead to far more significant welfare gains, highlighting the considerable potential for strengthening the EU economy. Such liberalization and integration of trade in services in the EU single market would thus be a much better alternative for strengthening the bloc's economy than trade policy measures aimed at reshoring, i.e., the extensive relocation of production back to Europe. In fact, such policies which would instead lead to considerable welfare losses (of -5%) (see Baur et al. 2023).

Figure 14: Change in Value Added after a 10% and 25% Reduction in Barriers



Note: Actual changes for IRL, LUX and MLT are twice as high at 25%.
Source: ifo trade model; calculations by the ifo Institute.

© ifo Institute

5 Conclusion and Recommendations

The service sector in the EU accounts for more than 70% of gross value added and employment. It has been a key driver of growth and welfare in the EU over the past two decades. The rapid development of digitalization leads to increasing opportunities for cross-border trade in services. However, despite these technological advances and the sector's importance, most services are still provided only within national borders, mainly because of the numerous barriers that continue to hinder their flow across intra-EU borders: instead of an harmonized single market, there are currently still 27 different systems within the EU. The varying bureaucratic and institutional regulations are deeply rooted in the national systems.

This means that small and medium-sized companies, in particular, have very few opportunities to exploit the benefits of a market of 450 million people. Compared to other large global markets such as the United States, China, and India, the market size of many EU member states is relatively small in isolation, while as a bloc it would comfortably exceed the US market in size. This constraint limits both the growth potential and the international competitiveness of firms and start-ups in the services sector and weakens EU competitiveness in the long term. It is therefore essential for the European Union and its member states to identify and minimize existing barriers to trade within their borders and to jointly establish a coherent, barrier-free single market for services. Such a strategic approach would open up significant growth opportunities, particularly for young companies, as well as increase investment in the EU single market, significantly strengthening the bloc's global competitive position.

We outline the following coordinated measures to lower non-tariff barriers to trade in services within the EU:

At the EU level:

- Strengthening the single market should be seen as a key priority, with a focus on removing barriers that hinder the growth potential of services trade. Proactive and well-coordinated support from the EU would be crucial to increase harmonization of national regulations. At the same time, the EU should avoid introducing new, restrictive regulations, such as excessive reporting requirements, and review its own obstructive regulations, such as the Posting of Workers Directive.

- The expansion of the central EU online platform (see "Single Digital Gateway") is one important way to reduce barriers associated with access to information

and administrative procedures. An online platform should provide comprehensive information on all relevant procedures and rules of the individual member states, be accessible in different languages, and support the digital and central processing of cross-border administrative procedures. This would facilitate access to legally reliable information for firms and could be particularly beneficial for SMEs.

At member state level:

- Improved harmonization of national regulations and standards is *sine qua non*, in particular of legal frameworks and practices such as e-commerce, property rights, recognition of qualifications, and safety and insurance requirements.

- A significant reduction in national bureaucracy and regulatory costs is crucial, as these represent the main obstacles to cross-border trade in services. This could include a reduction in documentation and reporting obligations as well as lowering barriers to the free movement of services, such as costly and lengthy licensing and approval procedures. This is particularly important in the single market's border regions.

Finally, investments in digitalization and cross-border infrastructure must be promoted to increase the opportunities for economic growth and scaling opportunities for companies through digitally tradable services in the EU single market. Through these coordinated efforts, the EU could create the conditions for a more efficient and inclusive Single Market, ultimately increasing welfare across member states and economic sectors.

References

Aichele, R., G. Felbermayr and I. Heiland (2016), "Going Deep: The Trade and Welfare Effects of TTIP Revised", *ifo Working Paper 219*.

Baur, A., F. Dorn, L. Flach and C. Fuest (2023), "Rethinking Geoeconomics: Trade Policy Scenarios for Europe's Economy", *EconPol Policy Report 44*.

Caliendo, L. and F. Parro (2015), "Estimates of the Trade and Welfare Effects of NAFTA", *The Review of Economic Studies*, 82(1):1–44.

Dorn, F., L. Flach and I. Gourevich (2024). *Die EU und der Binnenmarkt – Potenziale eines vertieften Dienstleistungshandels*, ifo-Studie im Auftrag der IHK München und Oberbayern.

Eaton, J. and S. Kortum (2002), "Technology, Geography, and Trade", *Econometrica*, 70(5):1741–1779.

European Commission (2023a), *Long-term Competitiveness of the EU: Looking Beyond 2030*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2023) 168 final.

European Commission (2023b), *Commission Work Programme 2024. Delivering Today and Preparing for Tomorrow,* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2023) 638 final.

Eurostat (2024), National Accounts Aggregates by Industry (up to NACE A*64), Eurostat Data Browser, https://ec.europa.eu/eurostat/databrowser/product/page/NAMA_10_A64.

Eurostat (2024), International Trade in Services (since 2010), Eurostat Data Browser, https://ec.europa.eu/eurostat/databrowser/view/BOP_ITS6_DET/default/table?lang=en.

Eurostat (2024), Comext Database for International Trade. Eurostat Data Browser, https://ec.europa.eu/eurostat/comext/newxtweb/.

Flach, L., J. Gröschl, M. Steininger, F. Teti, and Baur, A. (2021). Internationale Wertschöpfungsketten – Reformbedarf und Möglichkeiten. Studie im Auftrag der Konrad-Adenauer-Stiftung e. V., München.

Flach, L., I. Heiland, M. Larch, M. Steininger and F. Teti (2023), "Quantifying the Partial and General Equilibrium Effects of Sanctions on Russia", *Review of International Economics*, 1-43.

Organisation For Economic Cooperation and Development (OECD) (2023), Services Trade Restrictiveness Index, OECD.Stat, https://stats.oecd.org/Index.aspx?DataSetCode=STRI.

Sforza, A. and M. Steininger (2020), "Globalization in the Time of COVID-19", *CESifo Working Paper Series*.

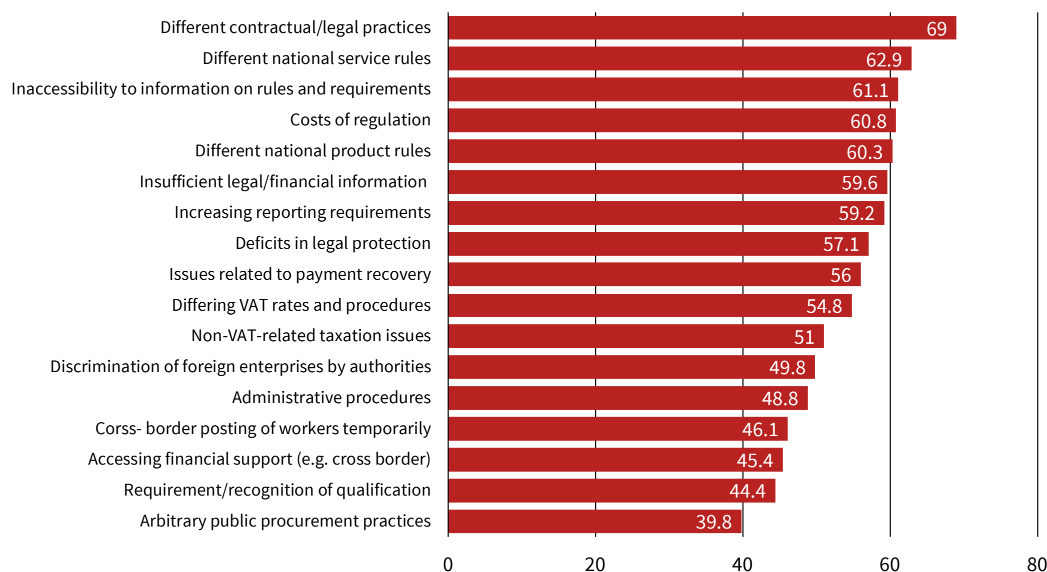
Appendix

Table 4: Intra-European Restrictions on Trade in Services

Barrier	Description
Voting rights	A common requirement throughout the EU is that the majority of shares must be held by traders so that control of a company remains in the hands of traders.
Requirements for board members	Special requirements apply to the members of the management of a service provider.
Offer price regulation	For certain services, there are minimum and maximum prices set by law or by professional associations that providers must adhere to when offering their services on the market.
Limited provider licensing	Quantitative and territorial restrictions limit the total number of service providers and thus hinder the market entry of new providers and restrict the freedom of establishment.
Shareholding requirements	Shareholders in companies must have a minimum amount of capital or specific qualifications in order to own shares
Discriminatory regulations	The regulations governing the provision of a service differ depending on the nationality, place of residence, or registered office of the service provider.
Authorization requirement	The company requires a license or authorization to provide a service.
Reporting obligations	Requirements that oblige service providers from other member states to submit notifications or register before they can offer their services.
Restriction on establishment	Service providers may only have one establishment in the respective member state.
Establishment requirement	The prerequisite for the provision of cross-border services is the establishment of the service provider in the member state concerned.
Recognition of qualifications	Regulations on the recognition of certain qualifications for service providers.
Legal form requirements	Authorization to carry out certain commercial activities is granted only to registered legal entities and excludes natural persons.
Activity restriction	Regulations that require service providers to limit themselves to one activity and to restrict the simultaneous performance of different activities or the formation of partnerships.
Insurance requirements	Cross-border service providers must take out professional indemnity insurance or another form of financial guarantee with cross-border cover.
Advertising restrictions	There is a restriction on advertising services.
Competitor involvement in granting of authorization	Competing operators are involved in the decision-making process of the competent authorities regarding the approval of service activities.
Economic test requirements	A license for a commercial activity will only be granted if the applicant can prove that its activity is economically necessary/in demand or has no negative economic impact on other market participants.

Source: “Mapping and Assessment of Removal of Legal and Administrative Barriers in the Services Sector” (2021).

Figure 15: Companies' Agreement Rankings on Barriers in the EU Single Market



Note: Note: Proportion of companies reporting very significant and significant obstacles (in percent). 55% of respondents are service providers and the remaining 45% are goods manufacturers. In terms of company size, 87% are SMEs and 13% are large companies. As far as cross-border activities are concerned, 67% of respond-ents use the EU single market.
Source: Eurochambres Survey 2024. 1004 business owners and entrepreneurs across all EU member states, survey period: Sept. 4 – Nov. 20, 2023.

© ifo Institute

List of Figures

Figure 1: Index of Goods Market Globalization 6
Figure 2: Development of Trade in Goods and Services in Relation to GDP 7
Figure 3: Sectoral Contribution to Growth in Gross Value Added in the EU27........ 8
Figure 4: Sectoral Contribution to Growth in EU27, 2000-2023........ 9
Figure 5: EU27 Trade in Services........ 9
Figure 6: German Trade in Services 10
Figure 7: Sectoral Interdependencies in Germany, 2019 11
Figure 8: Average Intra- and Extra-EEA STRI by Country, 2022........ 13
Figure 9: Intra-EEA STRI, 2022........ 14
Figure 10: Intra-European Restrictions on Trade in Services 15
Figure 11: Change in Welfare from a 10% Reduction in Non-Tariff Barriers to Services Trade 17
Figure 12: Share of EU Growth after a 10% Reduction in Barriers........ 18
Figure 13: Change in the Level of Value Added after a 10% Reduction in Barriers........ 19
Figure 14: Change in Value Added after a 10% and 25% Reduction in Barriers........ 22
Figure 15: Companies' Agreement Rankings on Barriers in the EU Single Market 28

List of Tables

Table 1: Germany's Most Important Trading Partners........ 10
Table 2: Change in Value Added in the Service Sector after a 10% Reduction in Barriers 19
Table 3: Change in Value Added in Manufacturing after a 10% Reduction in Barriers . 20
Table 4: Intra-European Restrictions on Trade in Services........ 27

Authors of this Issue

Florian Dorn

Florian Dorn is senior secretary to the president of the ifo Institute and member of CESifo. As director of EconPol Europe, he regularly engages with policymakers at the national and European level. His research focus on political economy, fiscal and economic policies as well as the economic effects of current geopolitical challenges. Dorn studied at the Universities of Munich (Germany), Mannheim (Germany) and Berkeley USA. He received his PhD in Economics from the University of Munich.

Contact: dorn@ifo.de

Lisandra Flach

Lisandra Flach is director of the ifo Center for International Economics and professor of economics at the LMU Munich. She is a member of CEPR and CESifo and associate editor of the Journal of Comparative Economics and the Review of International Economics. Her main area of research is international economics, with a focus on the international activity of firms and on international trade policy. Flach received her PhD from the University of Mannheim (Germany) in 2012.

Contact: flach@ifo.de

Isabella Gourevich

Isabella Gourevich is a Junior Economist and Doctoral Candidate at the ifo Center for International Economics and LMU Munich. Previously, she studied at the University of Mannheim and the Barcelona School of Economics and worked in the Research Department of the World Trade Organisation. Her research focuses on industrial policy and the contribution of international trade to a circular economy.

Contact: gourevich@ifo.de