



# Barriers to productivity growth in business services

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## Chapter 1

# Employment and productivity in business services

Business services represents 9 percent of gross value added in private services in Denmark. It consists of three subsectors: *professional services* such as lawyers, accountants, advertising firms and consultancies, *technical services* such as engineers, architects and land surveyors, *operational service* such as leasing office equipment, security firms and employment agencies. Professional services and technical services are sometimes combined and labelled *knowledge based services* (Chapter M of the standard industry classification), while operational services are labelled as the less straight forward sector *travel agents, cleaning, and other operational services* (Chapter N).<sup>1</sup>

Business services have large spillovers on the rest of the economy since these services are used as inputs in other businesses. Knowledge based services such as lawyers, accountants, engineers, architects and consultants are increasingly perceived as a central factor for company competitiveness. The transfer of knowledge, for example from academia to business, is one of the core functions of knowledge based business services companies, and these services are themselves catalysts of productivity improvements in other businesses through the services and advice they sell. Ensuring good regulation and effective competition in these services are thus important not only for the sake of productivity improvements within these sectors, but also because of the significant benefits for the rest of the economy from a well-functioning, innovative and productive business service sector.

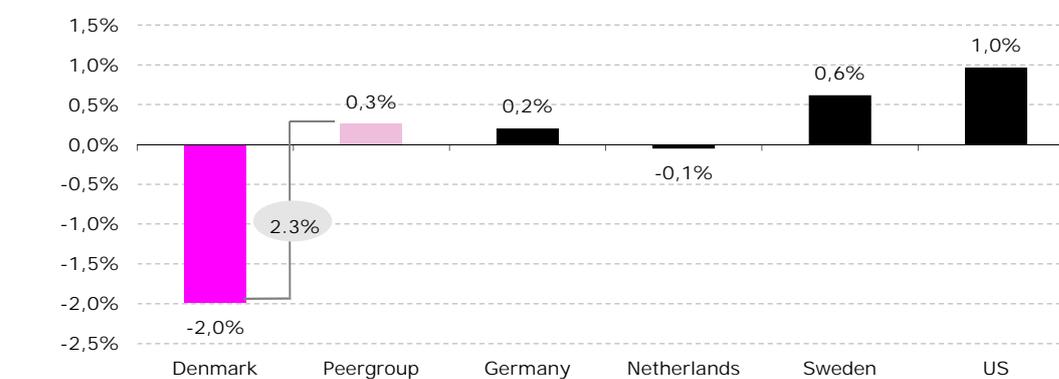
### 1.1 The productivity gap

There is room for improvement in performance of business services when it comes to productivity growth: On an aggregated level, productivity growth for business services in Denmark has been substantially below the average of the peer countries, and productivity growth has been much behind best practice countries (Sweden and the U.S).

Danish productivity growth in business services was negative in real terms and decreased by an average of 2 percent per year in the past 15 years. Given the nature of these human-capital-intensive businesses, productivity is measured as hourly labour productivity (gross value added per hour). Danish business services are well behind their Swedish colleagues, whom experienced an average growth of 0.6 percent per year in the same period, cf. Figure 1.

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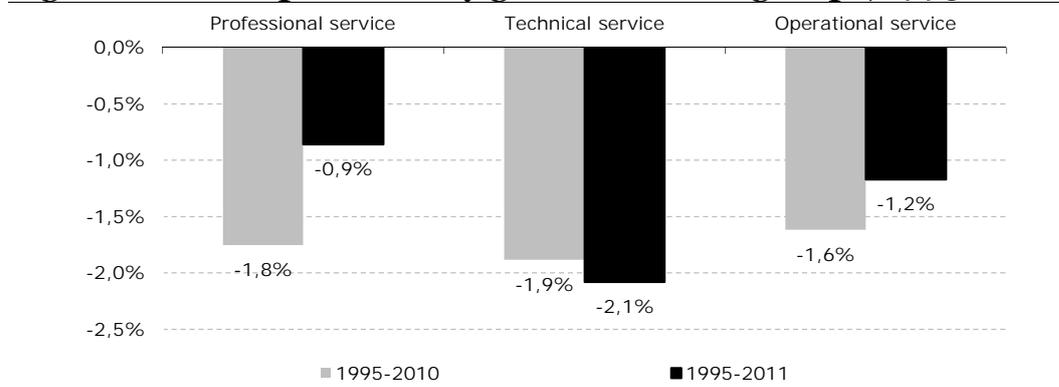
<sup>1</sup> Statistically, *business services* as treated here are confined to chapters M and N of the standard industry classification.

**Figure 1 Productivity growth relative to peer group, 1995-2010**

Note: Hourly labour productivity measured as gross value added in 2005-prices per hour worked. Covers business services comprised of Chapters M\_N.

Source: Copenhagen Economics based on data from Eurostat and U.S. Bureau of Economic Analysis.

Breaking the development down by the three main parts of business services, we find similar poor performance across all main groups for the period until 2010, but with a significant improvement in 2011 for professional services (combined of legal, accounting and consulting etc.), cf. Figure 2.

**Figure 2 Danish productivity growth in main groups, 1995-2011**

Note: Hourly labour productivity measured as gross value added in 2005-prices per hour worked.

Source: Copenhagen Economics based on data from Statistics Denmark, detailed National Accounts.

A further break-down by subsectors shows, cf. Figure 3:

- *Within professional services*, the decrease has been worse for advertising and market research activities than for legal, accounting and consulting combined.
- *Within the technical services*, the development is dominated by the development for architects and engineers, which constitutes two-thirds of the technical services. Productivity for architects and engineers combined decreased by 2.4 per cent since 1995.
- *Within operational services*, the decline is dominated by travel agencies with a decrease of more than 10 percent per year since 1995.

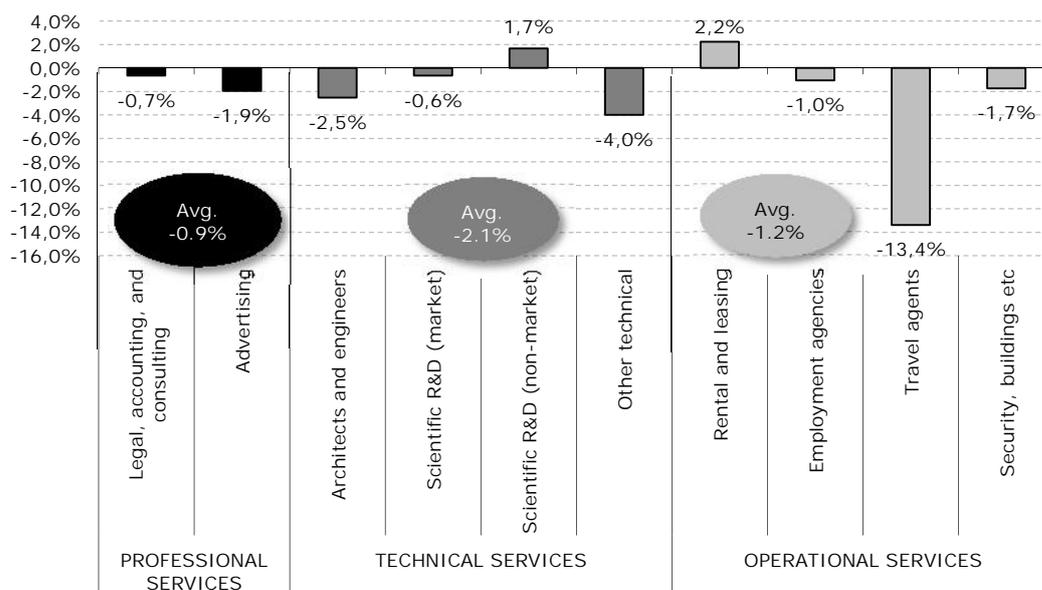
In a national Danish context, business services consist of partly subsectors with a low productivity level and a low productivity growth relative to other Danish industries.<sup>2</sup> This is the case for:

- Scientific R&D (both market based and non-market based)
- Advertising and market research
- Cleaning
- Other operational business services

Partly, there are also subsectors of business services with a high productivity level relative to other Danish industries, but with low growth. This is the case for:

- Legal services
- Accounting and auditing
- Architects and engineers

**Figure 3 Real productivity growth by subsector, 1995-2011**



Note: Hourly labour productivity measured as gross value added in 2005-prices per hour worked.

Source: Copenhagen Economics based on data from Statistics Denmark, detailed National Accounts.

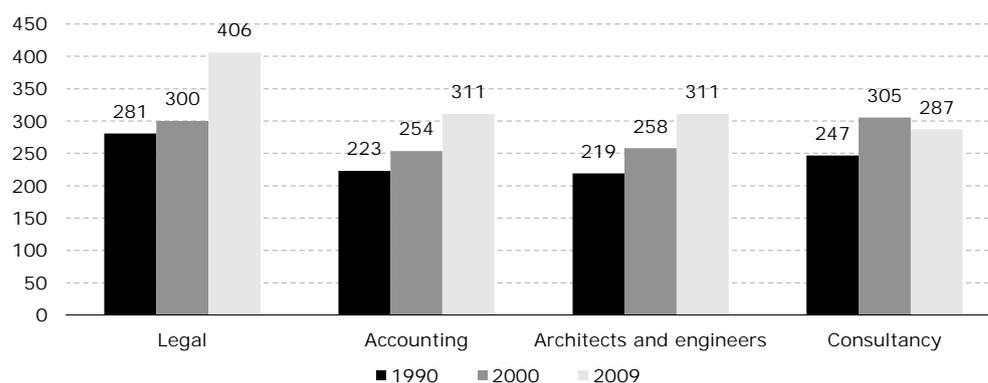
A comparison of the four knowledge-based services shows a common drop in gross value added per hour worked for all four, but while the drop continued in three of the four, the situation stabilised for legal services during the 2000's, cf. Figure 4.

<sup>2</sup> See Ministry of Business (2011), "Branchernes Produktivitet", March 2011.

**Figure 4 Gross value added per hour worked, 1990-2009 (real)**

Note: The diagram shows real gross value added at 2005-prices per hour worked. Not updated after 2009.  
Source: CE analysis based on national accounts, Statistics Denmark.

A steep drop in real gross value (GVA) added per hour worked can be a sign of negative productivity, but may also result from increased competition and lower prices, while demand conditions and eventual structural changes in demand should also be taken into account. Repeating the above analysis for nominal gross value added per hour (current prices) shows that the nominal GVA per hour went up for legal services and down for consulting, while accountants and architect/engineers maintained a stable increase in nominal GVA per hour, cf. Figure 7. Chapter 3 looks into these developments.

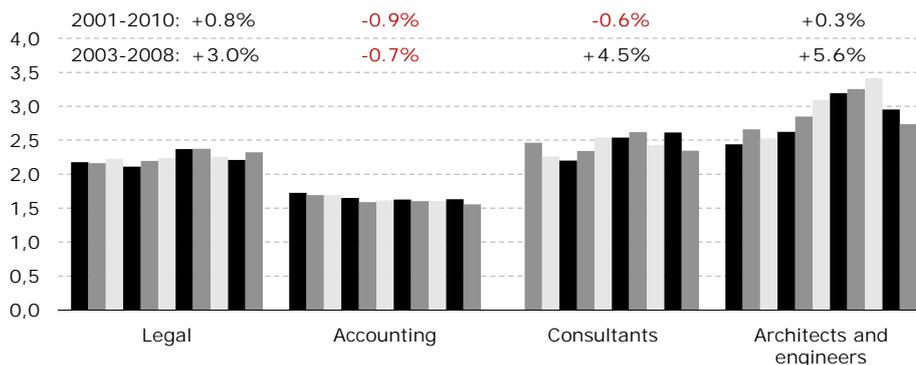
**Figure 5 Gross value added per hour worked, 1990-2009 (nom.)**

Note: The diagram shows gross value added at current prices per hour worked. Not updated after 2009.  
Source: CE analysis based on national accounts, Statistics Denmark.

Another way of assessing productivity is to analyse operating income per person employed, or more precisely operating income per person employed relative to wage per person employed. This factor shows the mark-up over wages to cover fixed costs and it

shows a different picture, with a solid annual increase between 2003 and 2008 of 3.0-5.6%. Only accounting shows a negative development over the period.

**Figure 6 Factor of operating income over wage 2000-2010**



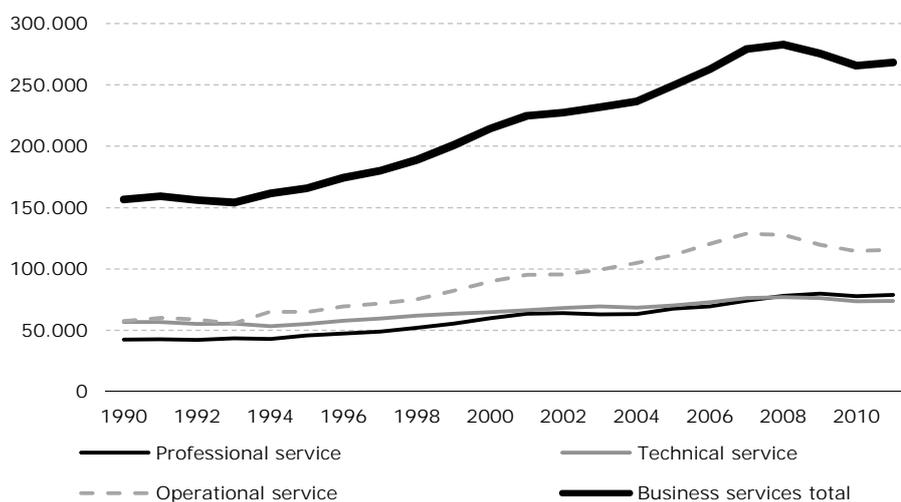
Note: The diagram shows the operating income per employee divided by wages per employee.

Source: CE analysis based on accounting data from Statistics Denmark.

This tells us that some prudence is needed before concluding that there is an underlying structural lack of productivity growth in these sectors. There is clearly a business cycle influence on these indicators, whether using GVA per hour or the factor of operating income over wage, and therefore comparisons made with the end-year being after 2008 is somehow affected by the economic crisis, and it raises the question whether business services are doing bad because the economy is doing bad, or whether there is a structural productivity problem?

### 1.2 The size of the subsectors within business services

Business services sectors employ 270.000 full-time equivalents and show an increasing trend in employment, especially in the low-productivity segment of operational services. Professional services and technical services each employ around 75.000 full time equivalents, while operational services account for approximately 120.000 employees, cf. Figure 7. Overall, productivity in the business services sector as one is pulled downwards because of an increasing share of the low-productivity segment of operational services.

**Figure 7 Number of employees in business services, 1990-2011**

Source: Copenhagen Economics based on data from Statistics Denmark, detailed National Accounts.

In the following, we shall elaborate mainly on the so-called knowledge-based services (i.e. the combination of professional services and technical services). Measured in terms of employment, legal services and research and development activities are the smallest sub-sector with 6 and 8 percent of total knowledge-based services. Measured in terms of value added, the two sectors have a larger weight with 11 percent and 12 percent respectively. Architects and engineers are the largest group in both numbers and value added while advertising comes second on both accounts, cf. Table 1.

**Table 1 Knowledge-based service divided into subsectors**

	Gross value added, total=67bn DKK	Hours, total=244m	Employment, total=156,000
Legal	11%	8%	8%
Accounting and Auditing	15%	15%	15%
Consultants	12%	14%	14%
Architects and engineers	31%	33%	32%
Research and development	12%	6%	6%
Advertising, market research and others	19%	23%	25%
Total knowledge-based services	100%	100%	100%

Note: Totals are for 2012. Subsector share are latest available year (2009).

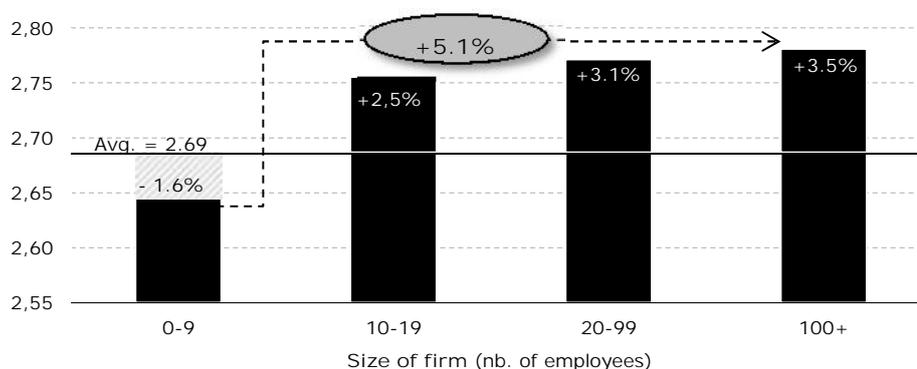
Source: Copenhagen Economics based on data from Statistics Denmark, detailed National Accounts.

### 1.3 Explaining productivity growth

Now we have seen that business services in Denmark suffer from low productivity growth relative to peer countries, and the key question is *why*?

To a great extent the Danish business service companies operate in a national marketplace with many small competitors. For instance the average number of employees in a UK law firm is 11 compared to 6 in Denmark.<sup>3</sup> One potential for improving productivity is by gaining economies of scale, which can be a challenge in a small home market as Denmark. Analysing the factor of operating income over wage shows a small scale advantage of around 5 percent between the smallest and biggest segment, cf. Figure 8.

**Figure 8 Economies of scale in knowledge-based services**



Note: The diagram shows the operating income per employee divided by wages per employee. Average for the period 2005-2010. The average factor across all firms is 2.69.

Source: CE analysis based on accounting data from Statistics Denmark.

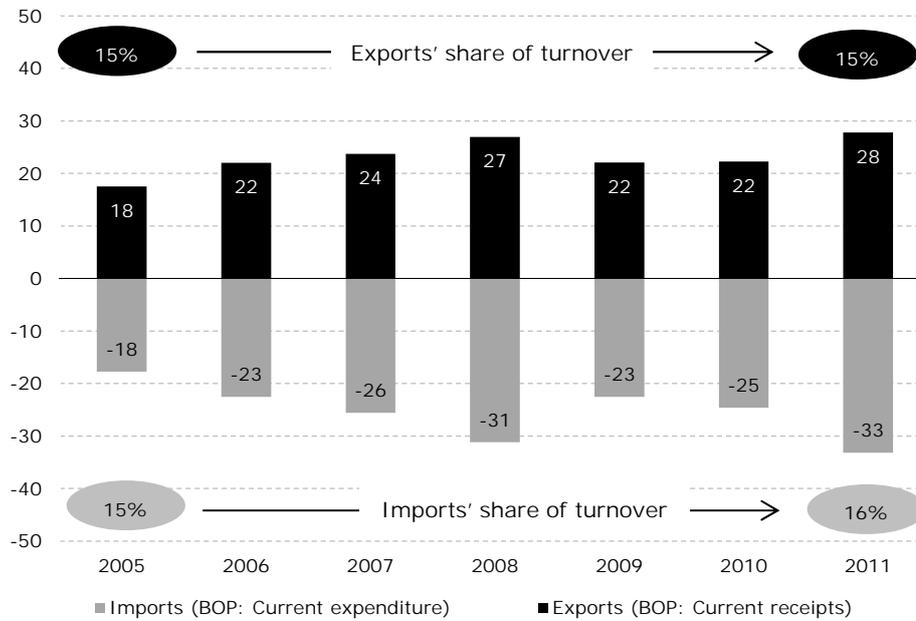
Furthermore, productivity can be improved by increased competition forcing companies to do their utmost, be innovative, cost conscious and apply best practice in order to survive and grow.

Domestic conditions for competition and cost level will certainly influence productivity, the openness of national markets to international competition is source of both increased competition from foreign companies and to gain scale from access to foreign markets.

However, international trade in knowledge-based services are often restricted by barriers, for instance regulations that restrict entry and therefore hamper competition or simply just increase the cost level by imposing unnecessary requirements for participating in the market. It is worth noting that there is already a high degree of cross-border trade in knowledge-based services, thus exports are 15 percent of total turnover while imports are roughly the same order of magnitude, and that cross-border trade increased until 2008, cf. Figure 9.

<sup>3</sup> McKinsey (2010).

**Figure 9 Import and export of knowledge-based services**



Note: Diagram shows the balance of payments (BOP) receipts (exports) and expenditures (imports) of "Other business services, miscellaneous business, professional and technical services". This is put in relation to turnover for the industry "M Knowledge-based services" from the domestic accounting statistics. The import and export data are shown after subtracting receipts and expenditures related to "services between affiliated enterprises".

Source: Copenhagen Economics based on accounting statistics and balance of payments from Statistics Denmark.

## Chapter 2

# Barriers to productivity growth

Regulatory conditions, e.g. ownership restrictions and exclusivity rights ('right to practice'), may hinder international players in operating in the Danish market in the form they optimally would prefer.

Potential actions to increase productivity in business services therefore include steps to enhancing competition by reducing barriers to entry for both domestic and foreign competitors and reducing cost-creating barriers.

In this chapter we investigate the potential for enhancing competition and productivity through changing the regulation of ownership, exclusivity rights and other barriers inhibiting domestic and international competition. The remaining part of this report is dedicated to identifying such barriers and discussing their impact.

### 2.1 Approach

To identify a gross list of barriers we have reviewed the existing literature and analysed input from a long range of sources, including databases on regulatory barriers from the OECD and the World Bank as well as the Productivity Commission's stakeholder inputs. We distinguish between two different types of barriers; rent-creating and cost-creating, cf. Table 2.

**Table 2 Different types of barriers**

Type of barrier	Explanation
Rent-creating	These are barriers that restrict entry and therefore create a rent for incumbents (hampers competition).
Cost-creating	These barriers raise the costs of participating in the market (increases the cost level).

Source: Copenhagen Economics

### 2.2 OECD's Product Market Restrictions (PMR)

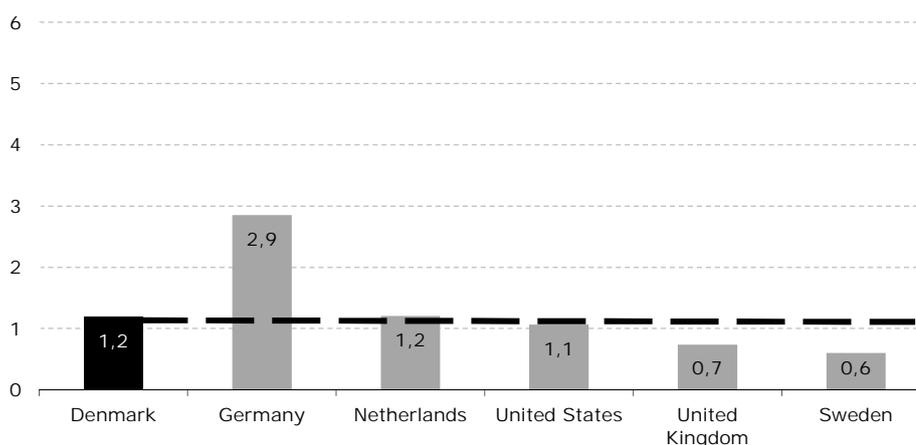
A key source for comparable data on restrictions is the OECD's *Product Market Restrictions (PMR)* database.<sup>4</sup> The OECD data on restrictions takes a broad view, and does not exclusively focus on barriers to trade in services, but is also addressing domestically oriented restrictions.

The OECD indicators measure regulatory conditions in the professional services as one of many sectors. The professional services indicators cover entry and conduct regulation in the legal, accounting, engineering, and architectural professions. They are available for the years 1996, 2003 and 2008 for 30 OECD countries.

<sup>4</sup> <http://www.oecd.org/eco/reform/indicatorsofregulatoryconditionsintheprofessionalservices.htm>

Comparing the OECD PMR data for knowledge-based services with the peer countries, we find that Denmark seem to be less restrictive overall than Germany and on par with the Netherlands and the U.S, and more restricted than the UK and Sweden, cf. Figure 10.

**Figure 10 OECD restriction index for knowledge-based services**



Note: Latest available year (2008). The index: 6 = most restrictive; 0 = least restrictive.

Source: Copenhagen Economics based on OECD PMR database.

Comparing the detailed subsector scores of the OECD PMR data for knowledge-based services with the peer countries, we find that Denmark seem to be the least restrictive in accounting of the six countries in the comparison. Architects and engineers are not facing any restrictions as captured by the OECD index, whereas a substantial degree of restrictions are found in the legal services sector, with only Germany obtaining a higher score amongst the peers. Our review, however, could not confirm this picture for legal services. These results are further analysed in chapter 3.

### 2.3 World Bank's Services Trade Restrictiveness Index (STRI)

In order to identify barriers related to international trade, we use the World Bank's *Services Trade Restrictiveness Index (STRI)*.<sup>5</sup> This index provides internationally comparable information on regulatory policies affecting trade in services and benchmark developed countries against each other in degree of restrictiveness.

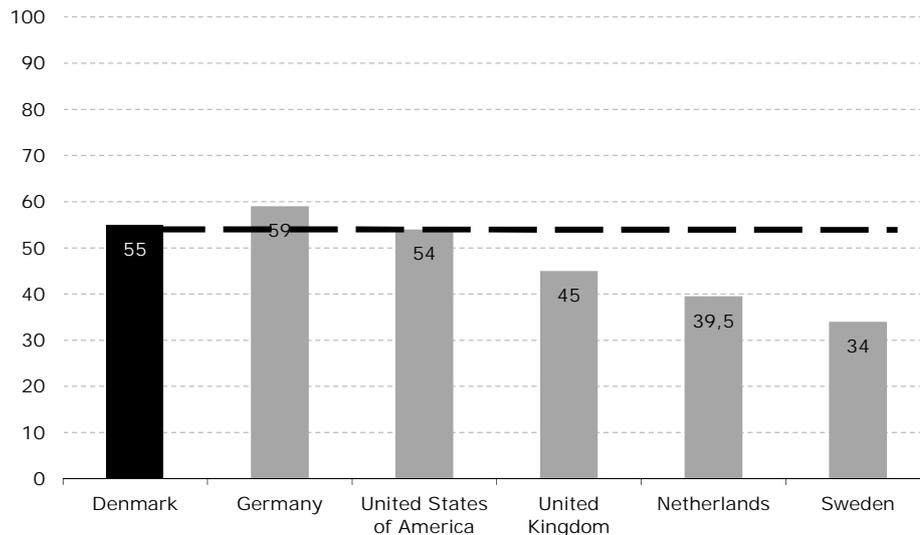
The database provides comparable information on services trade policy measures for 103 countries, five sectors (telecommunications, finance, transportation, retail and professional services) and key modes of delivery.

The STRI for professional services covers legal services and an aggregate of accounting and auditing. The combined index for the service trade restrictiveness of these professional services shows that these Danish sectors, on average, are at the more restrictive end, with an overall index of 55 out of 100. This is slightly less than in Germany and on

<sup>5</sup> <http://iresearch.worldbank.org/servicetrade/default.htm>

par with the U.S., with other comparator countries appearing as less restrictive, cf. Figure 11.

**Figure 11 World Bank's STRI for professional services**



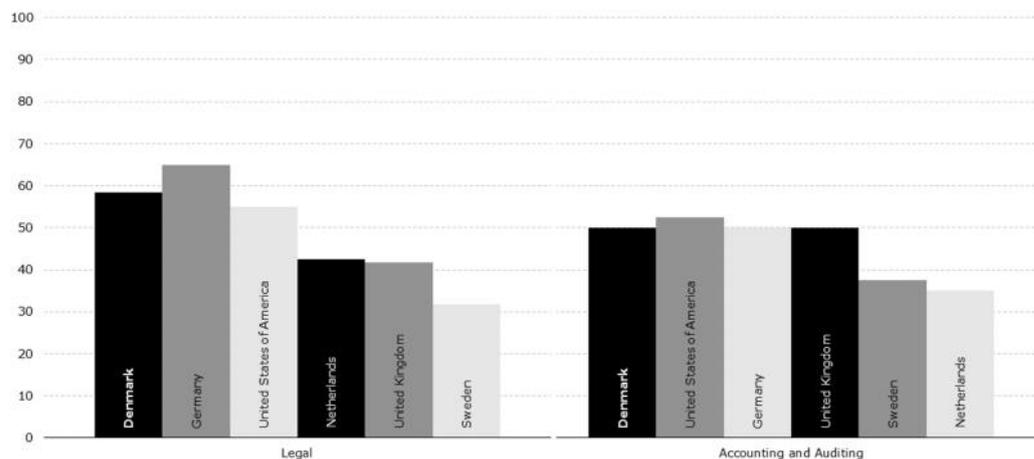
Note: Latest available year (2008). The index goes from 0 to 100 with 100 representing a closed sector.

Source: Copenhagen Economics based on World Bank STRI database.

For legal services, regulation in Denmark is on par with Germany and the U.S., while the regulation appears as more restrictive from a service trade perspective when comparing with the UK, the Netherlands and in particular when comparing with Sweden. Again, we have found that a number of adjustments are needed to make the index information up-to-date, and the information included in the World Bank index is not fully reflecting the actual restrictions in the Danish legal sector. Some of the restrictions are no longer relevant.

For accounting and auditing, the regulation with respect to service trade restrictiveness, Denmark is shown in the World Bank index to have a regulation on par with Germany, the U.S. and the UK, while regulation is less closed for accounting and auditing in the Netherlands and Sweden, cf. Figure 12.

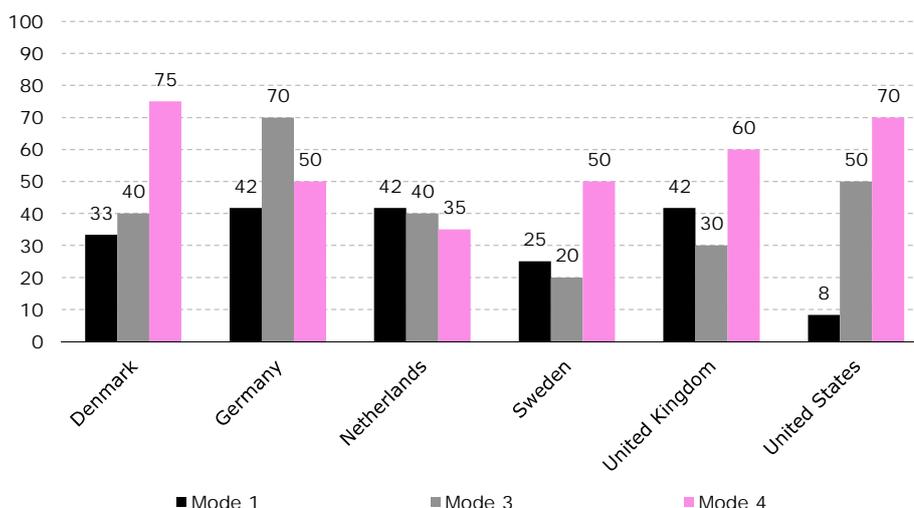
**Figure 12 World Bank’s STRI for subsectors in Denmark**



Note: Latest available year (2008). The index goes from 0 to 100 with 100 representing a closed sector.  
 Source: Copenhagen Economics based on World Bank STRI database.

The World Bank STRI also allows for comparisons by mode of delivery. This shows that Denmark is more on par when it comes to mode 1 (cross-border trade) and mode 3 (establishment), while Denmark is more restrictive for mode 4 (movement of natural persons). The latter indicates a cross-cutting challenge with respect to more strict regimes for allowing individual professionals to practice in Denmark, cf. Figure 13.

**Figure 13 Restrictions in professional service by mode**



Note: Latest available year (2008). The index goes from 0 to 100 with 100 representing a closed sector.  
 Source: Copenhagen Economics based on World Bank STRI database.

## Chapter 3

# Regulation in individual subsectors

In this chapter we analyse the regulation of professional business services in more detail. We analyse the regulation subsector by subsector with a focus on legal services and accounting, where the comparative regulatory analysis identified the most restrictions.

### 3.1 The need for regulation

Regulation of professional business services such as legal advice, auditing and accounting must balance a number of objectives. The regulation of legal services, for example, serves to accommodate non-economic objectives such as legal certainty and access to justice.

From a purely economic point of view, it is also necessary to balance different aspects. The regulation of the professional services can have both economic advantages and disadvantages that must be balanced. The advantages are that regulation can solve market failures that would otherwise occur in a free market. It is for example difficult to maintain good quality without regulation when the clients themselves find it difficult to assess the quality of the professional experts. The disadvantages of regulation are that it reduces competition by creating entry barriers or by limiting the competition between existing professional service firms.

The usual starting point for an economist is that a free market without regulation gives the best economic outcomes with optimal allocation of resources and the correct combination of price and quality. However, there are two important exceptions - asymmetric information and externalities – which mean that a totally free market for professional services will not function optimally. These exceptions are relevant to the many of the professions in this segment of private services and in turn make it advantageous to have a certain degree of regulation.

#### Regulation solves market failures

We find that there is a need for some degree regulation of professional services such as lawyers and accountants because a totally free market will lead to serious market failures. This conclusion is in line the EU Parliament decision regarding market regulation and competition rules for the professional services in which the EU Parliament concludes:

*“that from a general point of view rules are necessary in the specific context of each profession, in particular those relating to the organisation, qualifications, professional ethics, supervision, liability, impartiality and competence of the members of the profession or designed to prevent conflicts of interest and misleading advertising, provided that they: (a) give end-users the assurance that they are provided with the necessary guarantees in relation to integrity and experience, and (b) do not constitute restrictions on competition<sup>6</sup>”.*

<sup>6</sup> European Parliament resolution on market regulations and competition rules for the liberal professions 16. December 2003.

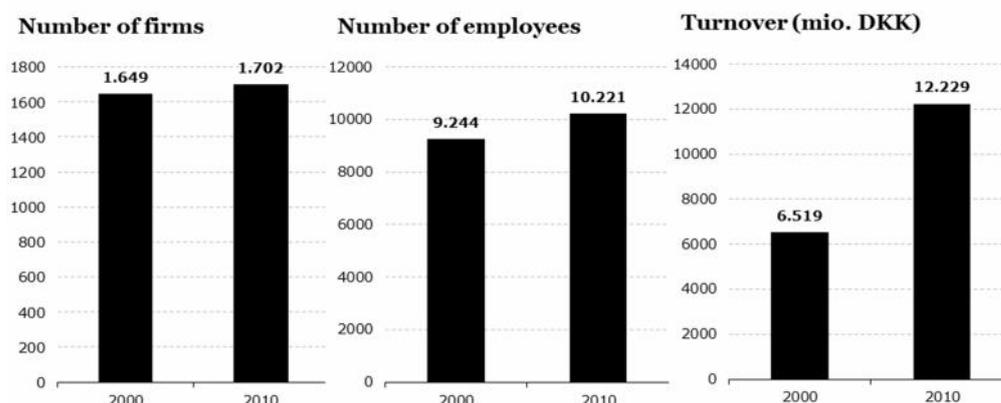
In the following section we examine whether it is possible to increase competition on the market for legal and accounting services by modifying some of the regulations.

### 3.2 Legal services

There are around 12.000 people employed in the legal services sector in Denmark.<sup>7</sup> Less than half are lawyers (*advokat*) by title. Around 4.750 lawyers are employed at Danish law firms and in addition around 900 lawyers under training (*advokatfuldmægtige*).

The legal service sector in Denmark has seen a net increase of close to 1.000 new employees the last ten years.<sup>8</sup> Revenues have increased markedly over the last ten years by more than DKK 5 billion.<sup>9</sup> This development is closely related to the development of the profitable corporate law market, which has grown significantly and changed the market. Corporate legal advice (*erhvervsrådgivning*) grew from 31 percent of total revenues in 2004 to 38 percent of total revenues in 2008.<sup>10</sup> Corporate clients account for 65 percent of total revenues and exports is around 6 percent of total revenues.

**Figure 14 Development in legal services in Denmark 2000-2010**



Source: CE analysis based on accounting data from Statistics Denmark.

The growth in the market has attracted international competition, through cross-border trade with foreign law firms servicing Danish clients, mainly corporate clients, from their offices outside Denmark, sometimes in cooperation with some Danish law firms, but often in competition with Danish law firms.

Around 100 new law firms are established every year and slightly fewer are closed every year. The *renewal rate* measured as the percentage of new firms as a share of existing firms is increasing slowly from around 6 percent to over 7 percent in 2009. The renewal rate is, however, lower in legal services than in other business services, where the renewal rate is between 10 and 25 percent.

<sup>7</sup> Our estimate based on latest available statistics from 2009.

<sup>8</sup> According to accounting data from Statistics Denmark for 2000-2010, [www.statistikbanken.dk/REGN1](http://www.statistikbanken.dk/REGN1).

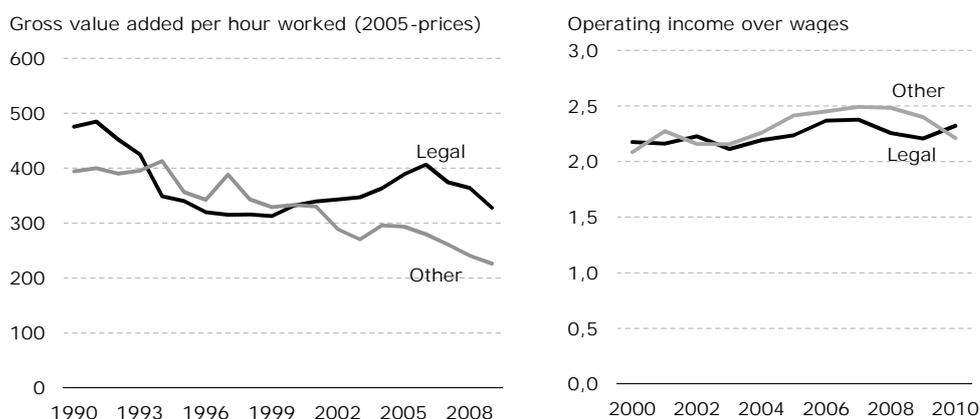
<sup>9</sup> According to accounting data from Statistics Denmark for 2000-2010, [www.statistikbanken.dk/REGN1](http://www.statistikbanken.dk/REGN1).

<sup>10</sup> See Danmarks Statistik (2005), "Nyt fra Danmarks Statistik", Nr. 239, 31 May 2005 and Danmarks Statistik (2011), "Nyt fra Danmarks Statistik", Nr. 600, 13 December 2011.

There is also an average increase in scale, with the average number of employees increasing slowly from 5.6 employees per firm in 2000 to around 6.4 per firm in 2008. Since 2008 there has been a general decline.<sup>11</sup>

Legal services are labour intensive, and productivity growth should be primarily be measured as growth in labour productivity. There are two available measures of labour productivity. One is the gross value added per hour worked and by this measure, productivity in the legal sector has developed more positively than for the other knowledge-based services (accounting, consulting and architects and engineers) the last ten years, cf. Figure 15 (left). This improvement in GVA per hour could be a result of higher margins. The second indicator is operating income divided by wages. By this measure, there is no significant difference between the legal services and other knowledge-based services. Here we find a factor of around 2.0-2.5 for both legal services and other knowledge-based services, cf. Figure 15 (right), and we find no sign of a higher mark-up over wages in legal services compared to the average of other knowledge-based services.

**Figure 15 Productivity measures in legal services**



Note: The left diagram shows real gross value added at 2005-prices per hour worked. Not updated after 2009. The right diagram shows operating income over wages.

Source: CE analysis based on national accounts and accounting data, Statistics Denmark.

One possible source for improving productivity is through economies of scale, and possible hypothesis could be that law firms in Denmark are lacking behind for example their Swedish peers because of lack of scale economies. However, the largest Danish law firms are not significantly smaller than in Sweden, Germany or the Netherlands. In fact, the largest Danish law firms employ the same number of lawyers as the largest firms in Sweden and almost as many as the largest firms in Germany, although the Danish market is much smaller. In Germany and the Netherlands, the largest law firms are on average larger, cf. table 3.

<sup>11</sup> According to accounting data from Statistics Denmark 2000-2010, [www.statistikbanken.dk/REGN1](http://www.statistikbanken.dk/REGN1).

**Table 3 Size of five largest law firms in Denmark and peer countries**

Denmark		Sweden		Germany		The Netherlands	
Kromann Reumert	300	Mannheimer Swartling	329	Rödl & Partner	620	Loyens and Loeff	894
Gorrissen Federspiel	296	Vinge	327	Noerr	380	De Brauw Blackstone Westbroek	375
Bech Bruun	285	Lindahl	250	Hengeler Mueller	305	NautaDutilh	360
Lett	283	Setterwalls	205	Gleiss Lutz	273	Stibbe	340
Plesner	250	Wistrand	143	Heuking Kühn Lüer Wojtek	243	Houthoff Buruma	326
Average of five largest	291	Average of five largest	251	Average of five largest	364	Average of five largest	459

Note: For law firms with multiple locations only lawyers based in Denmark and Sweden respectively are counted.

Source: Company websites, The Lawyer European 100 2012.

This comparison shows that there is no reason to expect that too low scale of the largest law firms is an explanation of the productivity development.

### Regulation of establishment or operations in legal services

In this section we review the Danish regulation of legal services with the purpose of identifying areas with a possible impact on productivity growth. This can either be in the form of regulation hampering competition or regulation which pushes up costs. We base our review on the two regulatory databases from the World Bank and the OECD.

#### *The World Bank index*

The service trade restrictiveness index (STRI) from the World Bank, as presented in Chapter 2, shows restrictions divided by mode of international service supply: cross-border trade, foreign establishment and movement of professionals. The index is constructed such that zero indicates an open market and the value of 100 indicates a closed market.

No restrictions are found in Denmark with respect to cross-border trade for legal services, i.e. serving a Danish client from an office in another country, and it is our assessment that foreign law firms, especially UK law firms are very much present in the large corporate law cases in Denmark through cross-border trade. Sometimes in cooperation with a Danish law firm, sometimes in competition with Danish law firms.

In the World Bank index, Denmark comes out as somewhat restrictive in comparison with other countries regarding establishment/foreign presence (mode 3), however with Germany and the Netherlands being more closed. Here, the score for Denmark is 50, which is described as "*major restrictions*". Sweden and the UK are ranked as more open in this regard.

Denmark comes out as the most restrictive of the peer countries in the World Bank measurement of temporary movement of natural persons (mode 4), where Denmark is given a score of 75, equivalent to a characterization as "*virtually closed with limited possibility enter and operate*". The peer countries are less restrictive on this mode than Denmark.

The UK is also quite restrictive on this measure, while The Netherlands, Germany and Sweden are ranked as more open by the World Bank index, cf. Table 4.

**Table 4 STRI – Legal Services**

Country	Cross-border supply of services (mode 1)	The supply of services through commercial presence (mode 3)	The temporary presence of natural persons (mode 4)
Denmark	0	50	75
Germany	25	83	50
Netherlands	25	50	33
Sweden	0	17	50
United Kingdom	25	17	67

Note: Latest available year (2008). The index goes from 0 to 100 with 100 representing a closed sector.

Source: Copenhagen Economics based on World Bank STRI database.

#### *What explains the high scores?*

To identify the detailed restrictions appearing in the World Bank index, we compare Denmark with Sweden on the 70 individual indicators included in the index. We have reviewed the index in the subsector foreign legal advice, where most restrictions are found.

In the 2008-version of the database, Denmark is the most restrictive of the five with a score of 50, while Sweden is considered more open with a score of 20. However, a number of adjustments are needed to make the index information up-to-date, and the information included in the index is not fully reflecting the actual restrictions in the Danish legal sector. Some of the restrictions are no longer relevant.

Our comparison still shows that Denmark is more restrictive than Sweden on certain aspects. In particular, Denmark is more restrictive in the following areas:

- *"Limits on ownership or control by foreign nationals"* which is found in Denmark according the World Bank data. Danish law firms shall be owned by lawyers having passed the Danish bar exam (*advokatbeskikkelse*) and they should have certain degree of practice in Denmark. Owners of a law firm in Denmark (entitled to use the title *Advokatselskab*) do not need to be resident in Denmark or to have Danish degree in law, but they must pass the bar exam and they must be practicing law in Denmark. Furthermore, up to 10 percent of the shares of the law firm can be owned by non-lawyers being employed at the law firm, however subject to passing a 2 hour written test by the Bar Society (*Advokatsamfundet*). Legal services can be offered with no restrictions, but the ownership of firms using the title "law firm" (*advokatselskab*) are subject to the above requirements. In Sweden on the contrary, a Swedish law firm can be owned by another law firm, e.g. a foreign law firm.
- *"License required"*, which is the case in Denmark but not in Sweden. There is no difference in the licensing requirements for Danish and foreign lawyers. Foreigners can practice in Denmark using their home country title (e.g. German

*Rechtsanwalt*), but they must not use the title "lawyer" (*advokat*) unless they pass the Danish bar exam.

- “*Education*” and “*Labour market tests*” for foreigners are required in Denmark, if the individuals want to acquire the right to the title “advokat”. The requirements in terms of compatibility of the education for foreign lawyers are determined by the Ministry of Justice, and not by the Bar Society.

#### *OECD’s index of restrictions*

The OECD product market restrictions index also covers legal services. It takes a different perspective than the World Bank STRI and looks at *entry regulation* and *conduct regulation*.

Our comparison of *entry regulation* shows that Denmark is not alone in having entry regulation for legal services. Denmark is on par with the Netherlands, Germany and the U.S. while Sweden and the UK are displaying few entry restrictions according to the OECD. Looking at the detailed indicators behind the above picture, we find that the Danish licensing requirements are scored similar to those of Germany and the Netherlands (score of 6, which is the most restrictive). The educational requirements in Denmark are judged as less restrictive with respect to entry than in Germany, the Netherlands and the U.S., but more restrictive than in Sweden and the UK.

With respect to *conduct regulation* Denmark displays requirements on the legal form of a law firm (only Partnership and some incorporation are allowed). In the other peer countries, no such restrictions are found by the OECD. This is reflecting the regulation of ownership described above. The OECD index on conduct regulation also includes two elements, which, according to our review, are no longer present in Denmark, and which have been abolished long before 2008.

#### *No restrictions on advertising*

The OECD lists restrictions on advertising and marketing by the legal profession as being under special regulation in Denmark, and law firm advertising is registered as prohibited. This is not correct. Danish Law firms are allowed to advertise, but law firms in Denmark are, like any other firm, subject to the general commercial law (*markedsføringsloven*).

#### *No recommended prices*

Finally, the OECD has registered that there are non-binding recommended prices on all services for legal services in Denmark. According to our review, there no recommended prices, and these were abolished long before 2008.

Consequently, the conduct regulation in Denmark is not as restrictive as it appears in the OECD index, cf. Table 5.

**Table 5 OECD regulation index – Legal services**

	ENTRY REGULATION			CONDUCT REGULATION		
	Licensing	Education	Quotas and economic needs tests	Regulations on the form of business and inter-professional co-operation	Regulations on advertising	Regulation on prices and fees
DEN	6,0	2,7	0,0	2,5	(6,0)*	(2,0)*
GER	6,0	3,4	0,0	2,3	3,0	5,0
NL	6,0	5,3	0,0	1,5	3,0	0,0
SWE	0,0	0,0	0,0	0,0	0,0	0,0
UK	0,0	0,0	0,0	0,0	3,0	0,0
US	1,5	3,3	6,0	0,0	3,0	0,0

Note: Latest available year (2008). The index: 6 = most restrictive; 0 = least restrictive. \*) The scores for Denmark on advertising and prices and fees are not reflecting the current situation.

Source: Copenhagen Economics based on OECD PMR database.

### *Report for the European Commission*

Based on a comprehensive report from 2003 on the regulation of professional services, including legal services, we note that the Danish legal sector has relatively few competition restricting regulations compared to other EU countries.<sup>12</sup> The report showed that Denmark is one of the countries in the EU where legal services are the least regulated, with only Finland and Sweden having less regulation. The index of competition constraints in Denmark is 3.0, while the EU average is 5.2. The report also documented that Denmark has neither minimum prices nor recommended prices, while this was the case in many other member states. This implies that the potential for enhanced competition through regulatory changes is far smaller in Denmark than in most other countries.

### **Summary of regulatory review**

Overall, having reviewed the regulation of legal services in Denmark, we find some regulatory differences, and these differences might give rise to some barriers to entry for both companies and individuals, and thus the current regulation of legal service may reduce the incentive for entry for certain types of activities, which in turn could have a negative impact on productivity.

We have not investigated the productivity growth of Danish law firms and compared with Swedish ones because of lack of comparable Swedish data. The only available data shows a difference in productivity *levels* (and not growth), with gross value added per hour being higher in Denmark (index 100) than in Sweden (index 90).<sup>13</sup>

We will therefore proceed with assessing whether the current regulation of ownership is having a restricting effect on the establishment of foreign law firms, and whether the regulation is likely to have a measurable negative effect on productivity for Danish law firms.

<sup>12</sup> IHS (2003), "Economic impact of regulation in the field of liberal professions in different member states. Regulation of Professional Services". Final Report. Study for the European Commission, DG Competition. January 2003.

<sup>13</sup> See McKinsey (2010) based on data for 2007.

### Restrictions on ownership

In this section we assess the possible economic impact of the regulation regarding ownership. The limitations of ownership have their base in the Code of Civil Procedure § 124 - 124g and related statutes on law firms (No 1427/2007) and the Law Society's practice (see Annex).

These provisions require that the owners of law firms in Denmark must be approved as a lawyer by the Danish Bar and Law Society. Foreign lawyers will need to obtain Danish approval (*beskikkelse*) to own a law firm in Denmark and they must have a certain degree of practice in Denmark. Still the same personal liability applies as applies to Danish lawyers, meaning that the owners are held personally liable and there are requirements to have specific insurances and guarantees. There are no differences in the requirements between Danish and foreign owners of a law firm.

Whether these restrictions are in fact a barrier to entry depends on whether this restriction is forcing foreign law firms who wish to establish themselves as a law firm in Denmark, to deviate from the business model that they would prefer to use in absence of the restriction.

Generally speaking, productivity or the growth of a company if the restriction means that:

- The company is restricted in its access to capital causing too little investment and scale effects and possibilities for consolidation are not exploited
- Smart money is not allowed to enter the firm i.e. some investors are knowledgeable and more patient than others
- Foreign capital is restricted and therefore it reduces the gains from foreign ownership and the economies of scale and scope from an international network.

For Danish law firms it is especially the last effect which is relevant. In our assessment, law firms are not constrained by lack of investments or capital and are not very capital intensive, so the first concern is small. Looking at the second point above, it seems unlikely that would be large gains from this source, and having non-lawyers as owners would lead to other regulatory concerns about controlling quality and independence as discussed in chapter 1. The third point may have some importance.

#### *Foreign entry*

Restrictions on ownership make it more difficult for foreign firms to establish a subsidiary in Denmark, but it does not exclude foreign firms from establishing offices and especially not from competing for instance through cross-border trade, e.g. when a foreign law firm assists a Danish client.

While the restriction does not prohibit foreign law firms from establishing in Denmark, in our assessment, it does make it more difficult. There are examples of foreign law firms establishing offices in Denmark. The large UK based *Eversheds* have had an office in Denmark for more than 15 years, but is now closed. The Finish law firm *Hannes Snellman* opened an office in Denmark in 2010, and more recently the UK firm *Bird & Bird* have entered Denmark in collaboration with Danish law firm Bender von Haller Dragsted.

There are two modes of entry. Either an independent “advokatpartnerskab” is established with the Danish partners as owners or a holding company is established with foreign partners, who have passed the Danish bar exam, as owners. The latter was the model of Eversheds. In Sweden, foreign law firms are not restricted from owning the Swedish subsidiary. This is for example the case for the UK law firm Linklaters’ Swedish office, which is fully owned by a holding company being owned with the UK law firm as the legal entity and ultimate owner. Such a construction would not be compatible with the current Danish regulation.

If the current regulation does not prevent foreign companies from establishing themselves in Denmark as they wish, then the regulation of ownership has limited effect as a barrier to entry. In other words, the constraints on ownership may be having little material impact, if foreign law firm do not wish to have foreign lawyers as owners of the Danish law firm, or do not wish that the mother company, e.g. the UK law firm, should own the Danish affiliate. We do note that this model is in fact chosen by UK law firms in Sweden.

If the restrictions do prohibit foreign firms from applying their favoured mode of entry, the restriction may have some impact on productivity. Comparing the Danish and Swedish regulation, the advantage in Sweden is that the mother company of the law firm can own the Swedish affiliate, while in Denmark, the Danish affiliate would need to be owned by the persons employed in Denmark, and these persons need to be held personally liable, whereas in the Swedish model, the owner is the foreign law firm. This increases the risks for establishing an office in Denmark, and consequently, it could have an impact on the attractiveness of opening an affiliate of a foreign firm in Denmark.

In the most common model, partnerships, the ownership regulation means that the Danish partners take on the risk with their personal wealth is used as collateral. Higher risk naturally limits the appetite for establishment and the ownership regulation is likely to making it slightly less attractive to establish a law firm in Denmark compared to for example Sweden, but we note that there are many other differences between the two markets of perhaps greater importance to the choice of opening an affiliate of a foreign law firm.

It is not possible to say how many entry decisions are being affected by the regulation – if any. Risks can be reduced by making special arrangements such as in the Eversheds-model, where the partners from the foreign firm owns the firm and therefore take on the risk, which is then again expected to be covered by the foreign law firm, in this case Eversheds LLP in the UK.

According to our understanding, the preferred “mode of entry” within the legal profession, is to hire local attorneys to operate in the local market and that local partners in the company should own the company because it is precisely the way law firms maintain their primary asset, namely the partners who can sell and perform legal services in that market.

This is also the usual practice when setting up new Danish law firms. Here it is often "defectors" from an existing law firm establishing a new law firm or switching to a competing law firm.

Thus, it is not immediately clear, whether the ownership regulation can be said to have a real negative effect on productivity in the industry.

Furthermore, there is no evidence of foreign owned law firms being more productive than Danish law firms, and we have not found any studies documenting positive spillovers from foreign ownership in business services, let alone legal services. This does not exclude that there are such effects.

### **Restrictions on individuals**

In this section we assess the possible economic impact of the regulation regarding individuals. The restrictions on foreign individuals in terms of licensing requirements and nationality requirements are also following from the Code of Civil Procedure and the Law Society's practice as well as the requirements from the Ministry of Justice in charge of educational requirements.

Individuals from other EU countries can, without major obstacles, act as lawyers in Denmark, as long as they are registered with The Danish Bar and Law Society and at the same time comply with the ethical guidelines of both Denmark and the home country and specify that they work as a foreign lawyer. The EU Establishment Directive is designed to ensure this.

Foreign lawyers in Denmark shall apply for authorisation as a Danish lawyer under Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications. To illustrate the practical challenges, the section of the Ministry of Justice's website on the matter is referring to a dysfunctional link to *vir.dk*, and the English language section of the website of the Danish Bar and Law Society is "under construction".<sup>14</sup>

Individuals who wish to set up as a practising lawyer in Denmark under their home-country professional title, can do so under Directive 1998/5/EC of the European Parliament and of the Council of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained.

It is difficult to assess the degree of impact of the restrictions on individuals. One way of assessing the impact is by counting the number of foreign lawyers practicing at the largest law firms in Sweden and Denmark, respectively.

Based on a count of the five largest law firms in each country, we found four foreign lawyers in Denmark (all at the biggest firm, Kromann Reumert), while 21 foreign lawyers were found at the five biggest law firms in Stockholm. Note that there are 1247 lawyers in total at the five largest law firms in Denmark, and 1254 lawyers at the top five law firms in

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<sup>14</sup> <http://www.justitsministeriet.dk/generelt/english/new-denmark> accessed April 2013.

Sweden. Consequently, while the numbers are still small, and therefore prone to some uncertainty, it still seems to indicate a small presence of foreign lawyers in Denmark compared to Sweden, cf. Table 6.

**Table 6 Number of lawyers educated outside country of practice**

Denmark		Sweden	
Kromann Reumert	4	Mannheimer Swartling	1
Plesner	0	Vinge	11
Bech Bruun	0	Lindahl	3
Gorriksen Federspiel	0	Setterwalls	2
Lett	0	Wistrand	4
Average	1	Average	4

Note: Mannheimer Swartling have several international offices which employ 71 lawyers combined.

Source: Company websites.

It has been shown that foreign experts generally increase the productivity of Danish firms<sup>15</sup>, and this would most likely also be the case within legal services. The restrictions on movement of persons (mode 4), where Denmark comes out as more restrictive, may therefore have an impact on the productivity growth of law firms. We underline, however, that the proportion of foreign lawyers in both Denmark and Sweden is still very small compared to the total number of lawyers, and it is questionable whether differences of this small order of magnitude has a measurable impact on productivity growth.

### Conclusion legal services

Reduction of regulatory barriers to international competition can improve productivity growth through increased competition. This happens when regulatory changes remove barriers that make it difficult to establish a business or when removing other barriers that constrain the law firms in hiring foreign experts. Changes to the ownership regulation can give foreign law firms better opportunity to provide legal services because the requirements for setting up a Danish affiliate law firm will decrease. The extent to which such changes will enhance competition and improve productivity through higher efficiency and better quality is questionable. A range of other market conditions of the legal sector will determine to what extent changes in ownership restrictions will increase competition. The processes and requirements for employing foreign experts to law firms may also be improved in practice, although the legal formalities are in place. In sum however, our analysis of the Danish legal profession indicate that the potential gain from such changes is limited.

When considering changes to the ownership regulation, it is worthwhile remembering the non-economic objectives that the regulation is designed to achieve, namely legal certainty and high quality of legal advice. If modifications are considered, these should not jeopardize the independence of lawyers and should not undermine lawyers' client confidentiality obligation. We conclude that there will not be significant gains from modifying the ownership requirements because it is unlikely that other owners can own and operate the law

<sup>15</sup> See Malchow-Møller, Munch and Skaksen (2011).

firms more efficiently than lawyers, but that some gains may arise from reducing the risk of foreign law firms and their establishment in Denmark.

### 3.3 Accounting and auditing

Auditing is regulated by law in Denmark in the so-called “auditor law” (*revisorloven*).<sup>16</sup> Denmark is required to register third-country auditors and audit firms, who conduct statutory audit on annual reports and consolidated reports from third-country companies, whose transferral securities are admitted to trading on a regulated market in Denmark.

Third-country auditors and audit firms, who have been registered in Denmark are subjects to the Danish audit control and investigation from the Danish authorities.<sup>17</sup>

Auditors and audit firms must be majority owned by approved auditors or approved audit firms.<sup>18</sup> This implies that, contrary to legal services, minority ownership (up to 49%) of audit firms is possible. Despite this possibility, virtually all audit firms in Denmark are 100% owned by auditors, according to our information.

In following we review the regulatory framework for auditing and accounting services in Denmark to search for possible modifications which can enhance competition and productivity.

#### OECD’s indicators of regulatory conditions in the professional services

According to OECD’s indicators of regulatory conditions in the professional services, the regulatory framework for accounting is actually less strict in Denmark compared to countries like Germany, Netherlands, Sweden, United Kingdom and the U.S, cf. Figure 16.

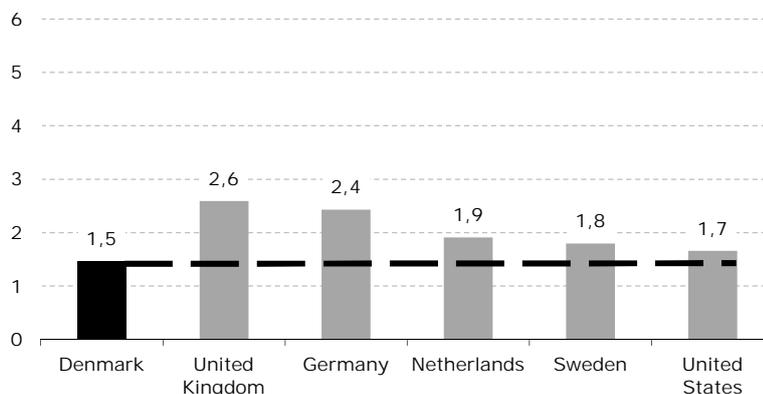
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<sup>16</sup> See law number L468 from 2008 (“Lov om godkendte revisorer og revisionsvirksomheder (revisorloven)”, lov 468, 06/2008.

<sup>17</sup> See Danish Business Authority: <http://www.dba.erhvervsstyrelsen.dk/third-country-auditors-and-audit-firms>

<sup>18</sup> Auditor law (L468) § 13, stk. 2.

**Figure 16 Overall degree of regulation - accounting**

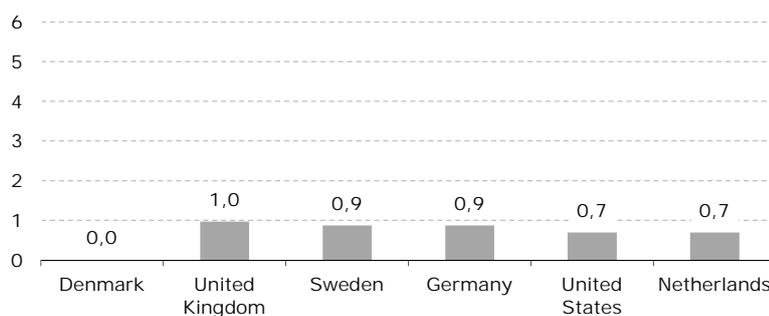


Note: The professional services indicators range the degree of strictness in countries regulatory framework on a scale from 1-6, where a higher score reflects strict regulation. The indicators are described in detail in the OECD Economics Department Working Paper No. 530

Source: OECD Indicators of regulatory conditions in the professional services

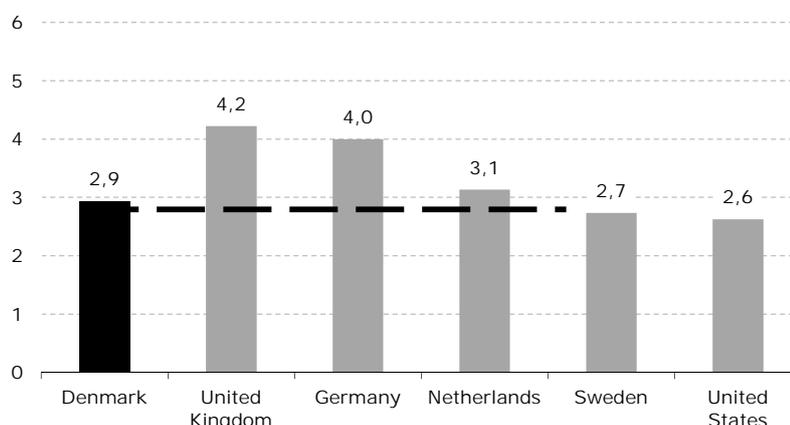
However, the OECD’s overall assessment of accounting regulation covers regulation of both conduct and entry. Looking in to the details shows that Denmark do have entry regulation beyond the level of Sweden and the U.S., but as the only country in the group, there is no conduct requirements, see Figure 18 and Figure 17 below.

**Figure 17 Conduct regulation - accounting**



Note: The professional services indicators range the degree of strictness in countries regulatory framework on a scale from 1-6, where a higher score reflects strict regulation. The indicators are described in detail in the OECD Economics Department Working Paper No. 530

Source: OECD Indicators of regulatory conditions in the professional services

**Figure 18 Entry regulation – accounting**

Note: The professional services indicators range the degree of strictness in countries regulatory framework on a scale from 1-6, where a higher score reflects strict regulation. The indicators are described in detail in the OECD Economics Department Working Paper No. 530

Source: OECD Indicators of regulatory conditions in the professional services

OECD's score of entry regulation is based on three parameters; licensing, education requirements and quotas and economic needs tests, but the parameter driving the difference between and Sweden and the U.S. is the education requirements for attaining authorization. While the auditor education and duration of compulsory training is in total seven years in Sweden and six years in USA, it is eight years in Denmark. While a shortening of the education period by one or two years might be worthwhile considering, and while it would increase the number of available freshman accountants for a certain period, it will not substantially change the entry barriers in the profession.

Based on these insights, we conclude that the OECD assessment does not indicate that an exceptionally great degree of regulation is to blame for the productivity performance in accounting services in Denmark.

### World Bank's Services Trade Restrictiveness Index

Another source for knowledge about regulation on knowledge intensive services is the World Bank's *Services Trade Restrictiveness Index*. The World Bank data confirms the finding from the OECD's assessments, that there seems to be no exceptionally devastating Danish regulation.

Table 7 below shows how Denmark performs in restrictiveness towards international trade in auditing relative to a range of comparable countries.

**Table 7 Services Trade Restrictiveness Index – Auditing**

Country	Cross-border supply of services (mode 1)	The supply of services through commercial presence (mode 3)	The temporary presence of natural persons (mode 4)
Denmark	100	25	75

Germany	100	50	50
Netherlands	100	50	50
Sweden	75	50	50
United Kingdom	100	50	50

Note: Open=0, Virtually open=25, Significant restrictions=50, Virtually closed=75, Closed=100

Source: World Bank Services Trade Restrictiveness Index

Commercial presence in Denmark is required in order to supply audit services to Danish customers. Even though other countries have similar requirements, Sweden is less restrictive, as statutory auditing services can be provided without commercial presence as long as the auditors are approved in Sweden. Approval requires a Swedish examination, working experience, and residency.

Besides the prohibition of selling auditing services from abroad, another barrier for international competition in auditing services is that it is difficult for foreign auditors to be approved for temporary work in Denmark. It is a general picture for the peer countries, see Table 7, that there are significant restrictions in this field, but Germany, the Netherlands, Sweden and United Kingdom generally allows foreign-licensed professionals under certain conditions, cf. box 1.

### Box 1 Auditing: Conditions for temporary presence of natural persons

- Denmark: Nationality is normally required, but there are certain exceptions.
- Germany: Foreign-licensed professionals are eligible to practice subject to certain conditions if they are nationals of EEA countries.
- Netherlands: Statutory auditors from other EU countries may practice in The Netherlands subject to some requirements.
- Sweden: Statutory auditors from other EU countries may practice in Sweden, subject to some conditions.
- United Kingdom: Foreign-licensed professionals are eligible to practice, subject to certain conditions.

Source: World Bank's Services Trade Restrictiveness Index

While auditing cannot be traded cross-border, the case is actually different for accountancy services. In this area, Denmark is open for cross-border supply; however it is difficult for foreign citizens to work as accountants in Denmark, because foreign degrees are generally not recognized.

### Table 8 Services Trade Restrictiveness Index – Accounting

Country	Cross-border supply of services (mode 1)	The supply of services through commercial presence (mode 3)	The temporary presence of natural persons (mode 4)
Denmark	0	25	75
Germany	0	50	50
Netherlands	0	0	25
Sweden	0	0	50
United Kingdom	0	50	50

Note: Open=0, Virtually open=25, Significant restrictions=50, Virtually closed=75, Closed=100

Source: World Bank's Services Trade Restrictiveness Index

As shown in Box 2 below, Germany, the Netherlands, Sweden and the United Kingdom all recognize foreign-licensed professionals under certain conditions while this is generally not the case in Denmark.

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## Box 2 Accounting: Conditions for temporary presence of natural persons

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- Denmark: Nationality is normally required, but there are certain exceptions.
  - Germany: Foreign-licensed professionals are eligible to practice subject to certain conditions if they are nationals of EEA countries.
  - Netherlands: Automatic recognition of foreign licenses is granted. Entry is allowed as an ICT or SSE.
  - Sweden: Statutory auditors from other EU countries may practice in Sweden, subject to some conditions. Statutory auditors from non-EU countries must meet the same education and training requirements as Swedish applicants.
  - United Kingdom: Foreign-licensed professionals are eligible to practice, subject to certain conditions.
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Source: World Bank - Services Trade Restrictiveness Index

### Conclusion

To sum up the most severe regulation identified from studying data from OECD and the World Bank is barriers for foreign accountants and auditors to work in Denmark. It can be questioned how much this impact productivity, however Malchow-Møller, Munch and Skaksen (September 2011) have shown that foreign experts generally increase the productivity of Danish firms.

Another issue is the length of education and compulsory practise necessary to be authorized. On average it takes ten years to gain authorization as auditor in Denmark, and the average age of candidates is thirty-four years.<sup>19</sup>

A bill under current discussion in the Danish parliament proposes a reform of the auditor education. The purpose of the reform is twofold. Firstly, it aims at enhancing confidence in the financial sector by improving the quality of audit of financial firms. Secondly, the auditor education has not been changed for many years, and does no longer necessarily match the auditor's role today as guarantor for the public.<sup>20</sup>

It has been suggested to make a wider range of master degrees qualifying for access to the auditor education and reform the exams to gain a greater success rate. The reform initiatives may influence the number of candidates and lead to a more efficient professional standard if it fosters better candidates.

Furthermore, a number of regulatory changes of the audit profession is being considered by the European Commission under the heading of *Audit Market Reform* following the financial crisis.<sup>21</sup>

The proposals focus on the statutory audit of public-interest entities, such as banks, insurance companies and listed companies, and the key proposals are summarised in box 2.

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<sup>19</sup> Association of State-Authorized Accountants

<sup>20</sup> Bill number L126 (2013)

<sup>21</sup> See [http://ec.europa.eu/internal\\_market/auditing/reform/](http://ec.europa.eu/internal_market/auditing/reform/)

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### Box 3 The EC proposals for audit market reform

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- Mandatory rotation of audit firms: Audit firms will be required to rotate after a maximum engagement period of 6 years (with some exceptions). A cooling off period of 4 years is applicable before the audit firm can be engaged again by the same client. Joint audits are not made obligatory.
- Mandatory tendering: Public-interest entities will be obliged to have an open and transparent tender procedure when selecting a new auditor.
- Non-audit services: Audit firms will be prohibited from providing non-audit services to their audit clients. In addition, large audit firms will be obliged to separate audit activities from non-audit activities.
- European supervision of the audit sector: In addition, given the global context of audit, it is important that coordination of and cooperation on the oversight of audit networks is ensured both at EU level as well as internationally.
- Enabling auditors to exercise their profession across Europe: The Commission proposes the creation of a Single Market for statutory audits by introducing a European passport for the audit profession. To this end, the Commission proposals will allow audit firms to provide services across the EU and to require all statutory auditors and audit firms to comply with international auditing standards when carrying out statutory audits.

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Note: Proposed in November 2011.

Source: Press release, European Commission, Reference: IP/11/1480, 31 November 2011.

While some of these measures might be helpful in further enhancing the already existing competition between auditors, there are also elements in the proposals which might have counter-productive effects in productivity (cost creating regulation), and elements which will increase costs of audits rather than reducing them.<sup>22</sup> In our view, many of these proposals would hamper productivity growth in the profession rather than promote it.<sup>23</sup>

### 3.4 Architectural and engineering activities and other business services

No significant restrictions are found in these subsectors.

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<sup>22</sup> An impact assessment from the European Commission services is available at:  
[http://ec.europa.eu/internal\\_market/auditing/reform/](http://ec.europa.eu/internal_market/auditing/reform/)

<sup>23</sup> Our review of the Commission's impact assessment is available at:  
<http://www.copenhageneconomics.com/Website/News/News-archive.aspx?M=News&PID=2169&NewsID=459>

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