The Single Market: A Look at its Benefits and Recommendations for Further Progress

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Paper Presented at the 33rd Annual European Studies Conference

At the University of Nebraska at Omaha

October 2-4, 2008

Introduction

More than 50 years ago the Treaty of Rome was signed, which created the European Economic Community (EEC). A significant aspect of the EEC was the call for the establishment of what became known as the 'four freedoms' – free movement of goods, services, people, and capital, whereby all would move freely among the six member countries of the European Community (EC). To say that the EEC has been a success would be an understatement. The EC has become the European Union (EU) and grown to 27 member states encompassing more than 500 million consumers. The EU has a larger Gross Domestic Product (GDP) than the United States (US) and is the world's biggest exporter.

While progress has been impressive, it has not always been so. By the early 1980s the EC had added a tenth member, Greece, and was in negotiation with both Portugal and Spain for their eventual admittance. The admittance of these three countries posed a potential significant economic burden on the existing nine members because all three – Greece, Portugal, and Spain were considerably poorer than the EU9. France, in particular, was very concerned with the ascension of the three because of the potential for redirecting a significant amount of money under the EC's Common Agricultural Policy (CAP). France was, and continues to be, the largest benefactor of the CAP. To allow a potential reduction in CAP payments accruing to French farmers was not politically advantageous for either of France's 1980s presidents, Valery Giscard d'Estaing or Francois Mitterrand.

As a way to appease the French and keep the accession of Portugal and Spain on track, European Commission President, Jacques Delors, a Frenchman himself, became an

ardent supporter of the so-called White Paper that called for the creation of the EC's internal market, also known as the Single Market or Single Market Program (SMP). Essentially what the internal market called for was a refocus on the 'four freedoms' contained in the original Treaty of Rome, as a necessary step to realizing the benefits of Community membership. The White Paper stated it somewhat more eloquently:

> Just as the Customs Union had to precede Economic Integration, so Economic Integration has to precede European Unity. What this White paper proposes therefore is that the Community should now take a further step along the road so clearly delineated in the treaties. To do less would be to fall short of the ambitions of the founders of the Community, incorporated in the Treaties; it would be to betray the trust invested in us; it would be to offer the peoples of Europe a narrower, less rewarding, less secure, less prosperous future than they could otherwise enjoy. That is the measure of the challenge that faces us. Let it never be said that we were incapable of rising to it (Commission, 1985, p. 55).

Subsequent to passage of the SMP, Paolo Cecchini published what became known as the Cecchini Report in 1988. The report delved into various structural weaknesses within the EC member countries that needed to be corrected before the 'four freedoms' could actually be realized. In response to the Cecchini Report, the European Commission agreed that the EC needed "to remove border controls, standardize industrial regulations, open up government procurement, liberalize financial markets and establish the right to free establishment in other services, harmonize VAT rates, and generally remove barriers to competition among EC firms" (Commission, 2007, p. 19). The Commission set the deadline for achieving the Single Market as the end of 1992.

Benefits of the Single Market

As suggested, the Single Market has provided major benefits for EU citizens. By removing barriers to trade, it has given consumers access to a greater and better range of goods and services, often at lower prices, and usually of higher quality. It has created a larger, more competitive pool of suppliers, allowing firms to be more competitive in the world market. It has strengthened competition leading to higher levels of innovation, entrepreneurship, and growth. The harmonization of technical standards as well as the principle of mutual recognition for goods has meant that businesses usually have to comply with only one set of rules rather than rules from each member state. New regulations on public procurement have opened up markets for companies in other member states as well as making it cheaper for governments to provide public services. The Single Market has lead to the liberalization of various industries as well as a general reduction in state ownership of major industries. Also, the Single Market was a necessary step prior to the creation of the euro. As the OECD stated: "The common currency simply could not work without a high level of economic and financial integration" (OECD, 2007).

Unfortunately, it is not easy to quantify the benefits of the Single Market, primarily because the biggest benefit – greater competition and the ongoing economic growth that it delivers – is impossible to measure. In spite of this, the European Commission has estimated that the SMP has raised income of EU citizens by two percent. However, most experts believe two percent is a significant understatement of the

true benefit. Other studies suggest that the Single Market has contributed to a quadrupling of foreign direct investment (FDI) within the EU, higher productivity in most sectors of the economy, and has led to a significant reduction in price-cost margins for EU industries.

Exports from the EU12 to the EU15 have more than doubled as a percentage of EU12 GDP since the beginning of the Single Market in 1993. Further, the tendency of EU consumers to buy goods produced in their own country has decreased significantly. However, it should be noted that both of these occurrences have tended to level off since the beginning of the 21st century.

It is interesting to note, that internal trade in manufacturing is higher among EU member countries than it is among Canadian provinces, although it is considerably lower than trade among US states. Internal trade among the seven most industrialized EU members – Germany France, Italy, the United Kingdom, and the Benelux countries (Belgium, Luxembourg, and the Netherlands) is better integrated than within any other customs union including NAFTA and ASEAN.

Foreign investment flows paints a similar picture. Cross-border direct investment between EU15 countries has risen from less than 10 percent of GDP at the beginning of 1993 to approximately 50 percent in 2007. However, again, most of this growth took place in the 1990s, much of it triggered by global mergers and acquisitions (M&A), and has leveled off significantly in this decade.

Why the Benefits of the Single Market Have Slowed

There are obviously a number of reasons why the benefits accruing from the Single Market have slowed, or as the Commission so succinctly states, "the potential of

the Internal Market (has) not been fully exploited" (Commission, 2007, p. 58). One of the most obvious reasons is the fact of the ascension of the Central and Eastern European Countries (CEEC).

As indicated, the Single Market became effective on 1 January 1993. Shortly thereafter, the EU reached ascension agreements with Austria, Finland, Norway (which did not ratify the ascension treaty and did not become a member), and Sweden. These countries all have advanced economies and their ascension on 1 January 1995 provided significant economic benefit to the EU. With the fall of the Berlin Wall and subsequent breakup of the Soviet Union, and with the Nordic ascension completed, by the mid-1990s, the EU turned its focus eastward and was beginning negotiations with several of the CEEC in addition to Cyprus and Malta. Compared to the then EU15, these countries were, and still are, relatively poor. The EU was also focusing on getting the European Monetary Union (EMU) up and running, the next step after implementation of the Single Market and necessary precursor for creation of the euro. These factors, coupled with the fact that there was significant momentum from the start of the Single Market, suggest that the EU had other items on its agenda.

Nevertheless, the EU did recognize that, particularly with the ascension of the CEEC, the Single Market would not of and by itself continue accruing benefits for everyone. Recognizing this, the EU established what has become known as the Lisbon Strategy for Growth and Jobs.

> In March 2000, EU governments signed up to the goal of making Europe 'the most competitive and dynamic knowledge-driven economy by 2010.' There were many goals, but the main ones included: 1) boosting innovation and research and

development (R&D), including setting a target for R&D expenditure of 3% of GDP; 2) faster structural reform, including completing the internal market; 3) modernizing the social model (for example, through labour market reform and tackling exclusion) with a goal of an employment rate of 70% (60% for women and 50% for older workers); and 4) cutting red tape (OECD, 2007, p. 42).

As the Single Market continues to evolve there is a continuing need for more and more regulations to help create a better functioning internal market. In EU parlance these regulations are called Directives, which are proposed by the Commission and agreed to by the Council of Ministers as well as the European Parliament. Examples of areas where Directives are necessary include establishing a "legal framework for electronic commerce; modernizing legislation in public procurement; consolidation and modernization of rules regulating the recognition of professional qualifications; and… a draft services directive" (Commission, 2007, p. 58).

Once the various EU institutions have agreed to a Directive, it must then be implemented by all 27 member states. Throughout the history of the Single Market, implementation of EU Directives has been a concern. Most recently, the EU has indicted that four euro area countries – Greece, Luxembourg, Italy, and Portugal – have been very slow in implementing recent Directives. The downside of this slow, uneven implementation process is a significant distortion of competition. The Commission's response is to file infringement suits against the member states. Member states had agreed to a 50 percent reduction in infringement proceedings over a three-year period by 2006. Unfortunately, no EU member country achieved that reduction.

Another area wherein the EU could do a better job in improving the efficiency of the Single Market has to do with the adoption of agreed upon standards and expanding the principle of mutual recognition. Product standardization needs to improve particularly for Small and Medium-sized enterprises (SMEs) especially within the 12 new member states. Also, the rapid development of information and communication technology (ICT) requires greater standardization for EU companies to be competitive. Further, the impact of globalization calls for greater standardization, not just within the EU, but also more significantly at the international level.

Although mutual recognition has long been a tool for implementing the Single Market, it is rather surprising to note that only a quarter of intra-EU manufacturing trade is covered by mutual recognition. It has been estimated that the cost of determining whether or not a product conforms to a member country's standard is approximately two percent of the total sales price.

Public procurement accounts for approximately 16 percent of EU GDP. In spite of the fact that the opening of public procurement has been a significant factor in implementing and improving the Single Market, direct cross-border procurement accounts for only three percent of the total number of bids. Even though not all bids are required to be open to competition, further opening of public procurement would improve competitiveness, especially within the areas of military procurement and ICT.

While there is definitely room for improvement in product standards, mutual recognition, and public procurement, there is even greater need (and opportunity) for removing barriers in the service sector. Services account for nearly 70 percent of value added in the EU15, yet services account for only 20 percent of intra-EU trade.

> Cross border transactions in services between two countries take place mainly through (i) the international trade of services, such as road freight transport, telecommunications or consultancy and financial services; (ii) the establishment of production units in another country (for example banking or accountancy services); and (iii) the consumption of foreign non-traded services such as tourism (Commission, 2007, p. 64).

While many would argue that the service sector would benefit little from cross-border activity, with the development of ICT that is no longer the case. As a result services have become more tradable and better able to stand up to international competition.

As part of its ongoing effort to increase cross border activity in the services, the Commission prepared a draft Services Directive in 2004, which, among other things, simplified administrative rules and suggested a shift from the system of mutual recognition to one applying the country-of-origin principle. Various studies have suggested that implementation of the Services Directive will generate more intra-EU trades, more FDI in service sectors, and lower prices for services. The upshot of this would be an increase of GDP from 0.5 to 1.5 percent.

Currently, there is no tax harmonization among the EU member states. As a result member states are free to design their tax systems however they want. The existence of 27 different tax systems results in high compliance costs, which creates an added barrier to full implementation of the Single Market. The following demonstrate some of the complexities and costs of this lack of tax harmonization:

> In a 2004 comprehensive survey covering more than 700 EU companies, the European Commission found that these costs represent 1.9% of tax collected for

large companies and 30.9% for SMEs….

Another tax obstacle concerns the VAT. In the 2004 survey, a substantial percentage of large companies (86.1%) also quote cross-border repayment or refund of VAT as a major difficulty. 53.5% of large companies have not requested refunding at some point because of the complexity or the length of the procedures under the 8th VAT directive (Commission, 2007, p. 72).

In addition to the fact that there is not tax harmonization among the EU member states, there is also no multilateral tax treaty. As a result cross-border taxation issues are dealt with via bilateral tax treaties where they exist between member states. Situations involving more than two EU member countries are even more complicated. This lack of tax harmonization is a major barrier to capital and labor mobility. For example, studies by P. B. Sorenson suggest that, on average, the EU would see benefits ranging from 0.18 percent to 0.94 percent of GDP from better tax coordination or harmonization. Regardless of the degree of benefit, tax harmonization would contribute to improvement in the implementation of the Single Market. Nevertheless, because of concerns by some member states, the United Kingdom in particular, tax harmonization is not foreseen to occur in the near future (Sorenson, 2000 and 2004).

One of the ‘four freedoms’ called for in the Treaty of Rome and reemphasized in the Single Market was for the free movement of people. Of the four freedoms, this one has probably been the least successful. In the EU15, only 0.1 percent of the working age population change countries of residence each year. In comparison, in the US approximately 3 percent of the working age population changes States of residence each year. As would be expected, language is one of, if not the most significant barrier to work

related mobility. Surprisingly, only 50 percent of EU citizens speak a second language. Other factors include are:

> the lack or insufficient information about administrative and financial burdens associated with mobility; economic ties to the home country (e.g. home-ownership); about the society and job prospects, legal requirements of the destination country; family concerns (disruption of family life, difficulties for the spouse, or children who want to join the migrant) (Commission, 2007, p. 73-74).

Also, the fact that each EU member country has its own social security, taxation, and pension systems has not helped. While efforts have been made to reduce some of these barriers, including implementation of language programs and a European health insurance card, minimal improvement has occurred.

Recommendations for the Single Market to Achieve its Potential

As indicated above, the Lisbon Strategy for Growth and Jobs was agreed to in March of 2000 with a goal of making the EU 'the most competitive and dynamic knowledge-driven economy by 2010.' Five years later the strategy was refocused and relaunched after a review had determined that minimal progress toward reaching the original goal had been made.

> At the 2006 Spring European Council member states identified four priority areas and agreed upon concrete actions to achieve progress. The four priority areas identified were: 1) investing more in knowledge and innovation; 2) unlocking business potential (e.g. by cutting red-tape), especially for small- and medium-sized enterprises; 3) greater adaptability of labour markets; and 4) guaranteeing

secure and stable energy supply (OECD, 2007, p. 42).

There are several ideas that could be further developed for the EU to move in the direction of achieving the goals of the Lisbon Strategy for Growth and Jobs.

If the EU is truly to become a region in which ideas and innovation flourish, there is a need to establish a common system of Intellectual Property Rights. In short, a harmonization of administrative and legal practices in the area is needed. Whatever system is developed it should be inexpensive, transparent, and uncomplicated. There should also be better coordination between an Intellectual Property Rights policy and broader policies including R&D and competition as well as education.

Another critical need for the Single Market to reach its potential is, in simplistic terms, for the EU to develop a more competitive business environment. As time goes on the EU should focus on the following: "More flexible wage and price setting behaviour, more integrated and developed financial markets, a better functioning single market for services, as well as more flexible labour markets clearly emerge as having a very important influence is this respect" (Commission, 2007, p. 78).

This does sound rather broad. More specifically, the EU should push for greater competition and market loosening in various network industries including energy, telecommunications, ports, transportation, and postal services.

Another suggestion is to insure that the SOLVIT network has adequate resources to operate effectively. The SOLVIT network deals with situations wherein public agencies may have misinterpreted internal market regulations to the detriment of EU citizens. An example of a situation that SOLVIT has handled successfully is:

A Czech citizen wanted to set up in Germany as a self-employed construction

> worker. The local German authorities insisted that he needed a work permit but refused to give him one. SOLVIT Germany clarified that no work permit was needed for self-employed workers and within four weeks arranged that the Czech worker obtained an establishment license (OECD, 2007, p. 79).

Another example of a SOLVIT success story:

> A UK manufacturer of medical scales wished to expand its market to France. The company was already selling its product in the UK and other EU countries in compliance with EU rules. However, French authorities refused to accept the product on their market and requested additional testing. For over a year, the company tried to have the scales accepted and finally asked SOLVIT UK for help. The UK company and SOLVIT UK worked closely together to obtain market entry for the product in France in a matter of weeks. According to the company, SOLVIT, helped them prevent a considerable loss (Commission, 2008).

In much the same vein, establishment of an EU-wide small claims procedure would go a long ways towards facilitating cross-border trade.

Two areas of concern that have intensified with the expansion of the EU from 15 to 27 members are taxation and migration. As has been discussed, there is no tax harmonization within the EU and the prospects of achieving such harmonization are slim. Evidence suggests that because of this lack of harmonization, particularly in the area of corporation taxation, many businesses endeavor to avoid paying taxes by relocating some or all of their activities abroad. Were the EU to have a common consolidated corporate tax base for companies doing business within the EU, tax compliance costs would be

greatly reduced. This would be a minor, but modest step toward harmonization, yet still allow member states to maintain their own tax systems.

Each member country has its own immigration policy. With enlargement there was concern that the industrialized western European countries would be inundated with workers from the CEEC. Some countries including Ireland, Sweden, and the United Kingdom placed no restrictions on workers from new member states, while other countries, including Germany and France, allowed no workers from the CEEC during the first two years after ascension, unless they were highly skilled workers. Establishing a common approach to migration policies among all member states should be considered.

As is well known, globalization has brought significant changes to all businesses worldwide including those within the EU. As the EU moves to improve the Single Market it should adopt various policies that will enhance the competitiveness of EU firms. Two ideas that should be pursued include simplifying the EU regulatory environment and making a concerted effort to have worldwide common standards through organizations as the World Trade Organization (WTO). If the world were to adopt EU standards, then EU exporters would be at a competitive advantage. For example, the EU has higher standards than most countries in terms of consumer and environmental protection. Internationalizing these standards would definitely be a boon to EU companies. In the same vein the EU market is more open and homogeneous than most markets. Therefore, the EU should endeavor to insure that worldwide markets become more open and that international rules be transparent.

Many would argue that the Single Market would be improved with less regulation. Others would argue just the opposite. Suffice it to say, that better regulation

and less red tape would serve the EU well. Better regulation is generally construed to mean more flexible and less prescriptive regulations. At the same time better enforcement of existing regulations should be encouraged. As an example, dealing with monopolies within the EU is not done consistently. Some member countries impose fines, which has proven to be less than effective, while other members impose criminal sanctions. A consistent policy, preferably the latter, should be initiated.

The existence of state aid can distort competition. The on-going verbal battle between Boeing and Airbus has been well documented in the press. Regardless of who is right, it does serve to demonstrate that state aid does exist in the EU.

> The Commission is revamping state aid policy, moving away from a rules-based approach and towards greater reliance on economic principles. As well as reining in the level of aid, the Commission wants it to be better targeted, especially towards innovation and human capital, and is streamlining administrative procedures so it can focus on the most distorting measures (OECD, 2007, p. 13).

In accomplishing this, the EU needs to make certain that it does not lead to a re-nationalization of industrial policy. The point is essentially to insure that politics is kept out of state aid decisions.

Establishment of the EMU and creation of the euro have done much to contribute to greater integration of financial markets. Capital flows are generally unimpeded and wholesale markets, in particular, are well integrated. Such is not necessarily the case in retail markets. Retail banking and the mortgage industry markets are generally national. In addition, cross-border merger of financial institutions is extremely difficult. In

response to these issues, the EU has created what is known as the Single Euro Payments Area (SEPA), which is an:

> initiative for the European financial infrastructure (which) involves the creation of a zone for the euro in which all electronic payments are considered domestic and where a difference between national and intra-European cross border payments does not exist. The project aims to improve the efficiency of cross border payments and turn the fragmented national markets for euro payments into a single domestic one (European Central Bank, 2008).

It is predicted that, when implemented, SEPA will reduce the cost of moving capital throughout Europe by two to three percent of GDP. SEPA will impact banks in all 27 EU member countries as well as those in Iceland, Liechtenstein, Norway, and Switzerland. It should increase competition among banks for customers across borders within the EU and Europe as a whole.

As is well known the CAP makes up the most significant portion of the EU budget. While the CAP is taking a lower percentage of the EU budget than in the past, there is still need for reform. It is important to note that reforms were agreed to in 2003, the most significant of which was a change from commodity-specific payments to a single farm payment. Previous payments were primarily tied to production, which led to the overproduction of many crops. Although improvement has occurred, more have 20 percent of CAP payments are still tied to production in agriculturally rich countries including France, the Netherlands, Portugal, and Spain. More reform should be done to reduce the incentive to overproduce.

Another area of potential reform is in export subsidies.

> Export subsidies have been reduced substantially but remain extensive by international standards, amounting to 5% of the value of agricultural exports. However, the European Union has conditionally proposed phasing out all export support, including export subsidies, in its offer to the Doha trade round (OECD, 2007, p. 53).

The EU should push for this to occur.

The EU should continue to adopt policies that reduce obstacles to labor mobility. As mentioned above, most member states placed restrictions on worker immigration from the CEEC upon ascension in 2004. Currently approximately half of the EU15 retain some restrictions on workers from the ten CEEC. Only two countries have opened their doors to workers from Bulgaria and Romania, which ascended in 2007. Countries that did not impose restrictions "have benefited through better job matching, a reduction in structural unemployment and the easing of labour shortages" (OECD, 2007, p. 17). Perhaps the member states that have imposed restrictions should reconsider.

The European Commission has, for several years, pushed for pension portability as a means to increase labor mobility. Again, perhaps it is time for member states to support these initiatives. Efforts to improve mutual recognition of professional and trade qualifications would help reduce or eliminate another barrier to labor mobility. Also, member states should enact measures to provide better housing for the poor.

Recommendations for improving operation of the Single Market and helping it achieve the objectives of the Lisbon Strategy for Growth and Jobs can best be summarized as follows:

In 2003, the European Commission presented a ten point action defining the

priorities to improve the operation of the Internal Market…to take into account the Lisbon objective, the challenges of enlargement and ageing. The ten priorities…:

- Facilitate the free movement of goods (e.g. by improving the implementation of the mutual recognition principle);
- Integrating services markets;
- Ensuring high quality network industries;
- Reducing the impact of tax obstacles;
- Expanding procurement opportunities;
- Improving conditions for business (e.g. by adopting a Community patent);
- Meeting the demographic challenge (e.g. by improving the portability of pension rights);
- Simplifying the regulatory environment;
- Enforcing the rules;
- Providing more and better information (Commission, 2007, p. 20).

Concluding Comments

The European Single Market was the topic of discussion throughout the late 1980s and early 1990s. The American press decried the advent of 'Fortress Europe' suggesting that US businesses would be shut out of the EU marketplace. Certainly, that has not come to pass. In fact the Single Market is far more open and far more integrated than many people thought possible two decades ago.

Because of the initial success of the Single Market and the change in EU focus toward EMU and ascension of the CEEC, discussion of the Single Market fell out of

favor as far as the public media was concerned. That said, the Single Market is far from perfect as the Lisbon Strategy for Growth and Jobs attests. It might be simplistic to suggest but the Single Market is a continuing process that requires enforcement of existing rules as well as enactment of new ones. The European Commission is well aware of the fact that the Single Market is a work-in-process and continues to fulfill its responsibility in its dual roles of enforcement and enactment.

It would not be misleading to suggest that the original White Paper has stood the test of time, that the Single Market has functioned largely as intended. Without question, the Single Market has provided significant benefits for EU citizens. That said, Desmond Dinan suggests:

> The main achievement of the 1992 initiative may well have been psychological. It created a climate in which individuals as well as firms could begin to identify themselves as European and look for opportunities beyond their own borders. It also created an atmosphere in which national governments could contemplate surrendering further sovereignty (Dinan, 1999, p. 376).

While this might be an overly optimistic assessment of the benefits of the Single Market, it did come at an opportune time in the history of the EU.

The Single Market, establishment of the EMU, and creation of the euro all suggest that the EU has been most successful in areas of economic interests. Yet, as this paper suggests, there is always room for improvement. Hopefully, many of the above recommendations will be adopted and the Single Market will continue to provide greater benefit for its citizens.

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