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EU Monitor
European integration

The Single European Market 20 years on

Achievements, unfulfilled expectations & further potential

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The Single Market is the core of Europe's economic and integration architecture. It has guaranteed the free movement of people, goods, services and capital in the European Economic Area since 1993 and has been continuously modified since then to keep pace with more recent developments, such as the growing importance of the service sector.

Has the Single European Market fulfilled the expectations placed upon it? The answer is a cautious “yes”. Some expectations were probably unrealistically high. After a period of now more than 20 years the general consensus is that the Single Market has had (i) substantial positive growth effects, which (ii) have, however, been less pronounced than predicted by the widely quoted Cecchini Report of 1988 and that (iii) have not yet fully materialised.

Empirical analyses show that the Single Market has realistically increased GDP in the EU by some 2-3%. Exports and foreign direct investment in particular have received a major boost. The dismantling of trade barriers has created cost advantages, intensified competition in the Single Market and made companies more competitive in the global arena. The reduction of barriers to intra-EU trade has also made the countries in the EU more attractive for investment by foreign firms.

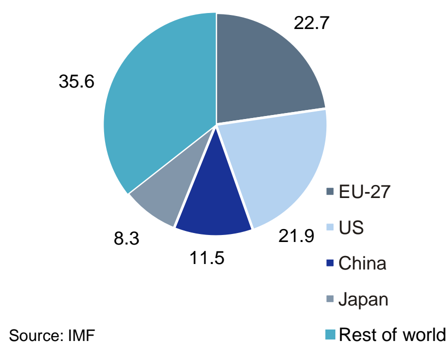
Given the structural problems in the eurozone and Europe's long-term dwindling importance for the global economy the continuing development of the Single Market is one absolutely essential element. In some areas, national borders in Europe still constitute unnecessary obstacles. For instance, the trade in industrial goods between the individual US states is equivalent to 40% of GDP and is thus nearly twice as high as between the EU member states, and also workers in the US are much more mobile. In the expanding sector for tradable services there is also still untapped growth potential. At the same time, there is a need to reduce unnecessary regulation and red tape.

The future development of the Single Market is of particular relevance for the current debate in the UK about the benefits of EU membership. Even though there are countries in the EU whose economies are more dependent on the Single Market, the UK does also benefit from being a member of a single European economic area.

The Single European Market: Taking stock

Share of global GDP by region 1

2012 in %



Source: IMF

In January 2013, nearly 20 years to the day after the "completion" of the EU Single Market, Britain's Prime Minister David Cameron announced that in the event of an election victory he intended to hold a referendum about continued UK membership of the European Union. According to recent polls, it is unclear whether the British would vote for or against continued membership. A country exiting the EU would be a unique occurrence. After all, since its inception as the European Economic Community (EEC) in 1957 the number of members has grown steadily from 6 to 28 at present, and the EU is now the world's most economically potent internal market.

The motivation for European integration was political as well as economic in nature. From an economic point of view the creation of a cross-border market should promote intra-European trade, boost competition, make Europe more attractive for foreign investment and create jobs. That is why those who oppose a British exit from the EU argue that Britain would be the main casualty of such a self-inflicted exit. By contrast, those in favour of a "Brexit" claim that it would in fact be economically beneficial for the country.

EU on an international comparison 2

	EU	US	Japan
Population (million)	507	313	127
GDP (EUR bn)	12.97	12.64	4.46
Per-capita GDP (EUR)	25,500	40,200	33,200

Sources: Eurostat, US Census Bureau

One reason for these diametrically opposed views is also the lack of robust empirical evidence of growth effects due to the Single European Market. The influential Cecchini Report (1988) forecast that it would increase GDP by 4.5-6.5%. Most reports that try to quantify the actual effects, however, make much lower estimates.

Even more than 20 years after the inception of the Single Market many of the original questions are still pertinent: which concrete benefits does the Single European Market generate, and in which areas are they most pronounced? Are there countries and sectors that benefit more than others and on which factors does this depend? Has the cost/benefit calculation for Single Market membership changed over time? And where does potential still exist to optimise the functioning of the Single Market? These are the questions we intend to tackle in this paper.

Milestones on the road to the Single European Market 3

1957: Signing of the Treaty of Rome and the founding of the European Economic Community (EEC).

1968: Founding of the European Customs Union.

1985: The European Commission's White Paper proposes 300 measures for reducing internal trade barriers, including the principle of mutual recognition.

1987: Single European Act (SEA) paves the way for the creation of a single European market and the realisation of the four fundamental freedoms by the end of 1992.

1988: Cecchini Report provides a much-read assessment of the economic impact.

1993: Over 90% of the objectives agreed in the SEA have been achieved.

1995: First enlargement of the Single Market via the accession of Finland, Austria and Sweden.

2004, 2007 and 2013: Step-by-step enlargement to a total of 28 members via the accession of 13 eastern European states.

2006: Adoption of the Services Directive.

Europe's path to the Single Market

The aim of economic integration is to provide citizens and companies with access to markets that were previously closed due to national barriers. The treaty on the founding of the EEC in 1957 already included the long-term objective of establishing a common market.

The starting point for economic integration is often a free trade agreement, a treaty under international law that guarantees free trade between two or more countries. It abolishes customs duties and tariff trade barriers within the free trade zone. The European Customs Union founded in 1968 additionally featured a joint customs policy for trade with third countries. And since 1960 there has also been the European Free Trade Association (EFTA) whose member countries have sought to engage in free trade with one another, but which did not want to commit to a joint customs policy. Over time, however, most of EFTA's members have switched over and joined the customs union. These countries include Denmark and the UK (1973), Portugal (1986) and Finland, Austria and Sweden (1995).[1]

[1] At present the only countries remaining in EFTA are Iceland, Liechtenstein, Norway and Switzerland.

The Single European Market constitutes a much deeper level of integration. It also abolished non-tariff barriers to the free movement of goods and services. They include barriers that are physical (borders), fiscal (taxes), legal (access restrictions, import quotas) and technical (product standards) in nature. In addition, the Europe-wide free movement of people and capital were written into law.

As members of the European Economic Area (EEA), the EFTA nations Iceland, Liechtenstein and Norway are allied to the Single Market. However, the EEA excludes some of the areas that are regulated at EU level, e.g. common agricultural policy and foreign trade policy. Switzerland is the only EFTA country that is not a member of the EEA and is only linked to the Single Market via numerous bilateral treaties.[2]

Most countries in the Single Market went one decisive step further and established the Economic and Monetary Union (EMU). An economic assessment of the Single Market therefore brings with it the conceptual difficulty of separating the impact of the Single Market not only from the consequences of globalisation, but also from the introduction of the euro.

Degrees of economic integration 4

Features	Free trade area (EFTA, NAFTA)	Customs union (Mercosur)	Single market (EU, AEC[3])	Currency union (Eurozone)
Abolition of customs duties for goods produced within the area	✓	✓	✓	✓
Abolition of tariff trade barriers within the area	✓	✓	✓	✓
Common customs policy vis-à-vis third countries		✓	✓	✓
Reduction of non-tariff trade barriers within the area			✓	✓
Reduction of barriers relating to mobility, establishment etc.			✓	✓
Introduction of a common currency				✓

The "four freedoms" of the Single Market

The cornerstones of the Single European Market are the four freedoms:

- Free movement of goods: no restrictions on the trade in goods, which also implies a fundamental ban on state subsidies, discriminatory taxes on imported goods and preferential tax treatment for exports.
- Free movement of people: includes the freedom of movement of workers and the freedom of establishment. This gives all EU citizens the right to work in another member state. In the process they must not encounter discrimination due to their nationality. Moreover, there is to be mutual recognition of educational and vocational qualifications.
- Free movement of services: providers of services may conduct their business in all member states without having to be settled there. Consumers can select the best offer from the whole of Europe.
- Free movement of capital and payments: capital controls and restrictions on the amount of currency that may be imported or exported are abolished and utilising the offers of foreign financial service providers is made easier.

[2] In addition, the EU also maintains customs unions with Andorra, San Marino and Turkey.

The Single Market from a theoretical perspective

Launching a cross-border market leads to the removal of barriers that previously hindered the international exchange of goods, services and (human) capital. National regulations are replaced by harmonised single market rules that do away with many border formalities and entry barriers. This enables efficiency and competition to be boosted. The economic benefits may not necessarily be evenly distributed, though. Moreover, extra costs can be incurred as a result.

What benefits does the Single Market offer?

Creating the Single Market opened up various opportunities for welfare gains:

— Direct cost reductions thanks to the abolition of border formalities and national regulations: harmonisation of production and quality standards enables products to be marketed more easily and cheaply within the EU. This reduces the price of imports for companies and consumers. A substantive breakthrough has been achieved by the principle of mutual recognition established by the Single Market Act. This ensures that a product which is already approved in one country can also be sold in the other member states. The abolition of national regulations should be reflected in an increase in intra-EU trade.

Mutual recognition vs. harmonisation of standards 5

The principle of mutual recognition means that member states recognise national regulations concerning goods and services across borders. If, for example, a product satisfies all the necessary requirements in one EU country, it must also be accepted in the other member states.

The harmonisation of standards represents an agreement on an extensive convergence in the requirements that products must fulfil within the EU. Compared with mutual recognition this can require a complex and therefore protracted coordination process. On the other hand, it provides the opportunity to set binding minimum standards.

Both principles can thus also be applied together. For example, basic product requirements can be laid down in a harmonised rule book and more sophisticated products can be mutually recognised.

— Economies of scale: access to a bigger market increases the sales potential of companies. Especially in industries characterised by increasing economies of scale (i.e. where profitability increases when the production volume rises, e.g. due to high fixed costs), companies can thus manufacture more cost-efficiently. Companies operating across borders can optimise their production processes by establishing international manufacturing networks and using comparative cost advantages. They can, for example, acquire stakes in foreign companies, merge with them and relocate individual links in the production chain within the Single Market. Overall, this should not only boost competitiveness vis-à-vis rival companies outside the EU, but also make the EU a more appealing destination for foreign direct investment from third countries.

— Stiffer competition due to lower entry barriers: simplified market entry for foreign firms increases the competitive pressure. Inefficient companies are squeezed out by more efficient competitors and the cost advantage is partly passed on to the consumer. This should reduce the mark-ups in heavily protected and inefficient markets and a Europe-wide process of price convergence should be perceptible. Another positive aspect for consumers is an increase in product diversity.

— Simplification of cross-border mobility and an increase in the labour-force potential: the freedom of movement guarantees all EU citizens the ability to settle in another Single Market country. They must not be subjected to discrimination there and they have to be able to participate in the labour market on the same terms as domestic workers. The recognition of vocational and academic qualifications enhances their labour market and earnings prospects abroad, and makes it easier and less costly for companies to attract skilled personnel from abroad.

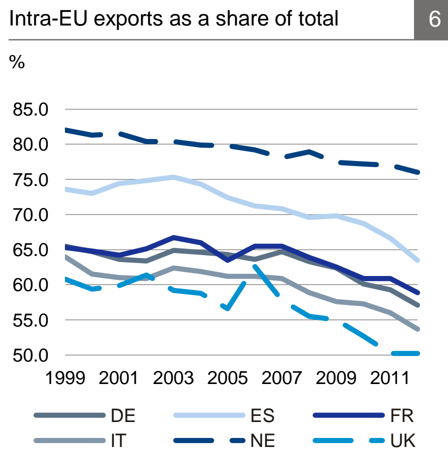
— Lower financial transaction costs: the liberalisation of capital flows and greater financial integration make cross-border financial transactions easier and cheaper. Moreover, consumers gain access to a larger variety of financial products and better portfolio diversification opportunities.

Heterogeneuos impact across countries

When assessing the impact of the Single Market it is important to note that countries may benefit to varying degrees and that the overall impact can be quite mixed. There is a series of factors that are key to a country-specific assessment:

Intra-EU exports as a share of total 6

%



Source: Eurostat

— Intra-EU trade intensity: the greater the volume of external trade with the other EU member states, the greater the benefits thanks to lower costs and trade barriers. Exports into the EU make up over half of total exports in nearly every country, and in some countries the share even exceeds 70%.

— Size of the country: the external trade intensity (exports + imports as a percentage of GDP) tends to be higher for small countries, which is why they probably benefit more from trade liberalisation. Moreover, for them the additional market is particularly large relative to the domestic market. On the other hand, companies that operated in a larger national market could better exploit economies of scale and become more competitive than firms from small countries, and were initially better positioned to reap benefits from the Single Market.[3]

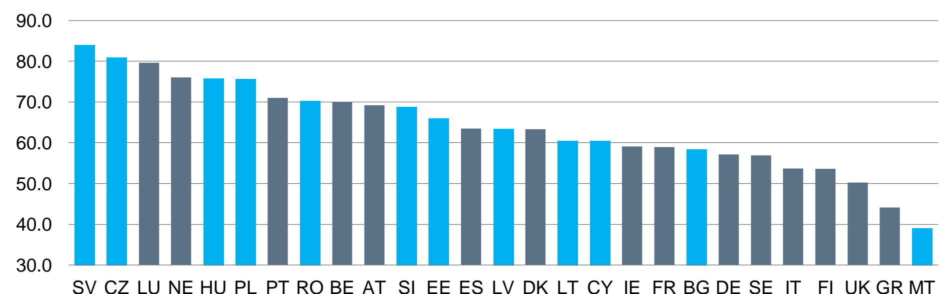
— Industrial competitiveness: the more competitive the companies, the better they can hold their own against their European competitors. The competitiveness has both a price component (e.g. unit labour costs) and a non-price component (e.g. innovative strength, technological advantage).

— Economic structure: Countries with a relative specialisation in industries with rising economies of scale should derive more benefit from the Single Market as there is greater scope to improve efficiency in these industries. Company size is also an important factor, as bigger companies are on average more export oriented and thus benefit more from trade liberalisation. They are also better placed to establish international production networks across the EU.

— Degree of liberalisation: In previously highly protectionist countries the benefits for consumers are greater than in those countries that already have a relatively high degree of liberalisation.

Intra-EU-27 exports as a share of total exports 7

2012, %; accession countries since 2000 (light blue)



Source: Eurostat

[3] From empirical studies, too, there is no clear evidence that the size of a country has an influence on the benefits from the Single Market (see Badinger and Breuss, 2006).

Which costs does the Single Market generate?

Apart from the above-mentioned benefits the creation of the Single Market also entails some costs. On the one hand, overregulation, inefficient bureaucracy and deficient allocation of tasks between the administrative levels of the federal system impose direct costs on companies. On the other hand, the greater opening of national markets led to adjustment costs for those countries and regions, whose companies were less competitive than their foreign rivals.

In principle, bundling responsibilities creates the potential for synergy effects. After all, most of the tasks that were transferred to the highest EU level by a uniform Single Market regime would otherwise have to be performed by the member states themselves. Standardised regulations have simplified many national administrative matters or even made them superfluous. To what extent the Single Market causes additional bureaucratic and regulatory costs also depends on how efficiently the national administrative systems themselves would otherwise operate and how they have adapted to the transfer of competences. Nevertheless, common regulations do not necessarily represent an improvement if they are geared more towards the standards of the majority rather than those of the most efficient countries.

The centralisation of competences is not an end in itself and runs counter to the subsidiarity principle, according to which responsibilities are only meant to be transferred to a higher level if they can be executed more efficiently there. However, this principle is not always adhered to in the EU. The demand made by David Cameron that it ought to be possible for competences to be returned from the EU level to the member states is correct in principle. This would, however, require a systematic evaluation of the distribution of competences between the EU and the member states. The Netherlands has recently had an assessment carried out concerning the distribution of competences between the EU and the member states and identified policy areas in which a greater re-transfer to the national level is desirable.[4] There are also demands for the EU level to concentrate on setting policy goals and to give the member states more leeway in achieving these goals, without striving for excessive uniformity in their implementation. Equally, more impact assessment analyses should be conducted for the purpose of auditing EU legislation.

According to estimates, the total administrative costs for companies are equivalent to about 3.5% of EU output, with major country-specific differences here as well.[5] In countries with efficient regulation (Denmark, Finland, the UK and Sweden) the share is less than 2%, in most southern and eastern European countries it is above 4%. Evidence from Denmark and the Netherlands shows, however, that national legislation accounts for the majority of costs (57% and 44% respectively). The remainder is said to be incurred directly for international (EU and non-EU) legislation or their national transposition.[6]

Especially in the less competitive countries the liberalisation of national markets also resulted in temporary adjustment costs. Firms that previously had a protected position in nationally demarcated markets suddenly had to contend with more efficient competitors from other countries. In order to support the less competitive regions by mitigating the negative effects of liberalisation the EU cohesion fund was strengthened considerably in the course of the Single Market launch. Opinions differ about the efficacy of EU structural policy, however, and most empirical studies come to the conclusion that it has generated virtually no significant growth stimulus.

[4] See Government of the Netherlands (2013).
[5] See Kox (2005).
[6] See European Commission (2006).

Optimistic expectations: The Cecchini Report (1988)

On behalf of the European Commission Cecchini et al. (1988) conducted an extensive and much-quoted analysis of the potential impact of the Single Market. They combined microeconomic and macroeconomic analyses and calculated a potential wealth effect of 4.25-6.5% of GDP for the twelve member states. They also calculated that increased competition between firms could bring down prices by some 6% and create two million new jobs. In the long run 5 million additional jobs and a 7% increase in GDP would also be possible.

Besides “static” growth effects, the report also expected “dynamic” effects. As competition intensifies firms could adapt their strategies to the new conditions, which would boost innovation activity and productivity. Baldwin (1989) estimated that these dynamic effects could generate an annual growth stimulus of 0.2-0.9% of GDP and opined that the Cecchini Report, which has frequently been criticised for being too optimistic, may even have underestimated the overall impact by at least 40%.

The pragmatists: Harrison, Rutherford and Tarr (1994)

A considerably more matter-of-fact assessment was made by Harrison et al. (1994). Their analysis is in principle also an ex ante exercise, as it could not fall back on data collected after the creation of the Single Market. They quantified the direct effect at just 0.5% of EU GDP. Combined with the long-term effects, they considered 1.2% to be realistic.

Moreover, they estimated the additional potential that could be generated by full integration and the elimination of all border and standardisation costs. The countries they identified as the biggest potential winners were those with high intra-EU trade intensity, above all Belgium and the Netherlands, with growth potentially being boosted by more than 6% of GDP. For most countries (such as Germany, Italy and Spain) they considered 2% to be feasible, and for the UK a mere 1.5%.

Expectations of the private sector overwhelmingly positive

A survey of more than 11,000 companies from the manufacturing sector conducted at the behest of the European Commission (see Nerb, 1988) delivers an interesting snapshot of the private sector's expectations for the Single Market at that time. 56% of firms said they expected the Single Market to provide more opportunities than risks (only 7% claimed the opposite). The most important elements mentioned were the removal of administrative obstacles, followed by the elimination of national standards and regulations and a reduction in the cost of waiting times at the borders. Companies expected their costs to be reduced by 2% simply by eliminating the direct costs of border formalities, national standards and administrative restrictions. Dynamic effects, via increased efficiency and economies of scale, had not yet been taken into account.

A net 54% of the companies surveyed expected a positive impact on total sales (59% positive compared with 5% negative), mainly on the back of higher intra-EU exports. On average they expected a 5% increase in turnover and an increase in employment of some 2%. Furthermore, a substantial share of companies expected a positive impact on exports to non-EU countries, which probably reflected improvements in competitiveness and cost structure.

What is also interesting is how the firms assessed their situation in their home market in the light of the growing competition from abroad. Whereas no major changes were registered in the Europe-wide average, many companies in the

Netherlands, Spain and Italy expected turnover to rise in their home markets, while the majority of French and Greek firms feared a negative impact (with net figures of -20 and -24 respectively).

Net number of companies with optimistic expectations in the following categories: 8

	EU-12	BE	DK	DE	GR	ES	FR	IE	IT	LU	NL	PT	GB
Lower costs	60	85	52	51	65	47	46	64	83	70	55	66	58
Turnover	54	81	47	54	25	34	33	55	68	70	40	51	68
Intra-EU exports	64	87	59	63	53	54	48	70	66	80	89	65	78
Extra-EU exports	24	33	10	27	21	37	10	0	34	40	20	21	12
Sales in domestic market	4	-7	-3	9	-24	20	-20	-4	18	10	28	-2	-7

Source: Nerb (1988)

Empirical evidence on Single Market effects

The wide range of expectations reflects the uncertainty regarding the Single Market's impact on growth. Although there have already been examples of trade liberalisation, they have not been on a comparable scale. But even retro-spectively the quantification has hardly become easier. The difficulty lies mainly in isolating Single Market effects from simultaneous developments, e.g. the consequences of globalisation.

The consequences of the Single Market cannot simply be determined as in a medical experiment by comparing a treatment group (the countries within the Single Market) with a control group (the industrialised nations outside the Single Market). For instance, the members have been “treated” several times, since the Single Market has developed continuously and expanded successively via several rounds of enlargement. Since anticipation effects can occur and, on the other hand, many effects require an extended period to fully materialise it is difficult to distinguish between the effects of different integration steps. On top of this, all EU-15 countries with the exception of Denmark, the UK and Sweden have also introduced a single currency.

There is also no clear control group, as industrialised nations outside the EU have also reduced both tariff and non-tariff barriers in recent decades via bilateral and regional treaties as well as via WTO trade liberalisation resolutions. The acceleration in globalisation led to a huge rise in the international trade volume, cross-border competition and in foreign direct investment.

Equally problematic are assumptions about the alternative scenario for the Single Market. After all, it is unclear in which areas liberalisation and partial integration would have also occurred without the creation of the Single Market and how pronounced these would have been. These were ultimately the very reasons why the EU member states decided to take a far-reaching step of economic integration, because they hoped to reap major benefits from this. It is therefore to be assumed that they would have made alternative arrangements to increase integration if an EU-wide single market had not been created.

So what do we know about the consequences of the Single Market for growth, direct investment, trade, competition and employment in Europe over the last 20 years? A number of developments, for example the sharp rise in exports (inside and outside the EU) or the foreign direct investment, are ultimately driven by global developments. Given the complexity of the assessment the empirical evidence on the impact of the Single Market is relatively sparse – particularly given the relevance of the topic.

Moderate effects on GDP

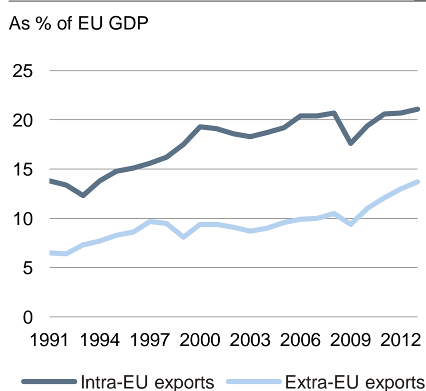
Most reports agree that the Single Market has had a positive impact on growth, which however has been less pronounced than anticipated by the Cecchini Report and has not yet achieved its full potential.

Comparing different studies is difficult due to the periods they cover. The comprehensive report by Straathof et al. (2008), for example, is based on the period 1958 to 2005 and estimates that European integration has boosted GDP in the EU by 2-3%. For the Netherlands, which has done disproportionately well out of European integration due to its strong trade links with other members, the overall effect is roughly twice as high at 4-6%. This is more pessimistic than Boltho and Eichengreen (2008), who estimate about 5% for the whole of the EU. Since they look at the impact of all the integration steps taken to date, however, the immediate effects of the Single Market are correspondingly smaller.

For the European Commission, Ilzkovitz et al. (2007) found that the Single Market generated additional income of 2.2% between 1992 and 2006.[7] Stripping out enlargement to the East in 2004 the effect amounted to nearly 2%. The number of jobs in the EU is said to have risen by around 1.35%. Most of the impact was static in nature, however, while the dynamic effects due to increased investment activity and productivity gains have been somewhat disappointing to date. A more recent report, which also covers the latest episode of the crisis, makes nearly identical findings, namely additional GDP of 2.13% and a 1.3% increase in jobs.[8] These conclusions tally with those of Copenhagen Economics (2012), which state that Single Market measures in four key areas (taxes, services, public procurement and mutual recognition) might have generated an additional 2.4% of GDP, but that one-third of this did not materialise due to substandard implementation.

Growth in goods exports 9

As % of EU GDP



Source: OECD

Large impact on trade volume

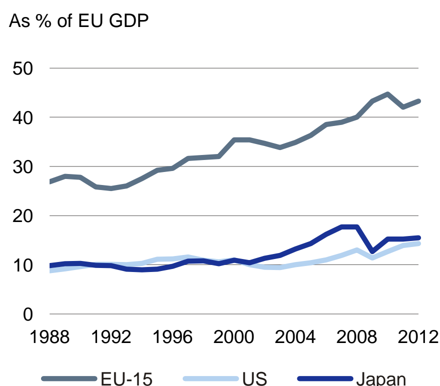
It is hardly contested that the Single Market led to an increase in international trade – both within the EU and with the rest of the world. Intra-EU trade intensity increased between 1992 and 2012 from around 12% to 22% of GDP. Exports to non-EU countries grew faster than intra-EU exports, which reflects both the global trend towards increasing trade and the high competitiveness of the export-oriented firms in the EU. The comparison with the US and Japan underlines the positive development of goods and services exports by the EU-15.

Straathof et al. (2008) come to the conclusion that exports and imports are now some 8% higher than they would have been if there had been no European integration since 1960. For the Netherlands, which is characterised by a high degree of openness, the effect was nearly twice as strong. The biggest increase occurred between 1981 and 1991, with the effect then receding slightly. This development can probably be largely explained by the constantly increasing trade liberalisation since then, which has also resulted in non-EU countries removing trade barriers. Britain's HM Treasury (2005) calculated that 9% of the increase in intra-EU trade can solely be ascribed to the Single Market.

With services, the Single Market effect is necessarily much smaller as the proportion of services that are actually tradable is lower. However, also the data available on the trade in services is much poorer, especially covering the initial years of the Single Market.

Goods and services exports 10

As % of EU GDP



Source: Eurostat

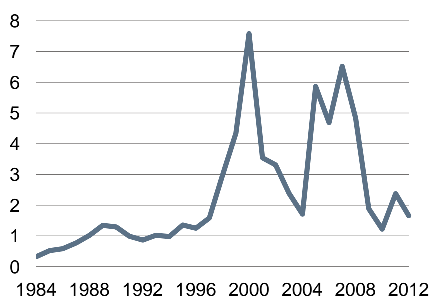
[7] Possible anticipation effects were thus not taken into account.
[8] See European Commission (2012).

The positive trade evolution also feeds through to the labour market. The European Commission estimates that in 2007 around 25 million jobs (or 10.3% of all jobs in the EU) were directly dependent on exports to non-EU countries (Sousa et al., 2012). Of this total, 15.7 million have been created in manufacturing and 8.5 million in services. A total of 9 million jobs came from the trade with inputs (both goods and services) within the value chains in the Single Market, which are processed into end products for trade outside the EU.

Foreign direct investment

FDI flows in the EU 11

As % of EU GDP



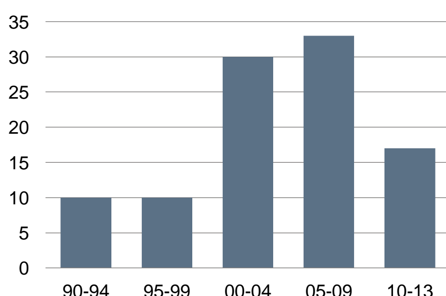
Source: World Bank

Back in the early 1980s foreign direct investment was not a major factor in the EU and constituted less than 1% of EU GDP. Since then its significance has grown constantly and in good years it has regularly exceeded 5% of GDP. Investment flows into the EU were severely affected by the global financial crisis, but overall the FDI stock in Europe has grown more than twentyfold since the early 1980s.

The huge increase in direct investment is, however, of course primarily a global trend and not a European phenomenon. Egger and Pfaffermayr (2004) estimate the effect of EU membership on the development of FDI stock with a “gravity model” in which they distinguish between three periods: 1986-1992, 1993-1995 and 1995-1998. According to their analysis, the Single Market and the enlargement in 1995 resulted in substantial anticipation effects, but following the completion of the respective integration step no further effect was discernible. According to Straathof et al. (2008), EU membership boosted bilateral FDI stock of countries within the EU by 28%. Firms from countries outside the EU invest 14% more inside the Single Market than in comparable non-EU countries.

Mixed evidence on mark-ups

Antitrust cases handled by the European Commission 12



Source: European Commission

Maybe surprisingly, the empirical evidence of margins being squeezed due to stiffer competition is somewhat mixed. On average, the goods market liberalisation of the Single Market led to a decline in the mark-ups in manufacturing (Griffith et al., 2007). Stiffer competition led in most industries to greater innovation activity and stronger productivity growth. Badinger (2007) also found that mark-ups fell in manufacturing and to a lesser degree in the construction sector. For most services, by contrast, they have actually risen.

The origins of European competition policy lie in the Treaty of Rome signed in 1957, but it initially served primarily as an instrument to deepen economic integration and less for combating cartel-like structures.[9] The creation of the Single Market made it necessary to reinforce the role of the European Commission in the area of competition policy. Following the model of US antitrust policy, the focus of the European Commission since the end of the 1990s has increasingly shifted towards regulating mergers and combating anticompetitive structures. This strengthening can also be seen in the growing number of antitrust cases processed.[10]

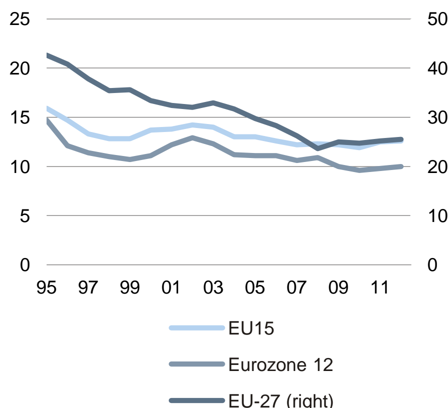
Price convergence due to converging incomes

The Single Market has led to a convergence in the price level of household goods. The reasons for this are not only the competition effect due to the Single Market but also an income effect in countries with lower per-capita incomes,

[9] See European Commission (2009).
[10] The European Commission estimates that its competition decisions concerning horizontal mergers in 2011 brought consumers gains of EUR 4 bn alone (European Commission, 2012).

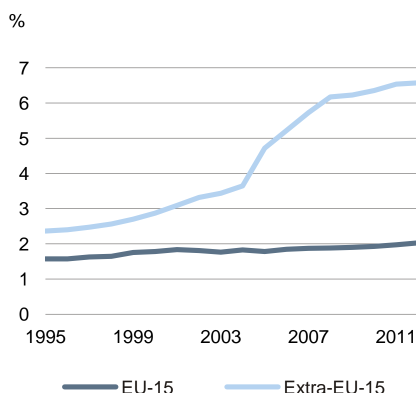
Price convergence for household consumption 13

Variation coefficient of price level for household consumption, %



Source: Eurostat

Share of workers from other EU member states 14



Source: Eurostat

whose influence is all the greater the more mixed the group of countries observed.

This can be seen by the very strong price convergence within the EU-27 in the second half of the 1990s, already prior to the accession of 10 eastern European states. After they joined in 2004 there was another major boost.

In order to reduce the distorting effect of the convergence in incomes it makes sense to look at the EU-15 countries separately, since they form a much more homogeneous group. In these cases, too, the price convergence witnessed during the 1990s can be explained at least partly by the catching-up process in Greece, Ireland, Portugal and Spain. Overall, since the inception of the Single Market there has been a continual process of price convergence. This process has stalled of late, though. This is probably due in no small measure to the fact that since the start of the current crisis incomes in the EU-15 have not converged any further.

Labour mobility evolves slowly

The freedom to take up employment in any member state initially has not led to a major increase in mobility within the EU-15. By 2004 fewer than 2% of EU citizens were working in another member state.

This situation only changed after the enlargement round of 2004. The huge differences in income between the new eastern European member states and the EU-15 created strong incentives for mobility. In the cases of Bulgaria and Romania, which joined in 2007, the gulf in incomes is even wider. Most of the older member states introduced the freedom of movement for new EU citizens only in stages, as there were fears of a huge spike in migration from eastern European countries.[11] This has not proved to be the case for the whole of the EU, but a pronounced unequal regional distribution is discernible. Some 70% of the migrants from the 2004 EU joiners went to Ireland and the UK, while 80% of Romanians and Bulgarians emigrated to Spain and Italy.

For the entire EU-28 the share of those who work in a different member state has roughly doubled since the early 1990s to about 3%. Due to high unemployment in southern Europe a marked increase in employment-driven migration has been discernible recently. It remains to be seen, though, whether this is a long-term development or simply a short-term crisis-driven effect. Precisely because the possibility of Europe-wide labour migration provides citizens in the EU with immediate benefits the mobility of labour should be promoted further and made easier, for example by establishing better links between national labour markets.

Why is the impact often less pronounced than expected?

The actually verifiable impact of the Single Market has mostly fallen short of the (in part highly optimistic) forecasts. One possible reason for the discrepancy between expectations and reality is the declining importance of the manufacturing sector. While services have become more important, the industrial share of value added has fallen continually since the 1990s. Economies of scale are far more significant for manufacturing, however, and its products are much more tradable than services. The changing economic structure in Europe may thus provide a partial explanation.

Analyses that compare the Single Market with other OECD countries are essentially founded on the assumption that both groups – accounting for control variables – only differ via their membership of the EU, but that they would have

[11] Only the UK, Ireland and Sweden opened their labour markets without restrictions.

Competitiveness of EU member states 15

1-20: Finland, Germany, Sweden, Netherlands, United Kingdom, Denmark, Austria

21-40: Belgium, Luxembourg, France, Ireland, Estonia, Spain

41-60: Malta, Poland, Czech Republic, Lithuania, Italy, Portugal, Latvia

61-80: Bulgaria, Cyprus, Slovenia, Hungary, Croatia, Romania

81-100: Slovakia, Greece

Source: Global Competitiveness Report 2013-2014, World Economic Forum

otherwise developed largely identically. This is a questionable assumption since over the same period other industrial nations (first and foremost the US and Korea) have grown much faster than Europe. It is also striking that the divide in Europe, between a competitive core and the only partially competitive countries of southern and eastern Europe, is quite persistent. If exports and direct investment in the EU had otherwise developed less dynamically than in other OECD countries the actual Single Market effect would even be underestimated.

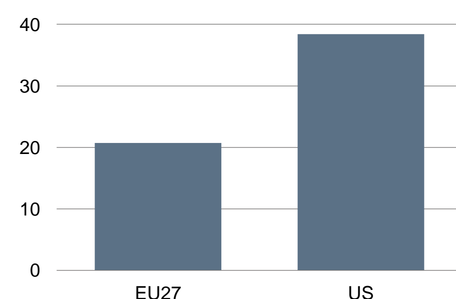
In part, however, the Single Market was accompanied with unrealistic expectations and a one-sided focus on its potential benefits. After all, in some countries the companies saw more risks than opportunities for their own business.[12] These pessimistic expectations were probably expressed primarily by firms that were not very competitive. Moreover, the benefits appear to have shrunk significantly at least in some areas due to additional costs associated with overregulation. Just a 25% reduction in the administrative burdens on companies would allow additional (one-off) growth of 1.4% (European Commission 2006). Those studies that analyse the success of the Single Market using observable indicators (GDP, exports, FDI etc.) measure the “net effect” of costs and benefits. A small impact can thus materialise both via fewer benefits and unexpectedly high costs.

It is also unrealistic to expect that stiffer competition in the Single Market leads to complete price convergence. After all, companies mostly do not compete on price alone. In markets with differentiated products (i.e. very similar but not regarded as of the same quality) companies can distinguish themselves from competitors via actual or supposed quality differences. Product differentiation creates market power that is barely reduced even by stiffer competition. Moreover, since companies have the opportunity to practise a differential regional pricing policy and consumers in Europe have differing preferences for cultural reasons, we observe different average prices in the same product category. Price convergence for many products is thus only possible and to be expected to a limited degree.

There are, however, sectors where huge price differences continue to exist that cannot be explained by product differentiation. One example is the telecommunications sector, where major regional price differences still exist despite very homogeneous products and price reductions resulting from the liberalisation of the sector. Pelkmans and Renda (2011) analysed eleven subsegments (e.g. long-distance calls inside/outside the EU, national mobile calls, roaming fees etc.) and found that the difference between the cheapest and the most expensive country in each category was more than 100%. In 50% of cases the same service cost five times as much in the most expensive country as in the cheapest. In a smoothly operating market such differences should not exist over the long term.

Trade in industrial goods between EU countries and indiv. US states respectively 16

2010, % of GDP



Source: OECD

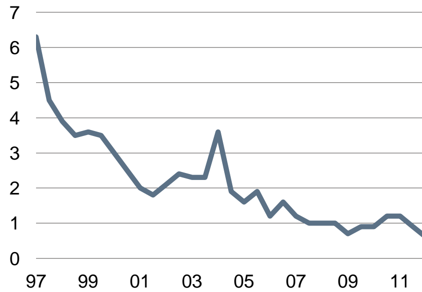
What potential does the Single Market still have?

The completion of the Single Market is a long-term process that is subject to constant development. The production and export structures of companies, consumption patterns of customers and workers' readiness to migrate also change only slowly. The comparison with the US does show, however, that national borders in Europe still play a major role. Controlling for potentially relevant variables (population, income, shared language and border etc.), the trade volume within a US state is 2.6 times higher than that between US states, but in the EU it is no less than 7.5 times higher (Pacchioli, 2011). The trade

[12] Of the companies surveyed by Nerb (1988) this figure came to 26% in Greece, 17% in Portugal, 11% in Spain and less than 10% in each of the remaining countries.

Transposition deficit of single market directives in EU member states 17

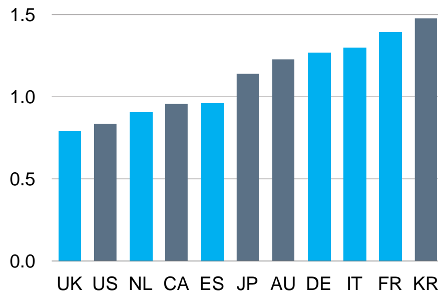
Directives not transposed, %



Source: Euroean Commission

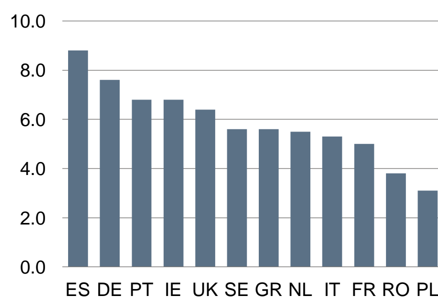
OECD product market regulation index 18

2008; index from 0 (lowest) to 6 (highest)



Source: OECD

Average number of bids for public-sector contracts, 2006-2010 19



Source: PwC (2011)

between individual US states accounts for nearly 40% of GDP, whereas in the EU-27 the figure is just 20%. This excessive “home bias” has barely receded since the Single Market has been in existence. However, given the language barriers in Europe and the associated difficulties in marketing in foreign countries and processing business deals the US is not a realistic benchmark.

Even though the implementation deficit for Single Market directives has been reduced significantly in recent years there is still considerable scope for improvement in the operation of the Single Market in several areas.

Further deregulation and harmonisation needed

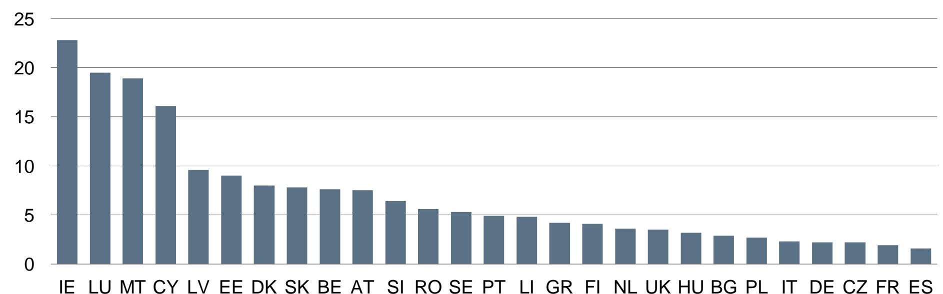
In some areas the regulatory burden is still unnecessarily high in the EU. The OECD Index for Product Market Regulation does indicate that since 1998 European countries have made major progress in deregulating their product markets, but there are still marked differences within the EU. Especially the UK, the Netherlands and Spain boast a relatively low regulation intensity compared with other industrial nations. By contrast, the regulation of product markets in Germany, Italy or France is much higher, which on the one hand shows there is still room for improvement, but at the same time indicates a deficit in implementing the “best practice” principle within the EU.

Public procurement still nationally dominated

The tendering of public-sector contracts is largely conducted at the national level. Further liberalisation could boost competition and cut costs for taxpayers. Between 2006 and 2010 just 3.4% of all public-sector contracts in the EU were awarded to foreign bidders. Since the likelihood of obtaining an efficient domestic bid is higher in large countries a negative correlation can be observed between the size of a country and the share of successful foreign bids. One notable feature in this respect is that Ireland still ranks ahead of the EU's smallest members that necessarily have to be more open because of a lack of domestic contractors. In the bigger countries there is a larger number of bidders per contract, but a much smaller percentage of contracts are awarded to foreign firms. The fact that in Italy, Germany, France and Spain less than 3% of all public-sector contracts are awarded to foreign firms is not in keeping with the spirit of cross-border competition in the Single Market.

Share of public-sector contracts with successful foreign bid, 2006-2010 20

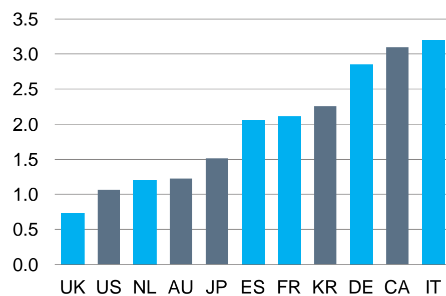
in %



Source: PwC (2011)

Regulation of professional services 21

2008; index from 0 (lowest) to 6 (highest)



Source: OECD

Facilitating cross-border mobility

Another important area requiring attention is the promotion of cross-border mobility. While the recognition of academic qualifications is usually straightforward, the situation with vocational qualifications is often more problematic. Bilateral tax rules make matters more complex as they give rise to additional information costs and redtape. In addition, the retention of pension entitlements and supplementary pensions accrued abroad is fundamental to exploiting individual mobility potential.

Access restrictions and the inconsistent regulation of occupations are another unnecessary obstacle to cross-border mobility. While other industrial nations are often less restrictive in this respect, the practice is again very mixed within the Single Market. While the OECD regulation of professional services index certifies the UK, Sweden, Ireland and Finland as being even more liberalised that the US, the poorest performers in the OECD are Italy, Luxembourg and Slovenia. Germany, too, does only marginally better. In total, around 800 different occupations in the service sector are subject to state regulation in the EU. Of these, however, 25% are regulated in just one country, which suggests that a substantial share of this regulation might be unnecessary.[13]

Increasing importance of services

Even though services now generate some 70% of value added in the EU their share of intra-EU trade is only 20%.[14] The lower importance for EU-wide trade is to a certain degree inevitable, since many types of services can only be provided locally and are therefore not tradable across regions. Classic examples are office services (catering, cleaning), taxi services and hairdressing. Nevertheless, the composition of the services sector has also changed over time and many services have in the meantime become at least partially tradable across borders thanks to new communications technologies, but are still hampered by trade barriers and shortcomings in liberalisation.[15]

The Services Directive implemented by the European Commission in 2006 pursued the objective of removing unnecessary legal and administrative barriers. The "country of origin principle", according to which a provider of services can offer these in all EU countries in accordance with the rules in his home country, was not, however, adopted because opposition from the member states was too strong. Moreover, exceptions were made, for example, with regard to financial, transport and postal services, telecommunication, healthcare as well as electricity and water supply. The directive concentrated mainly on liberalising business-related services, real estate, wholesaling and retailing, construction, tourism and the entertainment industry, which together account for some 40% of GDP.[16]

Although the Services Directive was actually meant to be transposed into national law by 2009 a number of obstacles have only been partially removed. Regulatory duplication for cross-border services (for example, the obligation to obtain insurance in the country of establishment, although an insurance policy has already been signed in the home country) drives up costs unnecessarily. Since there is often uncertainty regarding the processing of services, competent

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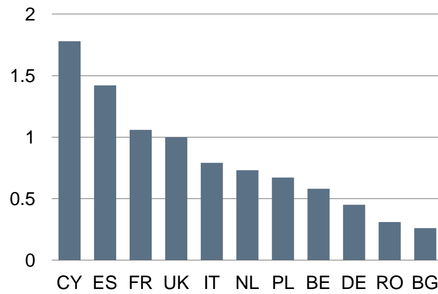
[13] See European Commission (2011).
[14] This does not include financial services, which on account of the peculiarities of the sector will not be addressed in more detail in this study.
[15] The OECD estimates that in industrial nations (using France, the UK and the US as the examples) some 25-33% of jobs in the service sector are tradable. In the EU the number of export-dependent jobs in the service sector rose by about 35% alone between 2000 and 2007, whereas in manufacturing the increase was a mere 7% (Sousa et al., 2012).
[16] For further details see Deutsch et al. (2006).

Impact of transposition of Services Directives to date 22

Additional GDP growth, %



Source: European Commission, 2012

"points of single contact" must be available. Some countries also still impose an economic needs test in regulated sectors. This test requires a foreign firm to prove that the market entry of foreign competitors is economically desirable. The market analyses required for these reports are time consuming, costly and hamper competition.

The Commission estimates that the implementation to date of the Services Directive could boost GDP by 0.8% during the first five years (Monteaguado et al., 2012), albeit with marked country-specific differences (between 0.3% for Bulgaria and 1.8% for Cyprus). For Germany an increase of 0.45% was calculated, while the figure for the UK was 1%. Additional growth of 0.4% is said to be possible, based on the conservative assumption that all countries implement the Services Directive to the same extent as the current EU average. In a more optimistic scenario, in which nearly all barriers were to be removed, additional growth could even be as much as 1.6%.

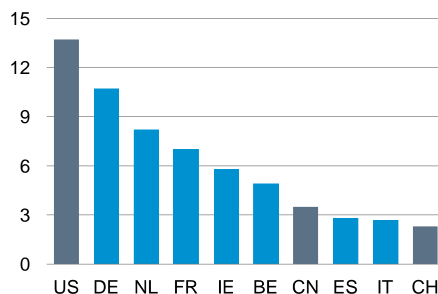
Is the UK a special case in the Single Market?

"Our participation in the Single Market, and our ability to help set its rules is the principal reason for our membership of the EU." (David Cameron) [17]

The potential referendum in the United Kingdom concerning membership of the European Union has led to a broad public debate about the concrete benefits of membership. The government has initiated a "Review of the Balance of Competences" in order to obtain information about the practical impact of the EU on the British economy and society from a variety of interest groups.[18] In total 32 policy areas are being addressed, but as the central element of the EU's economic architecture the Single Market is accorded special attention.

UK: 10 most important export partners 23

% of total exports

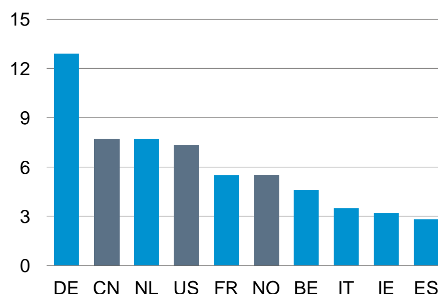


Source: Office for National Statistics

Even among supporters of the EU it is undisputed that some countries derive greater benefits from the Single Market than others. The UK economy is less dependent on trade with the EU than is the case for the Benelux countries, for example. This is shown by a report from HM Treasury (2005), which states that EU membership led to an average increase of 38% in trade with other EU countries, but in the case of the UK only resulted in an increase of 7%. Nevertheless, the EU is the most important market for British goods and services and therefore an advantageous arrangement is in the country's own interest. Some 50% of both exports and imports go to and come from the EU and seven of the ten biggest export and import partners come from the Single Market.

UK: 10 most important import partners 24

% of total imports



Source: Office for National Statistics

The answer to the question of whether the Single Market is the best solution for London has three components: firstly, what influence has European integration had on Britain's economic development to date? Secondly, which improvements could be made and what is the untapped potential within the existing framework? And thirdly, what would be the alternative?

Does the Single Market benefit the UK?

Britain is the most important European target country for foreign direct investments. About half of it comes from the EU, but 16.1% of the FDI stock in the UK comes from the US. Moreover, from 1980 to the present day Britain has been the biggest European recipient of direct investment from Japan, primarily from firms in the automotive, engineering, electrical and electronics industries. There are various reasons for this – including the relatively well trained English-

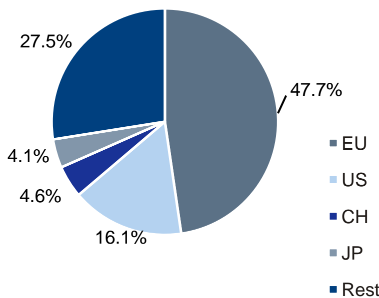
[17] https://www.gov.uk/government/speeches/eu-speech-at-bloomberg
[18] https://www.gov.uk/review-of-the-balance-of-competences

speaking population, the presence of suppliers and a relatively large local market. One major factor is, however, also the access to the Single European Market. In its contribution to the "Balance of Competences Review" the Japanese government remarked:

"More than 1,300 Japanese companies have invested in the UK, as part of the Single Market of the EU, and have created 130,000 jobs, more than anywhere else in Europe. This fact demonstrates that the advantage of the UK as a gateway to the European market has attracted Japanese investment. The Government of Japan expects the UK to maintain this favourable role."[19]

If it were to leave the EU, the UK could maintain its access to the Single Market via another avenue, for example by joining EFTA and the EEA (the "Norwegian solution") or via bilaterally negotiated treaties with the EU (the "Swiss solution"). All the same, both Prime Minister David Cameron and the House of Commons have ruled out these options as Britain would in this case have no direct say in the further development of the Single Market.[20] These options cannot therefore really offer any advantages and it appears unrealistic in any case that other countries would countenance such an arrangement.

FDI stock in UK by origin (2011) 25



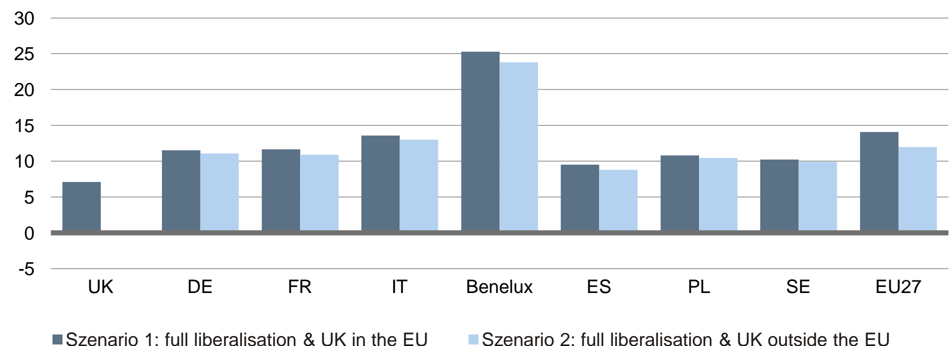
Source: Office for National Statistics, UK Parliament

An arrangement in which the United Kingdom would de facto no longer be a part of the Single Market would probably be even more disadvantageous. The most likely consequences would be a decline in foreign direct investment, relocations of production facilities and a drop in sales by British firms in the EU. A majority of the export-oriented companies therefore stated that they benefit economically from the Single Market (HMS, 2012). "Brexit" supporters argue that leaving the EU could in turn free the country from its straitjacket of onerous regulations and make it more competitive internationally. Even continuing with this logic it does appear unrealistic, however, that a positive net effect would result from this.

The Department of Business Innovation and Skills has simulated the impact of two illustrative scenarios (BIS, 2011). In Scenario 1 all the tariff and non-tariff trade barriers that still exist in the Single Market would be removed. The abolition of every barrier is illusory, but this scenario is interesting as a case of the maximum potential that can still be realised. Scenario 2 also illustrates a complete liberalisation within the EU, albeit excluding the UK, which would merely maintain the status quo. According to this scenario, complete Single Market liberalisation would provide the UK with additional growth potential of around 7% of GDP, whereas outside the EU and without further liberalisation it would practically stagnate (growth effect of -0.3%).

Additional growth potential if all trade barriers in the Single Market are removed 26

% of gross national income



Source: BIS (2011)

[19] http://www.uk.emb-japan.go.jp/en/japanUK/governmental/130711_UKEU.html
[20] See Discussion in House of Commons (2013).

There are a number of other aspects of the report that are also interesting: 1. Countries with a high intra-EU trade intensity, first and foremost the Benelux countries, could make further huge gains as a result of a deepening of the Single Market. 2. The direct negative effects of a UK exit would be very small for most other countries. 3. Deeper trade integration with another group of countries, e.g. members of the North American Free Trade Association (NAFTA), would not be a better alternative for the UK.

Even though the immediate benefits of the Single European Market for the United Kingdom are smaller than those for most continental European members, continued membership appears to be the most sensible option from an economic point of view. The "Balance of Competences Review" thus comes to the conclusion that:

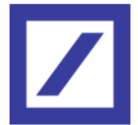
[…] Integration has brought to the EU, and hence to the UK, in most if not all observers' opinions, appreciable economic benefits. It has also spread the UK's liberal model of policy-making more widely across the EU. But it has brought with it constraints on policy-making of varying kinds, and a regulatory framework which some find difficult to operate within or find burdensome, even if the obligations are not necessarily any greater than would have been imposed nationally. Is that trade-off, between cost and benefit, between economics and politics, of overall benefit to the UK? … Most observers, and indeed most of the evidence received for this report, answer positively. They do so, not without qualifications or reservations, but with a focus on the economic benefits already achieved… and on those potentially available in the future.

Does the EU need Britain?

Britain is home to some 12% of the EU population and generates nearly 15% of EU GDP. Due in no small measure to the relatively favourable demographic forecast, above all compared with Germany and a number of eastern European countries, Britain's economic importance in Europe will certainly not decline for the foreseeable future. Britain will therefore remain important as a market for continental European firms, and for companies with intensive trade links to the United Kingdom an exit would of course not be beneficial.

The UK is, however, also important for other reasons. Many aspects of EU-wide deregulation and the opening-up of national markets were initiated and decisively shaped by Britain. In the current architecture of the European Union, which is characterised by a democratic deficit and relatively weak control of bureaucracy and administration, an occasionally critical look can help to preclude undesirable developments. As a services-oriented economy the UK probably will continue to be among the driving forces of liberalisation in these areas since it would be one of the main beneficiaries.

On the other hand, the difficult negotiations concerning the Multiannual Financial Framework for 2014-2020 show how delicate the balance is between constructive criticism and intransigence. Should Britain insist on special arrangements along the same lines as the Common Agricultural Policy being applied in other areas, the economic benefits of Britain's EU membership for the other countries would rapidly become negligible. Also an arrangement in which the UK were no longer an EU member but would nevertheless retain all its decision-making rights would be of no benefit to the other EU member states and is therefore not a realistic option.



Conclusion

Is the Single European Market a success story? 20 years on from its inception this question can be answered in the affirmative, albeit not without some qualifications.

The high and in part probably too optimistic expectations have not all been fulfilled. Nevertheless, the Single Market has resulted in increased competition and higher exports in most industrial sectors and made them more appealing for foreign direct investment. Overall, positive growth effects can be confirmed, albeit not on the scale forecast by the Cecchini Report. Even though the concrete impact differs on account of the diverse economic and trade structures of the countries, the Single Market is a beneficial arrangement for all members.

The experience gathered to date shows that the development of the Single Market is not yet completed by a long way. In the freedom of goods and people and tradable services there is still quite some potential available. However, the transition from national markets to an integrated economic area cannot be achieved overnight. Companies alter functioning export networks only slowly, while investments and reorganisations of production processes only make sense within the framework of a long-term strategy. In addition, many workers still do not possess the necessary qualifications and language skills to be able to derive major benefits from the existing freedom of movement throughout Europe. These developments require time above all else.

Given the declining relative importance of the EU, mainly compared to China and other emerging markets, the continued development of the Single Market is an important factor for the global competitiveness of the EU. Demographic trends will not only ensure that Europe's share of the world's population continues to decline but will also result in a lack of skilled personnel in many areas. That is why boosting labour mobility within the EU is a particularly important objective. If Europe wants to maintain its prosperity and influence in the world, the only means of achieving this will be to join forces and operate a well-functioning common economic area.

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Theresa Eich

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