European Economic Policy

Topic 5. The Single Market

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- **SEM:** an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured (Single European Act, 1987).
- Since the Treaty of Rome, it was essential to remove tariffs and quotas but also **non-tariff barriers**.
- Non-tariff barriers (NTB) can consist of many things including even national regulation (justified or not).
- This can be tackled using: national treatment, prohibition or **harmonization/ approximation**.
- National treatment leaves the market fragmented and prohibition may be extreme hence harmonization/approximation was common.
- But after the Customs Union was completed, the completion of the Single Market was delayed.

- 1970s: oil price shocks 1973, 1979; new competitors: Japan, and the Newly Industrializing Countries (NICs).
- **“New protectionism”** applied through non-tariff means (GATT prevented the use of tariffs).
- Harmonization very slow, i.e.: definition of **chocolate**.
- Between 1969 and 1985 only 270 directives were adopted.
- New regulations adopted faster than reducing barriers.

- More optimism about the Single Market – gradually.
- Lobbying from “Big Business” and Round Table of European Industrialists – economies of scale.
- Underlined by poor performance.
- Even the UK agreed on promoting the Single Market (free market orthodoxy under Margaret Thatcher and benefits for financial services, London).
- New Commission from 1984 prioritised the Single Market.

- **<u>Internal Market White Paper</u> (1985):**
  - Minimum harmonization *(approximation* usually sufficient).
  - Deadline end of 1992.
  - QMV spread to most areas of SEM (except: tax, free movement of people, rights of employed).
  - Control new non-tariff barriers.
  - *"Mutual Recognition"*.
  - European Standards: develop but not to restrict trade.

- **Removal of three kinds of barriers**:

  - **Physical** (i.e.: border checks for general reasons).
  - **Fiscal** (i.e.: border checks for different VAT, indirect taxes).
  - **Technical** (i.e.: regulations, standards, public procurement – important particularly for *services: recognition of qualifications, rights to establishment).*

- **Economics of non-tariff barriers (NTB)**.
- **Definition: NTB** alter volume and/or direction trade flows:
  - Intentional or otherwise.
  - Artificial not natural.
  - But natural factors can be manipulated (i.e.: language).
  - NTB may increase flows (subsidies) or reduce flows (trade barrier).

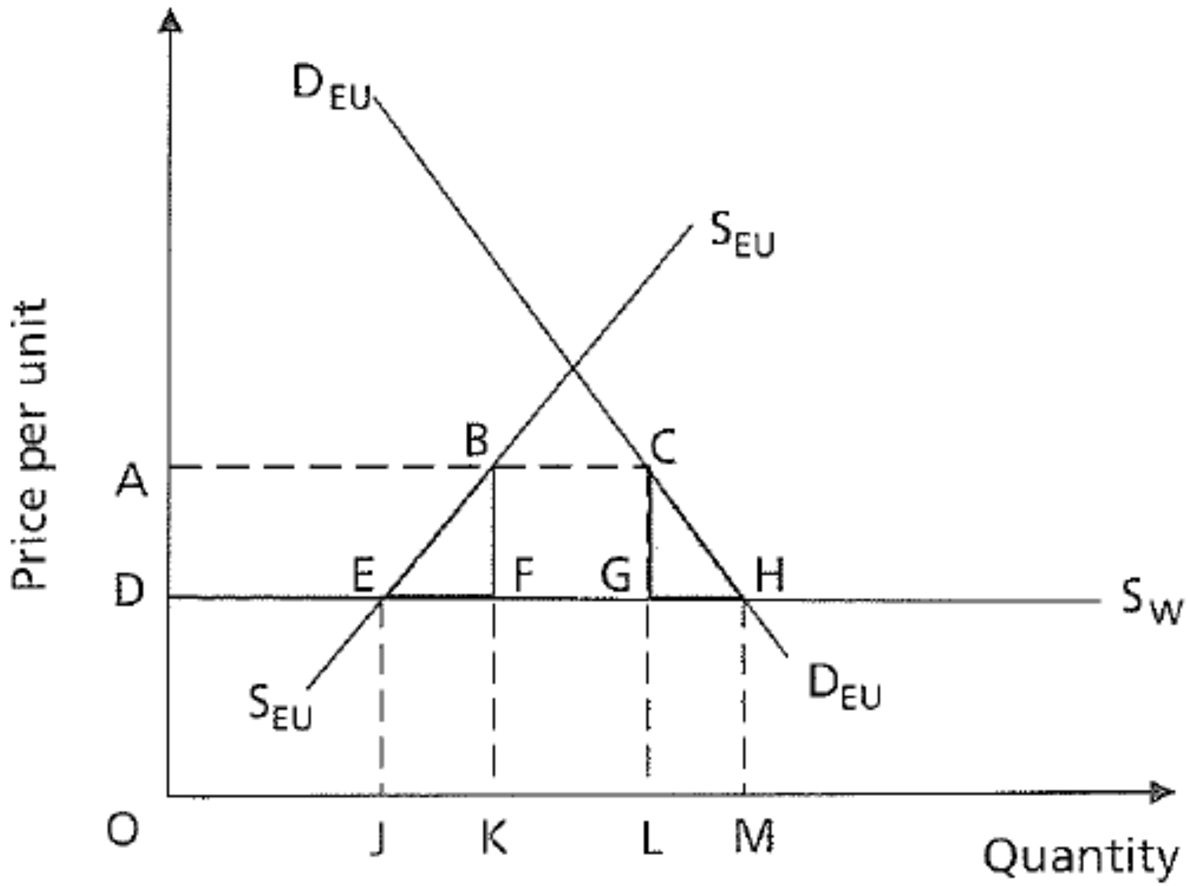

Figure 7.1 The effects of tariffs and non-tariff barriers

Source: El-Agraa (2011).

- **The effects of this tariff:**
  - Consumption is reduced and consumers are worse off.
  - Part of the consumer loss is transfered to government.
  - Domestic producers' revenue increases.
  - Most of the additional cost to the consumer is extra tariff revenue for the government or producer surplus.

- **Effects of a NTB of the same size:**

  The same except:
  - NTBs are cost increasing rather than revenue generating.
  - Difficult to measure NTBs, less transparent.

- **So, eliminating NTB should be very beneficial** (see table 7.1):
  - Cost savings large.
  - Apply to a larger proportion of output than with tariff reduction.
  - May impact more directly on economies of scale because production can be standardised.

Table 7.1 Measures of protection by country and industry

	Tariff rate		Non-tariff barrier rate	
	Rate[1]	Standard deviation	Rate[1]	Standard deviation
Protection by country				
Belgium	7.0	7.6	19.6	28.2
Denmark	7.1	4.1	18.2	27.0
Germany, West	7.4	6.0	22.3	27.4
Greece	7.0	8.6	25.5	25.8
Spain	6.8	4.8	13.9	22.1
France	7.4	14.3	18.4	26.1
Ireland	7.5	7.5	20.8	27.0
Italy	7.6	14.4	20.9	27.1
Netherlands	7.1	7.6	20.6	28.1
Portugal	7.1	3.4	19.1	20.2
Protection by industry				
Food products	9.8	33.6	45.9	30.0
Textiles	11.7	24.5	69.8	38.2
Apparel	12.3	30.4	71.7	35.7
Footwear	13.3	44.5	33.8	41.9
Furniture	6.4	46.2	0.9	46.5
Industrial chemicals	10.2	23.5	9.1	30.1
Iron & steel	9.8	38.0	47.7	34.6
Machinery electric	8.6	28.3	14.3	33.3
Transport equipment	7.9	30.7	25.5	38.8
Professional & Scientific equipment	6.5	23.6	2.7	30.3

Note:
[1] Import weighted measure.

Source: El-Agraa (2011).

- By 1992, 95% of the measures of the 1985 White Paper were in place.

- But more measures were needed: **“transposition” of EC Directives** to the national level (legislation and practice).

- Vigilence, enforcement.

- By October 2009, there were 1,521 directives and 976 regulations related to the SEM.

- But much more needed doing...

- **Three areas identified where further progress was needed:**
  1. Traditional SEM area (services, consumer rights, SMEs, simplification of regulation…).
  2. New areas (digital single market and green industry).
  3. Improving context in which SEM operates (directives transposition may be slow, incorrect or not done!).

- **Services Market** – “major disappointment” of SEM:
  - Delay in integrating the services market.
  - In 2009, services accounted for 74% output and 70% employment in the EU 27.
  - **Two attempts to open** up services:
    1. General Services Directive.
    2. Financial Services Action Plan .

- Barriers to cross-border trade in non-financial services remain high.
- Different and complex regulatory regimes.
- High discretion by the MS – to protect i.e.: accountancy, retailing, wholesale trade and IT.
- It has been calculated gains would be significant from further service integration – increases in trade between 30-60% and FDI stock between 20-35%.

- Original proposal for a services market directive (2004) tried to extend "mutual recognition" to services; freedom of establishment, freedom of movement (country of original principle and right of recipients to use services in other MS).

- Very controversial! "Frankenstein Directive"/"Bolkenstein Directive".

- Consequences for social dumping, undermining minimum wages and health and safety? Foreign firms could use cheap foreign workers employed on lower standards.

- Pleading by special interest groups?

- **Modified services directive** (2006) with exemptions:
  - Original exemptions: electronic communication networks, transport services.
  - New exemptions: healthcare, pharmaceutical services, audiovisual services, gambling, social services in housing, childcare, family support and dependent people.
  - Principle of “regulation by country of origin” – out.
  - Not mutual recognition. Two sets of regulation must be satisfied.
  - El-Agraa concludes this makes service integration more complex.

- **Financial services**.

- **Financial Services Action Plan** (1999) to reinvigorate financial integration with four aims:
  1. Complete a single wholesale market.
  2. Develop open and secure markets for retail financial services.
  3. Stability of EU financial markets.
  4. Elimination of tax obstacles to financial market integration.

The financial crisis has fundamentally changed priorities. New institutions were created, focused on supervision and risk assessment.

- To what extent has a Single Market been achieved?
  - Price convergence & extent of trade and FDI.

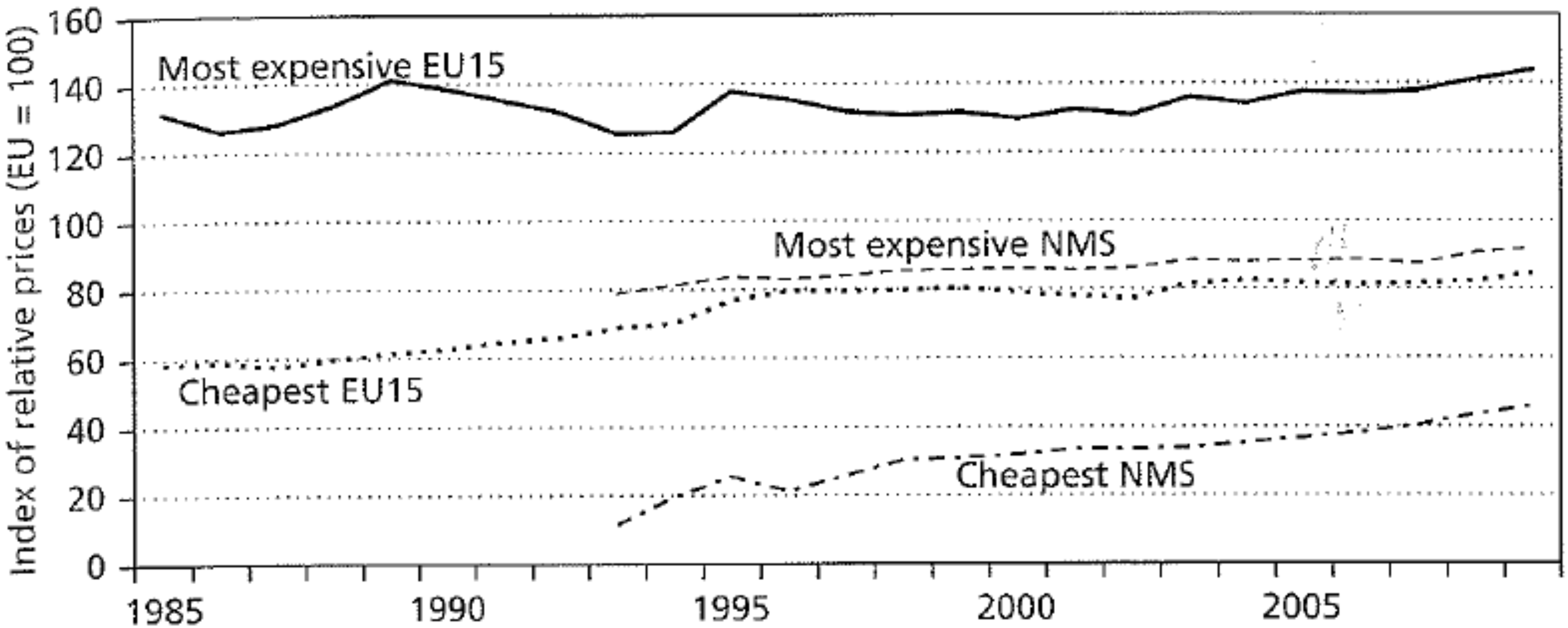

Figure 7.3 Price dispersion in the EU *Source:* CEU 2010c

Source: El-Agraa (2011).

- As for **price covergence**, SEM should make prices differences between markets harder:
  - Price convergence in EU 15 1989-2000; but some divergence since 2000.
  - New MS show signs of price convergence.

- **Is SEM the cause?** Or income convergence?
  - *Arbitrage* is the reason for price convergence in tradable goods.
  - For non-tradable goods, price convergence may be explained by the *Balassa-Samuelson* effect.

- In poorer countries, prices of some goods and services (housing, non-tradable services) may be cheaper.
- Development means increases in productivity especially in tradable goods:
  - Here, wages can rise without affecting competitiveness.
- Wages in non competitive sectors may also rise, without increasing productivity; and prices rise.
- Hence, the process of convergence in income levels may cause price convergence.
- So, is price convergence due to SEM or income convergence?

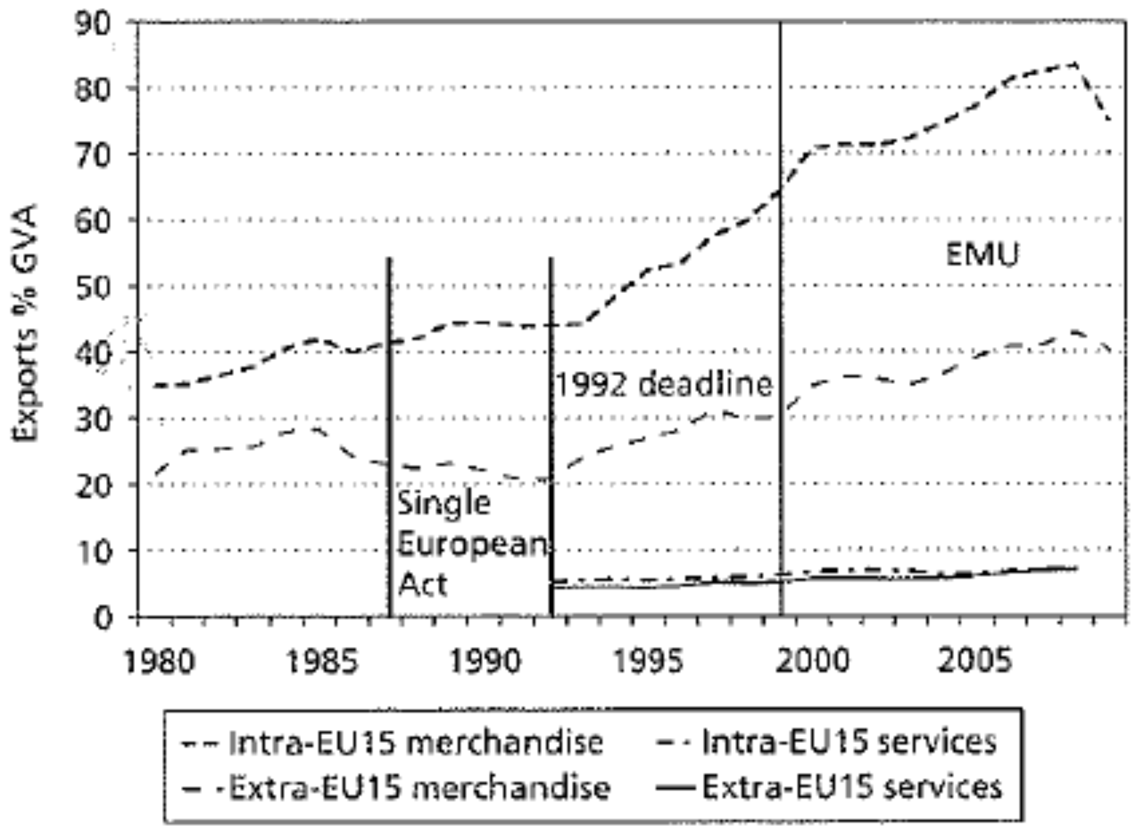

Figure 7.2 Intra- and extra-exports' share of GVA

Source: El-Agraa (2011).

- SEM should cause price convergence by increasing output traded.
- Intra-EU exports increased their share of GVA rapidly after SEM measures.
- Extra-EU exports increased but to a lesser extent.
- Clear indication of the effects of SEM (extra-EU exports should have grown faster due to faster growth of non-EU GDP).

- Different situation with **services**.

- Both intra and extra-EU imports have low shares of GVA in services.

- There has been growth but trade remains low.

- Low growth and the fact that intra growth not faster than extra growth indicates service markets have not been integrated yet.

- This is particularly true for the EU 15.

- SEM should increase the amount of FDI (companies locate and concentrate on cheaper locations and move for markets).
- Intra and extra EU 15 FDI accelerated in 1998 when world flows were booming.
- But from 1999, intra exceeded extra.
- Single currency.
- EU increasingly attractive for non-EU FDI.

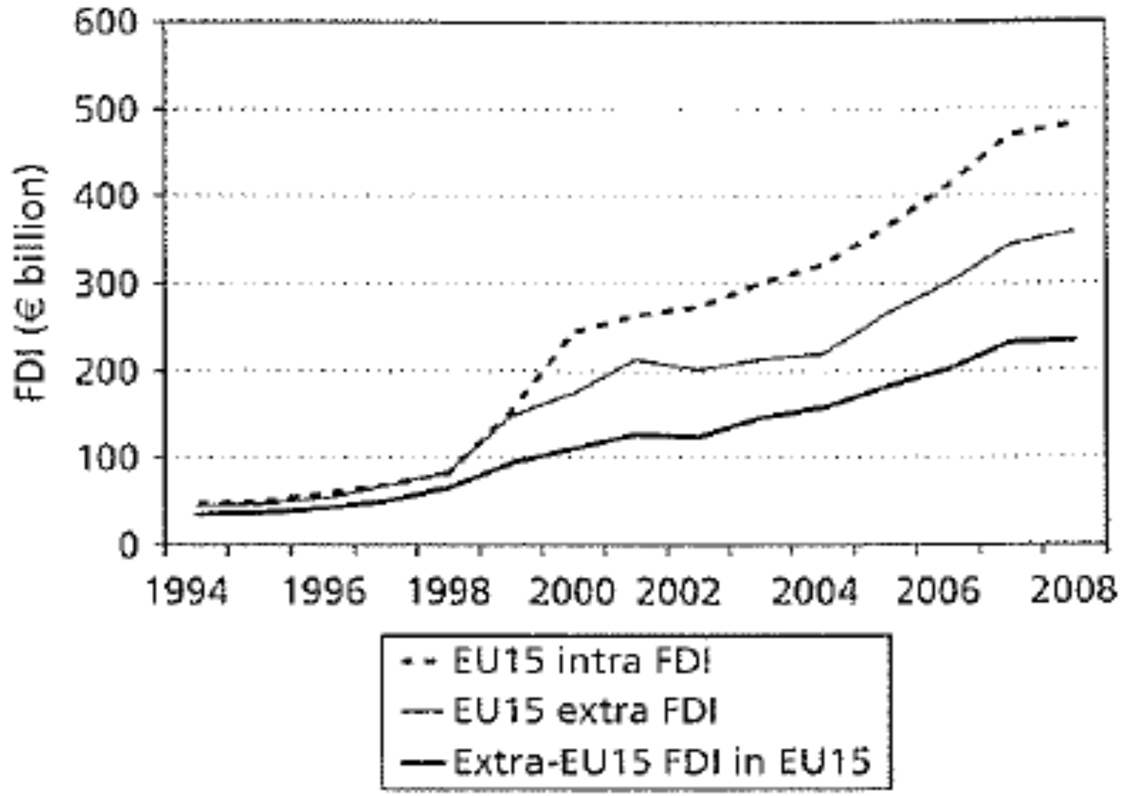

Figure 7.4 EU15 foreign direct investment

Source: El-Agraa (2011).

Conclusion

- Concluding remarks on the SEM.
- SEM a political success, though not yet complete.
- Goods markets have largely been opened up.
- But in economic terms, benefits less clear.
- EU economic performance: not dramatically better.
- Report by Ilkovitz et al (2007) gains during 1992-2006 around 2.2% GDP and 1.4% employment. Quite modest.
- Why? Limited progress in services, long-term nature of the project, difficulties of implementation? Expectations too high?