

**“The Economic Policy for the Single Market of the Future”  
Bruegel – DG Internal Market seminar, 16 January 2007**

**Summary\***

Bruegel and Directorate General for Internal Market and Services of the European Commission hosted the seminar “The Economic Policy for the Single Market of the Future” on 16 January 2007 in Brussels. The seminar was divided into two sessions, dealing with the changes in the economic model of the single market and what this meant for future single market policy.

The seminar was opened by Jean Pisani-Ferry (Director of Bruegel) and Jörgen Holmquist (Director General, DG Internal Market). Fabienne Ilzkovitz (Head of Unit, DG Economic and Financial Affairs) made an introductory presentation.

**Introductory remarks**

**Jean Pisani-Ferry** highlighted the relevance of the seminar in view of the changes European economies have gone through in the last twenty years. Twenty years ago the single market programme was designed to create a single European economy but followed a relatively simple agenda of mostly harmonising measures. The exercise, however, turned out to be more challenging than anticipated. Nowadays, despite the progress made, one cannot speak in many fields of a single European economy. Jean Pisani-Ferry identified three major differences between the EU of the 1980s and today:

- The EU was simpler at the time not only because the number of members was smaller but also because there were fewer divergences between them.
- The relations with international partners were also more straightforward: the EU, Japan and the US were the main players in the world economy. Europe could think about the single market without looking at what was happening outside of Europe.
- The underlying model of the single market was also more basic and mostly static, downplaying the dynamic effects of entry competition and innovation.

Such differences, amongst others, justify rethinking the policies designed to increase integration and improve competitiveness. The purpose of the seminar

---

\* This summary has been prepared by Bruegel. The text of the summary has not been approved by all the speakers and therefore, does not necessarily represent their opinions.

was therefore to provide new ideas that could re-launch one of the main successes of the EU: the single market.

**Jörgen Holmquist** highlighted the relevance of the seminar for the review of the single market currently carried out by the Commission. The review aimed to analyse how single market policies could be best adapted to ensure that the single market remained the best response to the challenges the EU economy was now facing. A blueprint for the modern single market policy would be delivered by autumn 2007. Jörgen Holmquist stressed that the review had to be based on sound economic underpinnings and therefore recommendations from the seminar would provide a very valuable contribution to the Commission's work. He also hoped that the seminar would stimulate renewed academic research on a more mature single market.

As background for discussions, he summarised the results of the European Commission's 2006 public consultation. A vast majority of respondents were in favour of the single market and thought it had delivered many positive results so far. However, in their view the single market still remained incomplete in some areas and failed to encourage sufficient innovation. They called for taking global context into account when designing single market policies, and for more leadership and vision, which should be underpinned by a comprehensive economic analysis.

**Fabienne Ilzkovitz** presented the main conclusions of a DG ECFIN report "Steps towards a deeper economic integration: the Internal Market in the 21<sup>st</sup> century"<sup>1</sup>. She commented first on the empirical evidence about the economic impact of the single market and the reasons behind its unexploited potential; and concluded by pointing to some future areas of reflection.

The single market, together with economic and monetary union and enlargement, served as a stimulus of trade and foreign direct investment (FDI), competition, internationalisation of firms and price convergence from its implementation until the late 1990s. However, the past decade has seen a slowdown in trade integration and price convergence, and business growth and innovation have become sluggish, when compared to the US.

The single market seems not to have contributed much to a shift towards high-tech growth sectors and firms' expansion into emerging markets. Overall, its potential has not been fully exploited yet. Its macroeconomic gains could be doubled if the following problems were tackled:

- Problems with correct and timely implementation of single market rules.

---

<sup>1</sup> See: [http://ec.europa.eu/economy\\_finance/publications/economic\\_papers/2007/economicpapers271\\_en.htm](http://ec.europa.eu/economy_finance/publications/economic_papers/2007/economicpapers271_en.htm)

- Problems with application of mutual recognition principle and insufficient opening of public procurement to competition.
- Remaining barriers in the services sector, fiscal barriers and barriers to diffusion of knowledge.

A comprehensive reflection was seen as necessary on the following issues and ways to tackle them:

- Improving single market governance via monitoring of selected key markets in order to improve market efficiency.
- Seeking synergies between single market, competition and innovation policy instruments.
- Designing mutually supportive external market and single market policies.
- Increasing political acceptability of further single market opening.

### **Session 1: The economic model for the single market: yesterday and tomorrow**

**Mario Monti** (Chairman of Bruegel), chairman of the session, launched the discussion by highlighting the important role and desirability of economic foundations to support single market acceptance and policy development, given the current reluctant stance of some member states to integration and market rules.

**Peter Holmes** (Sussex University) drew attention to some historical facts relevant for the future of the single market. His main message addressed the importance of complementary macro and micro policies and stimulating a more dynamic development of the single market. Some other ideas developed in this presentation are summarised below:

- The single market programme was not an attempt to create a complete single market, as it is now understood. Instead, it was a technical project to create an area without frontiers to movement of goods, services and factors as announced in the 1957 Rome Treaty. Additionally, the single market programme was designed to trigger more competition and create a favourable political climate for future integration.
- Its implementation as a package deal has proved a success. However, some of its expectations did not materialise. The design of the single market programme aimed to reduce not only costs but also prices through intensified competition. Profit margins would fall but firms were to be compensated in terms of overall profits via higher volumes of business.

However, although the intensification of competition did occur as expected, the growth effect did not at first compensate falls in margins.

- The current environment is very different from mid 1980s: the single market is blamed for some negative effects of globalisation and for the macroeconomic slowdown; there is higher political resistance to change and governments are willing to use protectionist measures; and it is the more difficult questions that remain to be tackled, creating a relatively less favourable conditions for success of the single market. The situation now is one of more varied policy preferences in an enlarged EU and also requires a focus on the external environment factor.
- The new model for single market policy should address this diversity of preferences, make benefits to consumers visible, focus on areas where gains are evident (e.g. services at retail level) and be supplemented by social and macro measures.

The presentation by **Thierry Mayer** (Paris 1 and CEPPI) described the developments in trade flows among the four largest EU economies – France, Germany, Italy and United Kingdom – and compared them to flows between the US and Canada. The main message was that the single market is not single at all when compared to other cases of regional cooperation such as between North American Free Trade Agreement (NAFTA) or Association of Southeast Asian Nations (ASEAN) member countries, where integration is higher not only in degree but also in pace. As a result, it is important to realise the limits of integration and to know how policy can increase trade and investment integration.

The following results presented by Thierry Mayer, were derived from the comparison of trade and investment flows inside and across borders using a gravity model-based methodology:

- The home bias remains very important in trade for many industries in the EU-4 area when compared to US and Canada, even for industries where the degree of integration tends to be higher, such as non- electrical machinery.
- The US-Canada area caught up with EU-4 in terms of trade integration in many industries after NAFTA came into force, so the completion of the single market might not have made a bigger difference than other regional trade agreements.

In terms of investment, a similar analysis was conducted for France. The results also provided strong evidence of home bias, i.e. there is excessive investment inwards given the market potential.

Thierry Mayer suggested two theories, which could explain the divergences between the EU-4 and the US-Canada. One quoted migration and firm networks as one of the main reasons, since trade flows are boosted when larger networks are in place. The second one pointed to the role of differences in legal systems.

**Gianmarco Ottaviano** (Bologna University and Bruegel) used a microeconomic approach to argue that the success of the single market programme is a matter of increasing the number of firms involved in European and global markets as much as a matter of increasing the involvement of firms that are already active in those markets. European firms currently take little advantage of the opportunities of either. In particular, they seem less involved in the global market when compared with US firms.

US data show that a small fraction of US firms export and they mostly serve a small range of destination countries – even in a relatively export-oriented sector such as manufacturing. US data also show high shares of top exporters in total aggregate exports. When intra-EU trade is not taken into account, the results for the EU are stronger and reflect little advantage-taking from globalisation. In the case of FDI, these tendencies are even more marked.

Few and only very productive firms are able to benefit from enlargement and globalisation opportunities. The extent to which firms seize these opportunities does not only depend on the technological environment, but also on institutional constraints. Single market policies on innovation, competition, labour markets or trade can reduce productivity threshold and therefore, boost the internationalisation of Europe's firms contributing to the success of its industries in a global market.

The presentation of **Jan Michalek** (Warsaw University) closed this session by discussing the implications of the accession of the new member states (NMS) for the economic model of the single market, based on the theory of new economic geography. The main ideas addressed in this presentation can be summarised as follows:

- There is a risk of dislocation of human and financial resources from NMS to core European regions. Less developed transport infrastructure in NMS and less effective use of structural policies are very important in this process. In this context, the migration outflows should be analysed in terms of the new economic geography to understand how important they are and how long this phenomenon can last.
- Given the important role of SMEs in NMS economies, the single market is perceived as a big challenge in terms of competition. In order to improve the position of SMEs one needs to focus on policies related to access to finance, patents or encouraging the links between SMEs and larger companies.

- Harmonisation of common external policy is important for the bargaining power of NMS in relations with neighbours like Russia on key issues, such as energy.
- There is a need to consider ways of improving business climate and policies for increasing the innovative potential of firms and economy, which are a greater problem for NMS than for old member states and are crucial to respond to global challenges.
- Because of their implications for liberalisation of trade in services, border effects should also be assessed more clearly in order to distinguish them from other effects, e.g. preference effects.
- Standardisation policy improvements can contribute to competitiveness and to higher GDP growth in NMS, especially in the long run and for smaller countries. Further gradual liberalisation in services as well as improvements in free movement of workers are also crucial.
- The enlargement should not be seen as an additional challenge but rather as part of an EU's answer to globalisation. EU's external competitiveness pressure can be reduced with the involvement of NMS' low cost / high skilled labour
- From the NMS perspective, liberalisation in agriculture and other goods is not as important as that in services in terms of GDP, welfare and trade flows. Policies involving e.g. the country-of-origin principle may deliver greater gains in terms of economic growth.

Following the presentations, a round of questions delivered the following reflections:

- It is clear that the single market has a role to play in strengthening EU's competitiveness in the globalised world. It may be considered as a natural stepping stone towards increased exports and FDI globally. It might also have positive effects on the global competitiveness of EU companies. However, it is also possible that the single market may not be able to help some firms, sectors or regions to take full advantage of global markets.
- Packaging of decision-making rules (as in case of the single market programme or financial services action plan) is still seen as a good approach for the success of the single market, as long as they are well focused and deliver good results. However, they are also prone to become perverse if distorted by the pressure of subsets of countries defending national interests. An alternative strategy would be to opt for targeted actions in a limited number of priority areas where progress is clearly lacking.

- International standards policies in goods and, especially, in services markets are very important to enhance the growth and competitiveness of EU firms within the single market and also in the global context. One should avoid setting too strict EU standards, which could decrease EU's international competitiveness.
- Single market policy-making should be more focused on the asymmetries in the single market's results which are visible across sectors and regions.
- Retail side of the single market is still underdeveloped, has little importance in cross-border activity and therefore, needs attention. According to a Eurobarometer study carried out by the Directorate-General for Health and Consumer Protection, a small number of consumers are prepared to buy financial services on-line and a small number of businesses are active cross-border.
- Increasingly, the promotion of the public acceptability of reforms needs to be taken into account in the political agenda of the Internal Market.

## **Session 2: Lessons for the future: from theory to policy – a modernised single market policy**

Session 2 of the seminar addressed the important issue of the future of the single market programme. **Thierry Stoll** (Deputy Director General, Directorate-General Internal Market and Services), chairman of the session, explained that the session should focus on how the economic theory can make more convincing the advantages of the single market and better underpin the reasons for it; and which policies the single market should focus on in the future.

The objective of this session was to analyse how single market policy should be adapted to respond to the new economic context. The debate was opened by **Stefano Scarpetta** (OECD), who underlined the importance of the link between regulation and productivity growth and stressed that more needed to be done to reform product market regulations (e.g. entry) as well as labour and financial markets regulations. He presented an overview of trends of the links between regulation, competition and allocative efficiency in EU countries across product, labour and financial markets. In each EU country, the sequencing of structural reforms seems to have started with liberalisation of manufacturing trade, financial markets and FDI, leading to domestic product markets and services trade liberalisation and labour market reforms. However, the timing and intensity were very different across countries and areas.

Stefano Scarpetta argued that in order to assess the impact of regulation on productivity growth one had to go beyond aggregate and sectoral analyses and assess the role of regulation at the level of the firm. By looking at micro firm data on entry and exit dynamics, as well as post-entry growth, he claimed that there is

a sizeable process of 'creative destruction' in all countries with strong competition (i.e. only 60-70 per cent of entering firms survive the first two years). However, the most productive firms in the EU tend to remain smaller than their US counterparts. This indicates that the degree of allocative efficiency in the US is much higher than in the EU.

Barriers to entry, labour market regulations and financial market development all affect market entry but the last one matters most for the entry of small firms. For promoting post-entry expansion of successful new firms, the impact of stock market on entry and post entry is stronger than that of private credit. Labour regulations curb the entry and exit of small firms and the associated job reallocations.

**John Fingleton** (Office of Fair Trading) continued the discussion by focusing on the relation between competition and single market policy. He argued that competition is a driver of productivity within the firm, between firms by shifting shares and allowing for free entry and exit, and stimulates innovation and technological progress. He saw competition as a complement of the single market policy, the two having the same common goals: productivity and consumer welfare (e.g. successful impact of competition rules in UK on productivity growth).

However, strong competition can increase pressure for protectionism. Protectionism can take many forms, such as promoting national champions or national ownership (e.g. the restrictions on the market for corporate control) that create market distortions (e.g. on the market for corporate control it results in presence of less efficient buyers). Industrial policy is in favour of private rather than public interests and should be used to create a favourable environment for business.

Looking at possible solutions, John Fingleton argued in favour of:

- Strengthening the decentralised enforcement of the competition rules (i.e. stronger domestic agencies) and introducing more private enforcement.
- Using a fuller set of instruments, such as sector studies, and having stronger independent domestic institutions to tackle protectionism and bad regulations.
- Joining up competition rules with consumer policies to deliver benefits to consumers and highlight the consumer welfare and the productivity enhancing side of competition measures.

**Bruno van Pottelsberghe** (European Patent Office, Chief Economist) talked about the benefits of a good patent system e.g. in delivering an integrated European market for patents, facilitating the diffusion of innovation, and stressed

its importance for SMEs and universities. He pointed out that the European Patent System (EPS) is far from being integrated, with different national priority filing and renewal fees and different litigation costs and outcomes. In his view, the EPS has the 'wrong' cost for the right quality, the high cost reflecting 'only' the complexity and lack of integration rather than the quality of the examination processes. Inventors (entrepreneurs, SMEs, academic spin-offs) face a more complex and expensive intellectual property system in Europe than in Japan or the US as it costs four to ten times more in Europe to protect innovations. The grant rate is smaller at the European Patent Office (EPO) and the subject matter is more restrictive, which might explain the three times higher popularity of the US for patent filings as compared to EPO.

For the moment there is no European single market for technology and it negatively affects through costs and complexity SMEs, academic spin-offs and independent inventors. However, some activities are being undertaken towards harmonisation of the EPS to reduce its costs and complexity. For instance, the London Protocol is supposed to reduce translation costs and the European Patent Litigation Agreement to reduce uncertainty, litigation costs and complexity. The adoption of the Community patent would be a substantial step in the direction of creating one single market for technology.

**Bernhard Speyer** (Deutsche Bank Research) continued the discussion by focusing on the future of financial market integration. He argued that the EU financial market integration was still incomplete. Although the degree of market integration had increased in the wholesale sector, the retail sector still remained more regulated and therefore less integrated. He made the following main points:

- The second banking directive established a single passport for EU banks that made market entry and cross-border business easier. However, the passporting regime can only be seen as a qualified success:
  - The cost of running a pan-European institution is still higher than running a national one.
  - The Investment Services Directive did not work as expected; and it is yet unclear what the effects of the Markets in Financial Instruments Directive (MiFID) will be.
  - Although the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive was a success, its notification requirement is misused in some member states as a market entry barrier.
  - The Prospectus Directive stipulates that issuers do not have a notification requirement but some member states still have additional demands that act as obstacles to market entry.

- Bernhard Speyer argued in favour of an extensive application of the Lamfalussy procedure, in order to make financial market legislation more flexible and ensure supervisory convergence of rules and practice. Although initial results were positive, still it was too early for a definitive judgment.
- He stressed the need for further and deeper integration, e.g. in retail markets and therefore for addressing issues such as consumer protection, taxation, contract law and supervision. In his view, mutual recognition was not enough if not complemented by targeted full harmonisation (e.g. definition of core consumer protection rights that would be sufficient and applicable to all retail financial services).
- Furthermore, he argued in favour of deeper integration at the level of the financial supervisory structure in order to avoid duplication and inefficient use of resources. While Lamfalussy levels 1 and 2 seem conducive to reach the objectives intended, the same could not be said for level 3. The Level 3 committees could therefore at best be seen as an interim measure towards a pan-European supervisory infrastructure.
- He stressed the importance of market-based solutions and avoiding too prescriptive regulations, while agreeing that national governments' and Commission's intervention was necessary to overcome obstacles to deeper integration.
- He also called for stronger linkages with competition policy as a sometimes more effective complement to single market policy (due to time-consuming infringement procedure) and suggested creation of a new framework for infringements, including establishment of a separate EU agency with (limited) sanctioning power and allowing the private sector to bring forward charges directly. He stressed the importance of maintaining and expanding the global competitiveness of EU financial services markets and providers.

**André Sapir** (Université Libre de Bruxelles and Bruegel) argued that in designing the future framework for the single market one needs to focus on what is different in the economic context today:

- Firstly, today one is faced with the diversity of 27 countries in the era of ICT technologies and globalisation. The single market policy should be seen as complementary to economic policies that tackle the reallocation of resources across markets and countries in the context of an increased diversity of economic endowments. He argued that despite the increase in the size of the market after enlargement, an increase in competition has not occurred, the role of the incumbents being predominant.

- Secondly, in addressing the single market policies one should take into account at the same time the performance at country level, on the basis of product and labour market regulation, R&D, education, deficit/debt structure.
- Thirdly, there is a need for more coherence of policies at EU level (i.e. Commission level) and between EU and national level, as well as between instruments across sectors and markets.
- Finally, there should be a strong network of EU and national institutions that ensures and delivers this coherence.

Following the presentations, the round of questions and answers produced the following reflections:

- When considering how regulation impacts on competition, there are also two other important factors that need to be taken into account: non-regulatory government action (e.g. state aid) and the relation of the business sector with the antitrust office. The allocation efficiency indicator presented is one way to look at a relation between regulation and competition but one should not look only at one indicator in assessing such causality.
- Liberalisation in the labour markets progressed much less than in product markets also due to specific components of the former that do not easily agree with competition rules (e.g. collective bargaining).
- The Commission has proven to be very effective in dealing with cross-border mergers and acquisitions and took decisions that were sometimes not entirely in accordance with member states' wishes. However, the Commission has not been that effective in making sure member states implement correctly the competition regulations. Infringement procedures are often long and ineffective.
- There is a need to move from a legal to a more economic approach focused on markets and sectors monitoring. Instead of focusing on finalising the single market, one should concentrate on specific issues, e.g. promoting innovation. However, one needs to carefully design the screening criteria for prioritising certain markets and sectors.
- Prioritisation can be based on the approach used by the Office of Fair Trading, which looks at impact of a potential sector on the economy; precedent effect (as in case of Sabena); and whether market might be able to find solution itself.

- The focus of the single market has changed: historically, it concentrated on the size of the market and economies of scale, whereas now it concentrates on the flexibility of the markets.
- The importance of better regulation was stressed to reach clearer understanding about what a specific legislation is meant to achieve.
- The discussion on the future of the single market should not focus only on legislative issues and new legislation in particular but the approach should be broader and take into account the regulatory programme and competition policy. Single market legislation should be only one point within this broad approach.

## **Conclusions**

**Thierry Stoll** noted a number of shifts in perspective that were emerging from the discussion:

- From simple economies of scale towards the need for more flexibility, adjustment.
- From a purely legal approach (applying the Treaty and aiming at four freedoms and abolishing borders) towards more economic analysis.
- From an instruments-driven towards a market-driven approach.
- From a broad approach to a more sectoral approach with prioritisation on the basis of economic analysis, including prioritising infringements.
- From Brussels-centered approach towards more partnerships with member states. Today, single market is both too small and too big: too small given globalisation, where reforms at EU level are not sufficient; and too big because many blockages are at national level.
- From treating single market policy in isolation towards joined-up policy and action, whereby competition, single market, social and consumer policies are brought together.