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EU's Internal Market Policy: Results and Problems

The power points can be found on

www.cbs.dk/staff/pne

Overview:

1) An Economic Portrait of Europe

2) EU Member States - much in common, but they also belong to different social models

3) The European Competitiveness Problem

4) A Porter Perspective on the EU

-a) factor conditions, - b) demand conditions

- c) supporting industries, - d) firm strategy

- a) through d) influenced by government policy

5) EU's Internal Market Policy

6) The Single European Market

7) Effects of the Internal market

- micro

- macro

8) The Lisbon Strategy

9) The Services Directive

1) An Economic Portrait of Europe

The EU economy is underperforming, but it is still an important trading entity:

- **20 per cent of the total trade in goods**
- **25 per cent of the total trade in services**

I most years, the EU is also the largest source of both inward and outward FDI.

Reflect the fact that the EU is home to a large number of MNC's

Global Fortune 500	
Country	**2005**
USA	**176**
EU	**159**
Japan	**81**
China	**16**
Canada	**13**
South Korea	**11**
Others	**44**

No matter what, the European Union is one of the world’s economic power houses:

EU-27 – approx. 500 million people

USA – approx. 300 million people

Japan – approx. 125 million people

Economy (GDP): EU-27 > USA >>> Japan.

2) EU- Member States have much in common, but also a number of differences

There are more or less constant tensions as far as convergence and divergence between the Member States and the EU is concerned.

Much in common:

1) all Member States have accepted a common legal framework (the acquis communautaire).

2) the economic structure is broadly similar:

3) agriculture has declined = 2 % of GDP,

4) industry has also declined = 20 % of GDP,

5) services dominate = financial, business services, tourism, public services

6) all Member States have mixed economies with (some degree of) social protection and private owned companies trading globally

But EU Member States also belong to one of the various European social models:

<u>Nordic model</u>:

a) active labour market policies

b) incomes are relatively compressed

c) high employment rates

d) social partners are important

<u>Anglo-Saxon model</u>:

a) market oriented model

b) high employment rates

c) huge income differences

d) social partners are not important

<u>Continental model</u>:

a) "social" market economies

b) many market regulations

c) benefits are connected to job and career

d) relatively low employment rates

e) social partners are relatively important

<u>Mediterranean model</u>:

a) low social spending

b) strong employment protection

c) low employment rates

d) social partners are not important

Figure. European Social Models

		EFFICIENCY	
		Low	High
EQUALITY	High	Continentals	Nordic
	Low	Mediterranean	Anglo-Saxon

A number of questions can be raised:

1) Is the Nordic social model an ideal model?

2) Can the Nordic social model be transferred to other European countries – or other countries of the world?

3) Are some countries or regions more competitive than others?

3) The European Competitiveness problems

Can states like firms be in competition with each other?

Answer: Only to a certain degree.

There are fundamental differences (Paul Krugman):

1) firms are motivated by profit – states are motivated by broader social and political issues

- continued:

2) when firm win new market shares it is often a zero sum game

- when states win market shares (more export) it is not a zero sum game – more international trade is a win-win situation

3) there is direct competition between firms, but much less so between states

4) A Porter Perspective on the EU

At the same time, states do have an influence on the competitiveness of firms

According to Michael Porter there are four primary factors supported by two other factors that can influence firm's competitiveness:

1) factor conditions: these factor conditions are created (like infrastructure, skills) or given (like size, population) factors of production

2) <u>demand conditions</u>: the higher and more sophisticated the level of demand, the more competitive are the firms

- and the more competitive the firms, the more sophisticated the level of demand

= the successful "competitiveness circle"

3) <u>related and supporting industries</u>: if internationally competitive, they spur innovation and change

– for example strong R&D supporting industries

4) firm strategy, structure and rivalry: intensity of competition (or rivalry) most important

= strong rivalry which lead to a selection process where the firms with the best strategy will win

5) chance (historical accident) – when firms are situated close to dynamic centers

- for example, historically, the Danish agricultural firms were close to the population centers of the UK and Germany where the industrialization started

6) government (government policies that influence 1) – 4))

Factor conditions in Europe

a) given factors:

historically, great variation in Europe's natural factor endowment:

- sources of energy (coal)

- raw materials (great variation – gold, silver, iron, timber etc)

- soil conditions (good conditions for increasing food production)

b) created factors:

- historically, individualism and Protestantism (Weber) enhanced conditions for economic growth

- recently factors have been created that slow down economic growth: - lack of flexible labour markets, especially in the Continental and the Mediterranean social model

- too few scientist – natural science has been downgraded in primary schools and high schools (however, Eastern and Central European countries help us)

Factor conditions continued:

-too few entrepreneurs

- capital markets are not fully integrated = more difficult to raise capital for new investments

- the physical infrastructure is not always sufficiently modernized for cross-border traffic

Demand conditions in Europe

a) Integrated single market

>>intensified competition

>> more research and development

>>more sophisticated demand

b) However, the EU market is not fully integrated.

Still, many parts of the services sector are not part of the integrated European market.

It is increasingly a problem as the services sector makes up a still larger part of the economy.

Related and supporting industries in Europe

a) lack of integrated industrial structures within Europe has hindered the forces for "creative destruction" (Schumpeter) within the economy

b) an absence of world-class supporting industries to aid competitiveness of firms - not least an competitive IT sector

c) continued national regulation has limited the intensity of competition

- these regulations are most often defended by national politicians that want to protect their "own" health sector, their "own" banking sector, their "own" railroad systems etc.

Firm strategy, structure, and rivalry in Europe

a) traditionally, European governments often sought to limit the intensity of competition through regulation and protectionism.

b) therefore, we have not seen a strong selection process to the benefit of firms that have successful strategies = firms with unsuccessful strategies have remained on the market

Firm strategy, structure, and rivalry in Europe – continued:

c) this has also limited the competitiveness of European firms outside of Europe

d) to some degree, the Single European Market policy has helped solve some of these problems. But only some of these problems - and only to a certain degree.

Government policy

a) The Single European Market programme is an example of how government policy can have an important facilitating role on the creation of competitiveness.

b) however, most often the politicians have an interest in preserving status quo. There are many vested interests in preserving status quo.

c) there is a constant struggle between pro-market (or anti-protectionist) political forces and anti-market (or protectionist) political forces – the results are seen in whether government policies facilitates or hinder the creation of competitiveness for firms.

5) EU’s Internal Market Policy

Potentially, EU’s internal market policy can aid international competitiveness of EU business in a number of ways:

- Better realisation of scale and scope economies
- A simple, more homogeneous home market with stronger competition
- Sharing best practises across firms
- More research and innovation
- More efficient capital and labour markets

The theoretical rationale of the market integration process:

- exploit more economies of scale in the production process
- effects of more intense competition
Lower barriers to entry

= over time, greater levels of employment and investment.

Benefits to the firm’s logistical chain are derived from:

- <u>Suppliers</u>: sourcing from new suppliers that offer lower prices and/or better quality inputs to the firm

- <u>Production systems</u>: developing new locations to enter new markets with low entry costs

- <u>Distribution systems</u>: more competition in services to the firm (transport, warehousing, retailing systems)

= rationalisation via a process of ”natural selection” or more cooperation (e.g. mergers and acquisitions)

<u>6) The Single European Market</u> programme of 1985 was only the first step towards a true Single European Market.

- 1985 White Paper Completing the Internal Market proposed nearly 300 measures to push the development of the Single European Market

- Formalised in the Single European Act of 1987

- Deadline for implementation: End of 1992

Barriers to be removed according to the White Paper:

a) Physical barriers between states: customs barriers.
b) Technical barriers: common standards, technical regulations, public procurement practises, harmonisation of business laws etc.
c) Fiscal barriers: Minimum levels or harmonisation of VAT and excise duties.

Underlying legal principle: “mutual recognition”.

The market integration process introduced by the Single European Market programme has had implications for other policy areas:

- <u>EU's competition policy</u>: a strengthening was needed in order to ensure a level playing field.

- <u>EU's regional policy</u>: a more effective policy was needed in order to counter the new imbalances.

- <u>EU's social dimension</u>: was needed in order to ensure the rights of wage earners.

<u>Commercial effects of the Single European Market programme:</u>

<u>- Estimates in the Cecchini Report:</u>

- 4 – 7 per cent growth in the EU's GDP

- two million extra jobs

Difficult to judge, however, the Single Market programme <u>can</u> be felt at a micro- and a macroeconomic level:

7) Effects of the Internal Market

Micro-economic effects:

- Evidence that both trade and cross-border investment have increased since 1992

- Limited evidence of price convergence (expected under the law of one price)

- Still different competitive conditions across the EU due to:

a) Different administrative rules and standards

b) Physical conditions such as geography and natural resources

c) Economic development and infrastructure

d) Information problems stemming from different languages

There has to be a convergence of customers before there is a convergence of prices. It’s a gradual process.

Macro-economic effects:

- Evaluation by the Commission in 2002: the Single European Market programme had added 1,8 per cent to the GDP and 1,5 per cent to the total employment

- The benefits are derived from the following sources:

1) Allocative efficiency: as prices are reduced due to increased competition

2) Productive efficiency: derived from scale economics

3) Dynamic efficiencies: derived from innovation and change

<u>The effects of EU's internal market policy on citizens/ consumers:</u>

Citizens/ consumers can benefit through

- Lower prices (insignificant effect)

- Increased choice (some effect)

- Extension of legal rights (some effect)

- A level playing field for workers wherever they may move within the EU (significant effect): since 1993 about 20 million citizens have moved to another Member State with 7 million currently residing in a partner state

8) The Lisbon Strategy

An example of pro-market EU government policy:

The Lisbon Strategy adopted at the EU summit in 2000

a) Aim: the EU shall be the most competitive economy in the world in 2010

b) Mean: making EU firms more competitive at home through an improvement of factor conditions

c) the EU decisionmakers took a Porterian perpective on how to create competitiveness

The key areas for policy action in the Lisbon Strategy:

a) a more effective internal market

b) better regulation

c) better infrastructure

d) more R & D

e) more innovation

f) more jobs

g) better education

A market-driven liberalization process that should drive European competitiveness forward

<u>Second phase of the EU's Internal Market policy – after the Single Market programme</u>

Focus on the fact that the Internal Market is an ongoing process:

- The uneven implementation of legislation – naming and shaming via scoreboards

- Omissions from the original programme: extend the Single European Market to more actors – such as the SME's – and more sectors – such as energy and the services sectors.

<u>Gaps in completing the Single European Market:</u>

- Energy: market opening has been frustrated by the French government

- Financial sector: implementation is held up by technical battles

- Takeovers: a- and b-shares = a measure to prevent foreign ownership

- European patent. Still national preferences

9) The Services Directive

- An effective proposal from the Commission: liberalisation based upon the principle of "mutual recognition"

- 600.000 new jobs

- increased FDI and GDP

The directive covers different types of service provision:

- The provider establishes in another state
- The provider moves into the state for a shorter period of time
- The provider offers services at a distance

Did only cover services that were liberalised beforehand. Not services that is non-economic in nature or public services.

Two basic principles:

- A right to open a subsidiary in another EU state

- The “country of origin” principle

What happened?

The services directive was watered down!

Only a moderate economic liberalisation came out of it.

Only moderate job gains and economic growth can be expected as a result of the Services directive.

Why?

Political opposition.

The <u>good</u>: Central and Eastern European member states (Estonia, Latvia, Lithuania, Poland, the Czech Republic, the Slovak Republic, Hungary and Slovenia) as well as the United Kingdom, the Netherlands and Ireland

The <u>bad</u>: Austria, Germany, Sweden, Italy, Denmark and Belgium .

The <u>ugly</u>: France.