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**Article — Published Version**

## We need to regain the confidence and boldness of the early days

Intereconomics

*Suggested Citation:* Gargani, Giuseppe (2003) : We need to regain the confidence and boldness of the early days, Intereconomics, ISSN 0020-5346, Springer, Heidelberg, Vol. 38, Iss. 2, pp. 60-63

This Version is available at:

<https://hdl.handle.net/10419/41723>

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## The Internal Market Ten Years On

*The EU internal market, "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured", officially began on January 1, 1993. Ten years later, what has been achieved, and what challenges remain to be faced?*

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Giuseppe Gargani\*

### We Need to Regain the Confidence and Boldness of the Early Days

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It is now twenty years since Jacques Delors had the vision and the courage to adopt a White Paper spelling out what had to be done to create a single market without barriers and setting the deadline of 31 December 1992 for achieving it. The underlying economic justification for the single market programme came from Paolo Cecchini's 1988 report, which was drawn up following research carried out under his leadership into the "Cost of Non-Europe" by an international team of economists. The Cecchini Report became the intellectual foundation for the political debate leading to the adoption of the Single European Act and that Act, in turn, provided the springboard for the decision to adopt a single currency – the euro. I would note in passing that, as Deputy Director General for the Internal Market, Cecchini was responsible for developing the concept of mutual recognition of national legislation, a policy initiative which has been hailed as the most important breakthrough in regulatory policymaking to have come from the European Union.

The single market programme required the adoption of around 300 directives and their implementation in the Member States – a remarkable feat in itself – in order to combat the economic threat posed by the USA and Japan in high technology and by the newly industrialising countries in assembly industries. The aim was to create an environment propitious for the development of European industries capable of com-

peting in global markets by removing the physical barriers associated with frontier inspections, technical barriers in the shape of legal and regulatory obstacles and fiscal barriers stemming from differences in indirect taxes and excise duties. It was decided to tackle these through a new Community standards policy, a common market for services, conditions for industrial cooperation, a single public procurement market, and plant and animal health controls.

#### Remarkable Success

The success of this strategy has been remarkable: according to estimates by the European Commission the Internal Market has increased the Union's gross domestic product by an average of €5700 per household and in many cases the poorer regions have benefited the most by the resultant increase in intra-Community trade. Of course, the impact of the euro in reducing trade and investment risks, and increasing competition, should also be starting to feed through.

And yet the price of success is eternal vigilance. The European Union cannot afford to rest on its laurels, since the rest of the world has also moved on since 1992. Admittedly, much has been achieved recently in liberalising the former State monopolies, particularly the energy supply industry and transport, where the rise of low-cost air carriers has yielded significant benefits for the citizen and the regions. But in order for competition to flourish, it is essential to have a level playing-field and often legislation will be necessary to that end, as we have seen with the proposal for a directive on take-over bids.

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Furthermore, after more than thirty years' wait there is at long last the European company, but further advances in company law will be necessary in order to allow our small business sector in particular to flourish. For instance, I consider that it will be essential for Member States to encourage freedom of establishment and easy business start-ups by modernising and simplifying their legislation and encouraging entrepreneurship, if we are even to begin to vie with the United States in having a flourishing small business sector.

But as Parliament's Committee on Legal Affairs and the Internal Market constantly emphasises, one key to a thriving small business community is to simplify and improve the quality of Community legislation, an issue which I am particularly keen on driving home and implementing through my participation in a high-level working group. Our entrepreneurs cannot compete on the world stage if their hands are tied by red tape and their resources misdirected by government into satisfying the demands of gold-plated legislation imposed by over-zealous bureaucracies. Moreover, we will need to make substantial efforts in this area if the Internal Market is to continue to be as successful as it has been in the past in attracting investment from outside the European Union.

### **Benefits for EU Citizens**

But it is also important to dispel the myth that the Internal Market is just for business. Citizens have reaped enormous benefits in terms of jobs, consumer choice and the lower prices and higher quality brought about by greater competition. The most striking area is telecommunications, where liberalisation has resulted in conspicuously better quality services at remarkably lower prices, with increasing innovation and customer choice. Great strides have also been made at the European level in the sphere of consumer and environment protection. Moreover, free movement has enriched European citizens' lives by opening up new possibilities to set up a business, work, study or retire in a different Member State. Indeed it is estimated that as many as 15 million European citizens have moved within the EU since 1993 and 5 million have chosen to exercise their right to live in another Member State. It is worth singling out for praise in this connection the Erasmus programme, which has helped a million young people to study outside their home Member State. This, along with the right to stand and vote in local and European elections and the portability of certain social security benefits and State pensions, has also helped make the concept of European citizenship and solidarity increasingly real to the man and woman in the street. In

this connection, the Internal Market has also fostered cultural exchanges, enabling Europeans to enjoy the full richness of the cultural diversity which is one of our greatest strengths. Here the revolution in satellite television has a role to play in fostering European culture, increasing consciousness of our common heritage and enhancing mutual understanding. These are some of the intangible benefits of the Internal Market which are all too often overlooked.

### **Improvements Needed**

However, not everything in the garden is rosy. The remaining barriers to free movement need to be brought down, in particular with regard to the free movement of professional people, who are deterred from exercising free movement by the absence of portability of private pensions. It is also true that we cannot afford to relax our efforts to increase consumer confidence, particularly in on-line transactions. Then again, not all Member States have followed Italy's example in speeding up and improving the transposition of Community law. The European Commission needs fresh ideas as to how matters can be improved in this area, but part of the answer lies, in my view, in better quality legislation from the outset at Community level. For this to be possible, I believe that Internal Market measures must comply scrupulously with the principle of subsidiarity and be drafted simply and clearly so as to enable directives to be implemented in the various Member States without undue delay and to reduce the likelihood of their being challenged in the Court of Justice. In many cases, much can be achieved through minimum harmonisation and application of the country of origin principle. But in the final analysis, as Lord Cockfield dryly put it, "It is one thing to enact legislation, but quite another to ensure that it is enforced. The primary duty rests on the Member States themselves ... But the Member States not only have the responsibility for enforcement; they are often the offenders." Part of the answer is to be found in improving the speed and efficiency with which the Commission handles enforcement cases and there is room for procedures for fast-track review in the Court of First Instance but, as I have said, this is only part of the problem.

Moreover, European industrialists have recently raised the concern that Europe risks paying a heavy price in terms of future economic growth and job creation if it continues to delay any further implementation of the commitments undertaken in Lisbon three years ago to improve competitiveness. Firms cannot be successful in business if the system is against them.

If the European Union loses sight of the overall goal set by the Lisbon summit of transforming Europe into the “most competitive and dynamic knowledge-based economy in the world” by 2010, the Union and the national governments risk losing credibility. As I have already said, there is a pressing need to cut red tape: innovation is the key to competitiveness and we need faster, less bureaucratic decision-making processes and a climate which allows ideas to emerge. Many industrialists are complaining that Europe is already starting to pay the price for delaying long overdue structural reforms. The dramatic falls in equity markets and the current weakness of national economies must act as a spur to action. By showing confidence in the market economy and a willingness to act resolutely in pressing ahead with the reforms begun ten years ago, Europe can give a lead to the world economy.

I also see a need to encourage, protect and reward European innovation and inventiveness. The recent agreement on a Community patent – after deadlock for 30 years – is welcome but, even though the cost of a patent will be cut by half, the cost will still be more than in the United States or Japan and the new patent will not be available until 2007-2008. Consequently, I could envisage some sort of action at Community level to assist small and medium-sized business in this area.

#### **Single Market for Services**

As far as the immediate future is concerned, clearly we need to consolidate and build on our existing achievements, but the major challenge must be the single market for services, since there are still too many barriers to cross-frontier provision and, in this area, there is every argument for adopting a firm commitment to the principles of country of origin and mutual recognition. We look forward to initiatives in this area to improve consumer choice and to encourage small and medium-sized enterprises in the tertiary sector to take full advantage of the Internal Market.

A further priority is the creation of a single market for financial services, as the necessary response to increasing financial trans-nationalisation. It is notorious in fact that inefficiencies in the financial sector spill over into the economy as a whole and it is estimated that the creation of a single banking market within the European Union could add an extra 1.5% to Community gross domestic product as a result of the lower cost of capital. Moreover, it can be argued that through the regional regulation of financial services Europe can make a major contribution towards preventing finan-

cial instability in a global environment characterised by volatility of relatively unregulated capital movements.

But the unresolved problems are not confined to the services sector. In the absence of common European standards or the application of mutual recognition, requirements for local testing and certification still add significantly to business costs, thereby frustrating the completion of the Internal Market.

Writing in 1996 the Commissioner Lord Cockfield, one of the architects of the Single Market, made an important point which is often, sadly all too often, overlooked. He said that the Single Market is “the foundation on which all future progress will be built ... You cannot have effective policies to deal with other economic problems, not least in the field of employment and welfare, unless the Single Market generates the wealth to support these policies.” One might think that this is so self-evident as to be hardly worth the mention. But all too often vested interests lose sight of this bigger picture in their anxiety to protect a model of society which is no longer viable in this age of globalisation and the Internet. I see this reflected in certain amendments tabled in the European Parliament, the effect of which is to take the edge off the drive for greater liberalisation and add to – rather than subtract from – the burden of red tape and bureaucracy under which our entrepreneurs in Europe suffer all too acutely by comparison with their competitors across the Atlantic and in the Far East. As President Berlusconi has cogently put it, we need to “liberate the energies of capitalism in such a way that capitalists, serving their own interests, also serve the interests of society at large”.

#### **Perspectives**

To conclude, the Single Market, or Internal Market as it is now known, must be counted as one of the success stories of the European Union. Indeed it is a truly outstanding political and economic achievement, which has brought countless benefits, not only to the business community, but also to citizens. The Internal Market has created millions of jobs and hundreds of billions of euros of extra prosperity. Citizens are now free to move between countries to work or set up a business. Consumers have more products to choose from and, thanks to the euro – which was the necessary second step after the creation of the Single Market – greater price transparency. In short, we are managing in many respects to keep both the demand side and the supply side happy! What we Members of the European Parliament should be doing now – particularly in this period of economic downturn and

uncertainty – is not only to maintain the momentum but to give the Internal Market programme fresh impetus. Successful enterprises use economic downturns in order to strengthen and prepare themselves for the next upturn in the cycle. The legislators and regulations in the European Union must follow their model. There is a real need to de-fragment our capital markets and this is the time to do it. The single currency has given us a unique opportunity to draw our capital markets together, making them broader and deeper, so that cheaper capital can flow to our entrepreneurs more readily, facilitating research and development and thereby boosting employment. The price transparency afforded by the euro – combined with the openness

created by the Information Society – should strengthen our arm in the battle to de-fragment the financial markets.

More generally, we need to regain the confidence and boldness of the days when the Single Market programme was first launched. After all, we have the raw materials, the capital – in the shape of a huge market of well-off consumers, and we now need to make the most of it. If we can get the Internal Market in goods extended into the sphere of capital markets and financial services, the potential rewards are enormous. But in order to do this, we need to work together – Commission, European Parliament and the Member States – and explain better what we are trying to do.

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Karl von Wogau\*

## Completing the European Home Market by 2009

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Ten years ago the completion of the European Internal Market was greeted with much celebration, and relief, that the most ambitious legislative programme ever undertaken by the European Community had been successfully negotiated. However the single market arrived “not with a bang but a whimper”. For most European citizens the only apparent change was the “blue channel” at the airport when they went on holiday.

A more tangible expression of the internal market came with the introduction of the euro and, at least within the euro zone, we should now have a single market where it makes no difference whether you are doing business within a single Member State or between Member States.

The reality is somewhat different. Anyone in business – particularly people in small and medium-sized enterprises – will tell you that it is still not possible to treat the EU as a single homogeneous “home market”. Not only are there linguistic, cultural and historical differences which cannot be legislated for and which will remain for the foreseeable future, but there are also different legal and technical requirements which could be, and should have been, ironed out. For large companies these differences may be an unnecessary additional cost; for small companies they can inhibit cross-border activity entirely.

Thus, while much has been done there is much yet

to do. The Kangaroo Group’s initiative on the completion of the European Home Market identified a large number of measures which still need to be taken before a genuine home market, ensuring the free movement of goods, persons, services and capital, can emerge. The practical reality of the single market is that while most of the physical barriers to free movement between Member States were removed in 1993 there remain many technical barriers to the exercise of all of the four freedoms. In theory these barriers should have been eliminated by applying the principle of mutual recognition; however, in practice this is easier said than done.

As matters stand the freedom to move goods between Member States (the area where most progress has been made) is still limited by technical constraints; while the movement of services and persons is subject to significant restrictions. The more significant of the measures required to remove these internal barriers are set out in the Declaration below.

The Commission estimates that EU GDP was 1.8% (€164.5 billion) higher in 2002 than it would have been without the single market; and that EU employment is 1.46% (2.5 million jobs) greater. One can only ask, if the single market in its current state can yield such benefits, how much greater would they be were a genuine home market to be established?

The agreement with regard to the first wave of enlargement means that this is a particularly opportune moment in which to review the single market process.

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When all is said and done, the single market is the very essence of the EU and it is the single market which is being enlarged. Arguments over voting rights, institutional reform, agricultural subsidies and so on occupy the lion's share of the headlines. However, the benefits of enlargement to the existing, as well as to the acceding, Member States, will in large part result from the creation of a larger internal market.

These benefits could be squandered if we fail to take steps to complete and maintain that market. The Kangaroo Group, therefore, calls on the Commission to adopt, as a priority, a legislative programme for the completion of the European home market. By this we mean a market with a homogeneous legal framework in which it is possible not only to move between Member States but also to operate within Member States as constituent parts of one market.

Maintaining the home market once it has been achieved will, of course, be an ongoing process. However, the basic measures necessary in order to create that market should be introduced and adopted before 2009 – that is to say in the lifetime of the present and the next Commission.

#### **Declaration on the Completion of the European Home Market**

1 January 2003 marked the tenth anniversary of the date on which the European Union was to achieve a single internal market under the Single European Act. By 1 January 1993 much had been achieved and more has been achieved since – particularly with regard to monetary union. However, there is still much to be done if we are to create “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”.

The Kangaroo Group has always taken a practical, step by step, approach to European integration and the completion of a European Home Market. In this spirit the Group now calls on the European Institutions and the Member States to adopt the following measures as the next step towards completing the European Home Market.

#### **Free Movement of Goods**

The free movement of goods is the most advanced of the four freedoms in the context of the single market. However, further progress needs to be achieved in areas which were previously left entirely to Member States and where we today realise the need for broader European cooperation. In many instances these issues relate to public procurement or public interven-

tion in sectors such as defence but they also include the health, agriculture and food sectors.

In all these sectors the Kangaroo Group calls for the elimination of barriers to the free movement of goods and, in particular:

- the creation of a full set of common technical standards for European industry such that all products can be traded throughout the EU without being required to comply with unnecessary national standards;
- the introduction of a single “mark of conformity” certifying that common standards in terms of quality and safety have been met and the elimination of diverging national certification procedures;
- the extension of the new approach to common standards and certification to areas such as food safety and defence policy;
- the effective inclusion of public procurement within, and in accordance with the principles of, the single market.

#### **Free Movement of Persons**

The ability of people to move freely, and to live and work throughout the whole of the European Union without impediment, is fundamental to the concept of a European Home Market. However, this goal is far from being realised. People still encounter significant technical and physical barriers to the exercise of this freedom.

The Kangaroo Group calls for the elimination of these barriers and in particular:

- the abolition of all physical checks on persons, such as passport controls, at internal borders of the EU and the introduction of measures at external frontiers which ensure equivalent safeguards with regard to illegal immigration, terrorism and organised crime;
- the creation of a European Corps of Border Guards answerable to each Member State for its actions throughout the EU and funded in such a way as to ensure an equitable distribution of the costs between all Member States;
- the simplification of administrative procedures for the mutual recognition of diplomas and qualifications; and measures to ensure that national regulations and professional codes do not constitute disguised protectionism;
- the actual introduction, in accordance with the conclusions of the Barcelona Summit, of a health and social security card valid throughout the European Union so as to reduce the administrative burden on individuals and to facilitate cross-border mobility;

- a European network to provide information and advice to citizens moving, or considering a move, between Member States and increasing the awareness of citizens of the possibility of such a move.

### **Free Movement of Services**

Ensuring the free movement of services requires the EU to remove a complex matrix of technical barriers. Moreover, for the most part these barriers do not relate to the service itself and may range from different rules regarding authorisations, employment and qualifications, to sales promotions, after sales support and so on.

The Kangaroo Group calls for:

- a proposal as soon as possible to remove the remaining barriers to the provision of cross-border services as envisaged in the Commission's Internal Market Strategy for Services. Such a proposal should ensure the removal of barriers to:
  - the regulated professions including limitations to the freedom to provide professional services e.g. restrictions on commercial communications and national regulations governing multidisciplinary practices;
  - the provision of services in the entertainment, leisure, professional training, and tourism industries, including the removal of restrictions resulting from, for example, prior authorisation requirements, red tape, price fixing regulations, or limitations to non-local tourist guides;
  - the free supply of retail and logistical services, for example strict, burdensome and non-transparent authorisation procedures;
  - the temporary posting of staff for the provision of cross-border services;
- the realisation of the e-Europe plan, and the effective implementation of the electronic communications package and the e-commerce Directive so as to bring the benefits of the information society to Europe's citizens and businesses;
- completion of current proposals and further initiatives in the field of ground and air transport (e.g. Single Sky) and postal services policies.

### **Free Movement of Capital and Financial Services**

The creation of a European Home Market for capital and financial services would contribute greatly to our future prosperity. It is, however, currently hampered by the existence of national regulations which generally seek to protect consumers but often end up having

the effect of protecting national and local financial service suppliers.

The Kangaroo Group therefore calls for:

- the creation of a single national regulatory authority in each Member State covering all financial services (i.e. banks, insurance, stock exchanges etc.), consolidating the various national supervisory agencies under one roof so as to facilitate the consistent implementation and enforcement of European regulations;
- the prioritisation of the current proposals for reform in the financial service sector with a particular emphasis on completing definitely an agreement on:
  - access to portable European pension schemes for citizens working across the Union through the removal of quantitative and national investment restrictions;
  - the full freedom of movement of EU investment funds (UCITS) via the Single Passport mechanism through the removal of local marketing and administrative restrictions;
  - the implementation of balanced business rules for investment firms (Investment Services Directive) marketing their products in multiple States of the Union;
- the harmonisation of the tax treatment (i.e. structure, base and timing) of pension funds so as to eliminate tax discrimination and double taxation; the applicable rates in the harmonised structure should, however, continue to be a matter for the Member States;
- facilitating the clearing and settlement of cross-border transactions in stocks and shares by enabling the establishment of a single entity capable of undertaking these activities on a pan-EU basis.

### **Concluding Remark**

In the past, the adoption of measures in the European Union has not always delivered the promised level of harmonisation. Delay and inconsistency in implementation, the introduction of new national regulations and a failure to enforce European law have all undermined the single market and prevented it from delivering the anticipated benefits.

The Kangaroo Group calls not only for the adoption of the above measures, but also measures to ensure that future national and European legislation is consistent with the principles of the Single Market; and for the effective implementation and enforcement of such measures.

Jacques Pelkmans\*

## Better Internal Market Regulation

The internal market is by far the greatest economic asset of the European Union. Potentially. Without it there would be no deep European integration, at best perhaps some kind of WTO-plus market access or a free trade area with a lot of limitations, exceptions, inconsistencies and legal uncertainties. Having the internal market in the treaty, however, only marks the beginning of two extremely demanding processes: its wide and deep “establishment” and the pursuit of its “proper functioning”. In the decade since the end of the EC-1992 programme the process of establishing the internal market has progressed significantly in major areas. Examples include the widening to the liberalisation of network industries (the former public utilities which had been left out of the 1985 White Paper) and the deepening of several first or second generation key directives which did, indeed could, not yield the competitive pressures, and hence the economic benefits, hoped for (the most impressive cases are the three financial services directives in the EC-1992 programme, now deepened and widened in the ambitious Financial Services Action Plan of no less than 50 directives and other provisions, leading to much more competitive bite, lower cross-border costs and restructuring). The EU also repaired a major flaw in the treaty, namely the lack of a proper legal base for EU-level intellectual property rights, by a tiresome steeple-chase for trademarks, copyright and, at long last, the Community patent.

Pursuing the proper functioning of the internal market is highly ambitious, too. For the most part, however, it is much less spectacular and quite resistant to economic guidance. For political leaders, the issues and focussed supervision of the proper functioning are not rewarding. The technicality of this process creates fundamental obstacles to the systematic application of economic rationality, even when, on the face of it, incentives and penalties would appear to be used. The proper functioning of the internal market is first of all a question of preventing or overcoming market failures. The two instruments to do this are competition policy and regulation. In sectors other than network industries these two are complements. In network in-

dustries there is overlap and intertwining: liberalisation requires, at the same time, pro-competitive regulation (which may reduce in intrusiveness over time if entry and competitive challenge is effective) and a “regulatory” approach to competition policy. The EU internal market must function properly in a multi-tier government environment as well. This generates further difficulties in exploiting the golden asset and trying to get the most out of the internal market.

The present article focuses on EU regulation with a view to the “proper functioning” of the internal market.

### Better Regulation on Three Fronts

In the Union one can discern a slow but gradually increasing recognition of the central importance of better regulation for the economic performance of the European economy. Nowadays it is pointless to view the internal market as a kind of customs-union-plus. The internal removal of tariffs and quotas was 35 years ago, at least for the EEC-Six, and most of the non-agricultural external tariffs are now very low while quotas have disappeared due to tariffication. The European economy has adjusted accordingly. The internal market today is about regulation, its appropriate economic justification, proportionality (that is, the least restrictive means given the objective), the assignment to the most effective level of government, the efficiency and effectiveness of the EU compliance regime as well as the optimal combinations of regulation with competition policy and of regulation at the EU and at national (if not regional) levels. To a large extent the proper functioning of the internal market (treaty jargon about getting the most out of the single market so as to serve best the socio-economic objectives of the Union) hinges on the achievement of high regulatory quality in all those respects.

For present purposes three categories of regulation may be distinguished where it is hoped to improve the performance of the internal market.

- *Regulation enabling liberalisation* i.e. as a prerequisite or corollary of the introduction or furthering of the free movements. This category includes common regulation (mainly in common policies such as the CAP and trade policy and exceptionally in other areas such as a recent regulation for the im-

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mediate unbundling of the local loop in telecoms), approximation of national laws where barriers exist, and mutual recognition (which avoids common rules or approximation but often requires adjustments at national level). The majority of the *acquis communautaire* consists of approximation directives in goods and services. Better EU regulation is therefore predominantly about the quality of today's *acquis*. The "invisible" element is about the improvement of the actual working of mutual recognition. Again, this is not a trivial issue since roughly half of the intra-EU industrial goods trade is subject to mutual recognition (the problems are found in the 30% where regulation at national level is applied, the other 20% concerns unregulated markets). The key query here is: does it lead to genuine and effective market access, reflected in credible potential or actual competitive challenge?

- Given the accomplished liberalisation, can the *quality of the EU regulatory acquis* be significantly improved? Quality refers to an assessment ideally based on cost/benefit analysis. The key query here is: can cost/benefit analyses be systematically applied to EU regulation, including one or more alternative options, thereby reducing considerably the transaction and other costs or augmenting the benefits?
- *National regulation*, when resulting from national powers (hence not subject to approximation or common rules) can be intrusive or otherwise costly. Of course, these costs largely fall on that national economy itself. Perhaps they even express the satisfaction of strongly held preferences (i.e. benefits). Unfortunately, more often than not, costly regulation results from specific national pressure groups and vested interests. Nonetheless, the proper functioning of the internal market is likely to be negatively affected in several ways, for example by raising the hurdles for mutual recognition (goods, services and diplomas), undermining economic dynamism and growth stimuli across borders, hindering the effective exercise of the right of establishment as well as the europeanisation of corporate strategies, and, not least, by causing so-called regulatory cumulation and the "gold-plating" of nationally implemented EU directives. A special case of highly restrictive regulation concerns the national labour markets. In fact, national labour markets in the EU are largely insulated despite the formal recognition of "free movement" of workers (but not, more generally, of "labour", only of persons; this is no coincidence!) Not only does the protectionist principle of "host country control" ap-

ply to all migrant workers – so they cannot challenge local wage agreements or secondary labour conditions – employment protection legislation and many other rules are so intrusive and complex, and often linked to the welfare state, that cross-border migration without the protection of a company is seen as risky. National regulation can be regarded as a result of economic policy. Since Maastricht, the treaty stipulates that Member States regard national economic policies as a matter of common concern (Art. 98 and 99, EC) and that they shall coordinate them. The coordination processes of Cardiff (since 1998), Luxembourg (since late 1997) and Lisbon (the spring European Councils) have increased awareness about the importance of regulatory reform at national level both for national and European purposes. The key query here is: do the "open method of coordination" and the relatively "soft" recommendations approach of the Broad Economic Policy Guidelines (BEPGs) of the EU improve the benefit/cost ratio of national regulation?

### The Long Haul of Progress

Battles on three front lines usually spell disaster. In any event, one cannot possibly expect the EU to transform into a good "regulator" all of a sudden. However, if one is willing to accept the long haul of several decades the case for arguing steady progress is strong. To begin with, before the Maastricht treaty (in force since November 1993), regulatory reform at the national level was not even brought up, let alone pursued, at EU level. Since the Amsterdam treaty of 1997 the open method of coordination and the Lisbon process (started in 2000) have undoubtedly contributed to a permanent drive to improve national regulation. There is hesitation about the effectiveness in the narrow sense of pushing EU Member States to reforms they were unwilling, at first, to undertake.<sup>1</sup> Harder to measure but likely to be significant is the longer run effect of repeated "peer review", regular exposure of administrations or political leaders to performance gaps compared to agreed EU indicators as well as to considerable deficits compared to "best practices". It strengthens the case of reformers at home even if the domestic political process needs time to process such reforms. Of course the gradual persuasion effect will work far better if the Luxembourg, Cardiff and Lisbon processes and the BEPGs are imbedded in domestic politics. Unfortunately, that is rarely the case nowadays<sup>2</sup> and it is urgent that this be improved, in the

<sup>1</sup> A. Dierx, F. Ilzkovitz and Khalid Sekkat: Structural reforms on European product markets: the Cardiff process, presented at the College of Europe Conference, June 2002.

enlightened self-interest of the Member States as well as the Union.<sup>3</sup>

In the first category, the trail of improvements in the last 20 years is impressive. CAP reform is an evergreen in the EU, yet the shift away from price support and the reduction of export subsidies has almost certainly lowered the huge implicit costs and made explicit the income support (even though for products such as sugar and milk reform resistance remains too powerful). Trade policy other than agriculture has become significantly less protectionist, with much lower common tariffs, all quotas disappeared (in 2 years time even for textiles) and no grey-area measures left. Approximation inside the internal market has turned to the new approach (and no longer under veto threats which led to all kinds of extra restrictions or exceptions) which is far less intrusive than the old approach, while the routine reference-to-standards (indeed, performance standards rather than rigid design standards) ensures market acceptance together with health and safety. In EU food laws a horizontal approach has taken over which has greatly reduced the costs of regulation without sacrificing the benefits. The old "recipe" directives in food have recently been rewritten in a much more flexible form. Mutual recognition has gradually become better accepted although its potential is still far from being achieved,<sup>4</sup> particularly but by no means only in services. Further deepening in second or third generation directives in a range of policy domains is proposed or has meanwhile been achieved so as to improve the economic effectiveness of market access. Besides the financial markets mentioned above this is particularly relevant in seven network industries, namely broadcasting, telecoms (and internet), postal services, gas and electricity, and air and rail transport.

#### **Towards Cost/Benefit Analysis in Regulatory Reform**

Perhaps the least attention seems to be paid to the second category. The regulatory quality of the *acquis* has only emerged as an issue since the later stages of the EC-1992 process. It is striking that few economists seem to know about Declaration no.18 attached to the Maastricht treaty about the application of cost/benefit analysis to EU regulation. Initially, this sound idea became entangled with the subsidiarity debate (which

is about the right level of government for a specific regulation) and proportionality (a principle applicable to both the Member States and the EU level, which suggests cost reduction by preventing measures disproportionate to the objective). For practically the entire decade of the 1990s the cost/benefit declaration was conveniently ignored. The issues were recasted as a lack of "regulatory quality" and checklists/guidelines for regulatory quality were adopted by the Council and the Commission in the mid-1990s. Curiously, although these institutions deal with the same directives, their lists differ in substance as well as sequence.<sup>5</sup> Subsequently, the debate shifted to very weak improvements such as consolidations and codification exercises of families of EC directives which had emerged over a long period of time. When business called for "simplification" as a euphemism for reform, an experiment of simplifying EU law (but without changing the aims) was pursued for a number of years (SLIM) which yielded very little. Other attempts to tackle the issue included business test panels (about the expected costs of draft directives), a special project to render internal market law more SME friendly and annual reports on "better EU lawmaking". The survey by Pelkmans, Labory and Majone,<sup>6</sup> shows clearly that the harvest of all these approaches was very meagre at best. Inspired by the original intentions of the Cardiff process and by the Lisbon objective (the most dynamic and competitive economy in the world by 2010) the European Council tried a somewhat bolder attempt. The Mandelkern report of November 2001 assumes a much wider perspective and proposes seven areas of immediate action with calendars and deadlines. In June 2002 the Commission presented a package of four proposals related to the systematic realisation of better EU, but mainly internal market, regulation. This package includes a paper on (regulatory) impact assessment, a more pragmatic furthering of consultation and an action plan on "simplifying and improving the regulatory environment".

It is too early to assess the significance and credibility of these new initiatives. Although a move in the right direction, there is a major risk that it will turn out to be "much more of the same thing". The orientation is very much one of public administration and public

<sup>2</sup> W. Wessels and I. Linsenmann: Models of economic governance in the EU, presented at the College of Europe Conference, June 2002.

<sup>3</sup> See also WRR: Slagvaardigheid in de Europese Unie (The capacity to act in the pan-European Union), The Hague, March 2003, SDU publishers.

<sup>4</sup> J. Pelkmans: Mutual recognition in goods and services, an economic perspective, Bruges, College of Europe, BEEP briefing no. 2, December 2002, [www.coleurop.be/eco/BEEP.htm](http://www.coleurop.be/eco/BEEP.htm).

<sup>5</sup> J. Pelkmans, S. Labory and G. Majone: Better EU regulatory quality: assessing current initiatives and new proposals, in: G. Galli and J. Pelkmans: Regulatory reform and competitiveness in Europe, Vol. 1, Cheltenham 2000, E. Elgar, pp. 461ff.

<sup>6</sup> Ibid.

management, with attention to structures and procedures but a rather shallow awareness of the economic issues concerned. There is an unspoken resistance to cost/benefit analysis in the Commission, except perhaps in the case of environmental directives. One should, in any event, not underestimate what it takes to set up and maintain a system that reveals the approximate costs and benefits of the existing acquis and new proposals.

The USA struggled for decades and under no less than six presidents before the Stevens amendment in 1996 led to an annual report by the Office of Management and Budget, reporting estimates of the total annual benefits and costs of all federal regulatory programmes.<sup>7</sup> This report has now become routine in the USA and considerable improvements have been achieved over time.<sup>8</sup> The revelation of enormous costs as well as benefits and their far-reaching specification has induced a different culture among lawmakers and lobbying circles. The empirical estimates build on the widespread empirical work done by economists in the

USA as well as by regulatory agencies themselves, a tradition that hardly exists in the EU. When the first report was published in the USA, leading regulatory economists held that half of the US regulations would not pass cost/benefit analysis.<sup>9</sup> Furthermore, most of these estimates are direct costs. But better regulation may impact on innovation, investment and productivity in ways that are little known. The Union should and could greatly improve the quality of its acquis and the economic gains are likely to be very large. However, these gains cannot be easily reaped; they require painstaking efforts and deep investment in empirical economic analysis of a permanent kind.

<sup>7</sup> R. Hahn: Government analysis of the benefits and costs of regulations, in: *Journal of Economic Perspectives*, 1998, Fall, Vol. 12, No. 4.

<sup>8</sup> R. Hahn and R. Litan: An analysis of the 5th Government report on the costs and benefits of federal regulations, Washington DC, AEI-Brookings Joint Center for regulatory studies, May 2002.

<sup>9</sup> R. Hahn, op. cit.; W. K. Viscusi: Economic foundations of the current regulatory reform efforts, in: *Journal of Economic Perspectives*, 1996, Vol. 10, No. 3.

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## A Fading Glory?

Compared to what had been achieved in the two decades before, the Single Market '92 policy was very successful. But more than 15 years after its initiation, such a comparison is no longer relevant for today's integration policy. Instead of highlighting the progress compared to the poor policy performance before, the relevant issue is the logic of the single market programme in itself: did the internal market policy perform well with reference to its own standards? Such a perspective for assessment of the internal market was adopted by the European Commission itself in the middle of the 1990s: during the first half of the 1990s, its statements relating to the single market were in general very positive, but they became more critical after the middle of the 1990s (except for some pamphlets full of praise for the single market in 2002 and early 2003 on the occasion of its 10th anniversary). The Commission even had to initiate revitalisation strategies in 1997 and 1999. Its critique is mainly directed towards the Council of Ministers and the member states which often only lukewarmly sup-

port the internal market. In particular, the Commission criticises

- reluctant implementation of agreed measures and transformations of directives into national law;
- a continuous delay of long overdue decisions in the Council necessary for a smooth functioning of the internal market;
- the lack of a political will to take decisions on new measures and policies deemed necessary to support and facilitate the effectiveness of the internal market.

With respect to its own activities, the Commission has admitted sometimes too complicated and cumbersome procedures and has taken steps to simplify the internal market administration.

### High Expectations

The European Commission created high expectations with regard to the economic benefits of the internal market. After the political decisions had been taken, it launched a large research programme with more than 20 studies on the "Costs on Non-Europe", i.e. on the disadvantages of the fragmentation of the European markets and on the benefits of an integrated

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internal market.<sup>1</sup> A popular summary of the findings is the Cecchini Report<sup>2</sup> with an ostentatious illustration of the advantages.

- Microeconomic advantages are, on the one hand, the immediate cost savings due to the elimination of border controls and of the technical (and administrative) barriers to entry into other member state markets (including the opening of public procurement to suppliers from other member states). On the other hand, medium to long-term cost reductions were expected as a result of the exploitation of technical economies of scale in industrial mass production and as a consequence of an intensified European competition which eliminates national monopolies and inefficiencies and enhances the productivity of European firms. In total, welfare gains amounting to approx. 5% of the community GNP were expected to materialise over a period of 5 to 10 years.
- Expected macroeconomic advantages are an increase in GDP, a decrease in consumer prices, an increase in employment and an improvement of the EU trade balance as well as the public budgets of the member states. These effects are mainly based on the assumption that the intensified competition will force firms to pass on cost reductions to the consumers; consumer prices may decrease by up to 6.1%. The enhanced efficiency will strengthen the position of European enterprises on the world market (so that the EU trade balance could improve by as much as 1% of the community GNP), and the stimulation of economic activity will relieve the public budgets by 2.2% of the community GNP. Finally, it was expected that the completion of the internal market would create 1.8 million new jobs. Depending on the macroeconomic policy in support of the internal market, these figures could change somewhat.

#### Effects and Effectiveness Studies

In 1992 the Council requested from the Commission a report on the effectiveness and effects of the internal market before the end of 1996. The Commission launched a large research programme in 1995. Although the programme comprised nearly 40 individual studies, the Commission did not consider it to be a comprehensive or final evaluation of the single

market programme, nor to be an empirical test of the forecasts of the Cecchini Report. For both it was too early: due to some delays, the single market was not yet completed in full, and in some sectors it had been completed only recently so that its effects had not yet unfolded fully (while the forecasts of the Cecchini Report assumed a fully implemented single market effective for at least 5 years). One wonders why the Commission did not wait for a couple of years before initiating a large and costly research programme. The need to present a report to the Council is not a convincing reason because reports of the requested type are usually based on a much more limited research work. A speculative answer is that the Commission might have felt that the results of the single market policy were not as positive as initially propagated. A confirmation by a solid research programme could not be in the interest of the Commission. Therefore it was better to have an early assessment which could not provide definite answers and would leave a lot of space for different interpretations of non-conclusive results.

Nevertheless, the findings of the research programme have been used for some revisions and a fine-tuning of the internal market policy. In general, the studies verified the anticipated positive effects of the single market, but these effects often did not have the expected quantitative dimensions, and sometimes positive effects emerged for other reasons than those envisaged in the Cecchini Report.

- The volume of foreign direct investments in the EU had increased. The dominant form was mergers and acquisitions. Companies increasingly supply foreign markets not by exports from a huge plant in their home country but by local production in their foreign subsidiaries. The classical "technical" economies of scale of mass production (implying increasing sizes of production plants) have lost much of their relevance while economies of scale and of scope in the management and in the services sphere (e.g. with regard to branding and marketing, financing, logistics, research) as well as the advantages of a decentralised production which exploits the comparative advantages of different locations have gained in importance. Thus, there are welfare gains from increased foreign direct investments, but not because of the exploitation of technical economies of scale.

- Against this background it does not come as a surprise that the foreign direct investments are not concentrated in industries with large-scale mass production, but much more diversified with a very

<sup>1</sup> All relevant documents (except the Cecchini Report) can be found on the website of the European Commission, DG Internal Market: [http://www.europa.eu.int/comm/internal\\_market/en/index.htm](http://www.europa.eu.int/comm/internal_market/en/index.htm).

<sup>2</sup> For the Cecchini Report see: Paolo Cecchini: *The European Challenge – 1992: The Benefits of a Single Market*, Aldershot 1988, Gower.

large proportion (approx. 2/3) in the services sector, facilitated by the deregulation of service industries such as banking, insurance and telecommunication.

- Most of the quantified welfare effects of the Cecchini Report are caused by a reallocation of resources and are one-off effects. For medium to long-term welfare perspectives, dynamic effects (technological progress, innovations etc.) with a potential to accelerate the growth rate are more important. Such dynamic effects result from intensified competition in the European goods and services markets; they will not materialise immediately. Therefore, the single market studies cannot assess them properly.
- Macroeconomic analyses were carried out with two econometric models which differ in how they reflect market interdependencies and what quantity and type of data they require. Both models computed an increase in GDP in 1994 attributable to the single market programme in a range of 1.1% to 1.5%, which is at the lower end of the forecasts of the Cecchini Report. With respect to the employment effects, the models produced very different results of 300 000 or 900 000 new jobs. Even the larger figure is only half of the Cecchini forecast. However, further employment effects were expected for the years to come.<sup>3</sup>

The interpretation of the empirical results of the study programme must be done with caution due to various conceptual and practical problems.

- The basic conceptual problem is that the economic development of the EU after 1992 was not only determined by the single market, but also strongly influenced by, inter alia, advancing globalisation, German reunification, the collapse of the Soviet Union and the transformation in Central and Eastern Europe. Under such circumstances it is impossible to extrapolate past trends into the future to envision what the world would have looked like without the internal market. Much more complex (and speculative) scenario techniques are needed. To complicate things further, it must be considered that the number of EU member countries was increased by 2 in 1985 and by 3 in 1993. Compared to such basic changes it seems to be a minor problem that the single market rules were not all implemented at the same time, and that they have different time-lags before their effects show in economic statistics.
- Practical problems result from the very early date of the studies: for many analyses empirical data were available only for the years up to 1994, i.e. only for two years after the official completion of the single

market. Several important pieces of the single market legislation entered into force only during 1992, and some other measures were not implemented at all before the deadline of the studies.

#### **Restructuring and Revitalisation of the Internal Market Policy**

In spite of necessary reservations, some generalisations are possible and some insights into the effectiveness of the single market have been gained. They formed the basis for a revision and later a revitalisation of the single market strategy by the Commission.

- By mid-1997 an "Action Plan for the Single Market" was adopted. It spelled out four strategic targets: to make the single market rules more effective, to deal with key market distortions (especially in the fields of taxation and competition policy), to remove sectoral obstacles to market integration (especially in the services markets) and to deliver a single market to the benefit of all citizens (especially with respect to social, labour and consumer rights). Between 4 and 6 specific actions were assigned to each strategic target. Considering the character of the strategic targets, the deadline of January 1, 1999 was extremely short. Not surprisingly, the goals were attained only partially within the set time-frame.
- Thus, as a follow up the "Strategy for Europe's Internal Market" for 2000 to 2004 was adopted. Its four strategic objectives are rather vaguely defined as "to improve the quality of life of citizens, to enhance the efficiency of Community product and capital markets, to improve the business environment, to exploit the achievements of the internal market in a changing world". More specific operational objectives and short-term target actions have been added. The Commission designs policies towards the objectives and identifies quantitative and qualitative indicators for an assessment of the progress made, on which annual reports are published.

A first report was presented in May 2000, and the Commission prioritised those target actions which could have the greatest and most immediate impact in improving the functioning of the internal market. These actions were in line with the conclusions of the European Council in Lisbon in March 2000 which had set the extremely ambitious goal of making the EU "the most competitive and dynamic knowledge-based economy in the world" by 2010. The second report of

<sup>3</sup>The Commission later used one of the models (QUEST II) for further computations, and it came to the figure of 2.5 million more jobs and an additional GDP of €164.5 billion by 2002 (European Commission: Implementation Report on "2002 Review of the Internal Market Strategy – Delivering the Promise", SEC(03) 43, January 14, 2003).

the Commission (in April 2001) presents a sobering balance of the internal market strategy.

- Of the 36 target actions to be achieved by June 2001, only 20 are expected to be completed on time, and only 8 of 12 priority actions will be delivered in time. Serious setbacks and too slow progress are reported in various fields such as postal services, public procurement and community patents.
- The national implementation of internal market rules is disappointing: only 3 member states had met the target of the Internal Market Strategy to reduce the implementation deficit to 1.5%. More than 10% of all internal market legislation has not been transposed in one or more member states.

The Commission concludes “that we only have a partial Internal Market operating well below its full capacity” (p. 5). “Too often, commitments made at European Councils are not translated into concrete action at lower levels of decision-making. A gap opens up between rhetoric and reality” (p. 20). The third report (April 2002) presents similar results, and the disappointment continues in the first Implementation Report (January 2003): “Only 6 out of 16 actions (or just under 40 %) which were due by end December 2002 have been achieved on time” (p. 2), and the “picture is [equally] worrying for target actions due to be completed by end June 2003” (p. 7).

### Setbacks in the Core?

In most parts of its reports the Commission deals with deficits in the internal market legislation and its transposition. But there are also problems with the effectiveness of measures already adopted and implemented. Problems with possibly far-reaching implications come up with respect to the application of the internal market's core principle of mutual recognition. The vast majority of trade in goods and services are covered by it.

The principle of mutual recognition will not lose its relevance in course of time but will continue to be of especially high relevance for all new goods with some degree of complexity. Innovative products with a large global market potential are of prime importance for the medium to long-term welfare progress of the EU. The commercial success of many of these goods crucially depends on the rapid penetration of sufficiently large markets in order to reap “first mover advantages”.

The number of reports of firms experiencing difficulties with recognition procedures has increased over recent years. In its second review of the Internal Market Strategy the Commission admits problems that

occur in particular in sectors “such as certain types of foodstuffs, vehicles excluded from EC type approval, financial services and professional qualifications” (p. 10), but complaints come also from other industries. The problems with mutual recognition are due to the fact that the recognition is not unconditional or automatic. Governments do recognise technical norms and standards for certain types of goods and services as mutually recognisable at a general legal level only. This does not answer the question whether the norms and standards are applicable to a specific (new) good or service. In order to secure mutual recognition for a specific product, a recognition procedure is required. The new product must be submitted to a conformity test in its country of origin. Conformity tests are usually carried out by an accredited non-governmental institution. The test procedures may differ from those applied in other member states. Based on the certified test results from the country of origin, the authorities of a country of destination should allow the marketing of the product. Seemingly the willingness of public authorities is rather limited to accept, without any further questions, the results of conformity tests, especially in cases where (factual or pretended) issues of safety are involved and where the products are innovative and rather complex. The unwillingness increases if the documentation is in a foreign language, if test procedures differ from those applied in one's own country and are not well established, and if the conformity-certifying foreign organisation is unknown or even has a negative public image.

It seems reasonable that in such cases the authorities call for an additional certification by an institution of their own country. However, if this became general practice, it factually would mean the end of the mutual recognition and a return to the former country of destination practice with a huge potential for protectionist abuse. Tendencies in this direction pose a serious threat to the effectiveness of the internal market and must be contained. “The Commission intends to publish a Communication which will help to clarify the situation. But the problems associated with mutual recognition are complex and vary from one sector to another. There are no instant, one-size-fits-all solutions” (p. 10).

To overcome the reservations of national authorities with respect to the recognition of foreign certifications, it may be necessary to centralise the accreditation of conformity testing institutions as well as the testing procedures. Centralised regulations must not always be bad.

Summing up, much has been achieved, but the in-

ternal market lost its momentum during the 1990s. For example, the (non-)progress in fiscal harmonisation is disappointing, the service sector is still highly regulated in many areas such as public utilities and health care, and the mutual recognition procedures are by far not as effective as they should be. Obviously, the com-

pletion of the internal market is an ongoing task which will become more difficult because in the future its results will be less spectacular and "national" interests seem to be more effectively organised. The eastern enlargement of the EU will not make it easier to revitalise, complete and secure the internal market.

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Friedrich Heinemann\*

## The Never-ending Story

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Without doubt the 1993 project was a highly successful undertaking for Europe. The credible commitment to a fixed deadline was able to overcome powerful protectionist resistance. In particular, the impressive and very concrete benefit calculations as presented in the famous Cecchini Report<sup>1</sup> proved to be a politically powerful argument in the struggle with lobbies and their preference for closed markets. Although nobody can precisely quantify the benefits *ex post* it is uncontroversial that the resulting push for integration contributed to European growth in the nineties.

Nevertheless, today many of the high expectations of that time appear greatly exaggerated. This is particularly true with regard to the title of the 1993 project – the so-called "completion of the single market". While it is right that integration has made substantial progress in that time it is also obvious that even ten years later European companies and consumers do not live in a completed single market. Many markets are still characterised by an amazing significance of national borders.

This can easily be demonstrated by a brief glance at European financial markets, which in many segments are still fragmented even in the fourth year after the introduction of the euro. Particularly for retail financial services national borders still constitute a considerable *de facto* barrier. Even with a single currency it is an extremely rare event that private individuals compare domestic offers of, for example, life insurance or mortgages with offers from suppliers in other countries of the single currency area. Up to now, insurance companies or banks can only realistically expect to reach consumers in other EU countries if they establish some form of physical presence in the target country – be it through a greenfield investment,

a cross-border merger or acquisition or some cooperative arrangement. The absence of frequent direct cross-border links between financial service providers and retail consumers holds true despite the fact that the euro has made product comparisons easier and that the internet has reduced information costs to a considerable extent.

Looking at the reasons behind the continuing distance from a true single market two distinct classes of obstacles can be identified: barriers that are either of a "natural" or a "policy-induced" type. Language differences, differences in consumer culture and habits but also consumers' preference for a personal relationship and a "handshake" limit the potential for cross-border business. These factors have to be accepted, they are part of the European heritage and explain why integration in Europe will for the foreseeable future not be able to reach the intensity of the US internal market.

This insight, however, should by no means obscure the fact that much more integration could be achieved if obstacles could be removed that are policy-induced. For retail financial services the following problems in the responsibility of politics are of considerable importance.

- *Fiscal discrimination*. In the fiscal field we have to diagnose the most disappointing situation ten years after the "completion of the single market". Within national fiscal systems it is often still very relevant whether a financial product is home or foreign made. Often foreign products are discriminated against on the tax side. What is even more disappointing is the fact that this discrimination is not only a heritage of the past but new discriminations are regularly introduced. German tax policy presents a revealing

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<sup>1</sup> Commission of the European Communities: European Economy: The Economics of 1992, No. 35, March 1988, Brussels.

example with the planned discrimination against foreign investment funds in the context of the newly established capital gains tax.<sup>2</sup>

- *Differences in consumer protection.* In the field of financial services EU member countries have kept wide responsibilities for individual additions to the common European consumer protection standards. These differences are at the heart of the problem of incomplete integration. Even though the internet would offer the technical potential for a pan-European distribution of financial services this is precluded by extensive national regulation of advertisement or information requirements. In regard to pension savings the German "Riester"-products are an example of how intensive national regulation precludes the development of a European market. The detailed and overburdened requirements for pension products eligible for government subsidies make it impossible for foreign suppliers to sell their mature pension products to German investors without costly adaptations.
- *Slow EU legislation.* Market practitioners increasingly complain about the slow adjustment of the Internal Market rules to new market developments. The problem is that the rules concerning the single passport in banking, insurance or other financial services would need a constant adjustment to new business developments. Often, however, the legal adjustment is far behind the actual trends with the result that the single passport is often not valid for the fastest growing parts of the business. The newly established Lamfalussy procedure is to address the problem of slow financial legislation but it remains to be shown that this will really bring a breakthrough.

Because of the stickiness of many obstacles the main message of the Cecchini Report is still valid today: Europe could gain substantially if further progress were achieved towards more integration. Benefits concern consumers and companies but also the economy as a whole through a positive impact on employment and growth. Recent reports have stressed that the economic benefits of more integration will still be substantial.<sup>3</sup> Among the benefits are the following.

- Product choice would increase, in particular for consumers in small countries who today suffer most

from incomplete retail market integration. In these countries, the supply of available funds, for example, could be augmented by a factor between 10 and 20.

- There is considerable scope for falling prices resulting from a higher integration level in financial retail markets. In the fund market, national fragmentation today leads to a large number of funds with an average fund size that is tiny in comparison to the US markets. Since there are substantial fixed costs in fund production, fragmentation immediately leads to high average costs. This is a specific example of the well-known economies of scale argument. Reaping economies of scale in a truly pan-European financial market would be particularly helpful in the ongoing European reforms of pension systems.
- Furthermore, a larger degree of financial integration would be associated with higher economic growth. Theoretical considerations and insights from the relevant empirical literature back the assumption of a significant link between financial integration and growth. Higher competition would reduce intermediation costs in the financial sector leaving investors with higher risk-adjusted returns and borrowers with better financing opportunities. Thus, more capital can be channelled into investment and thus induce growth.

These benefits make it worth sticking to integration as a top priority for European policy. Recent experience also stresses the fact that a policy based on "wait and see" is not justified. Market trends alone are not strong enough to overcome imperfect integration. This can be seen from the fact that even the internet was not able to create pan-European markets e.g. in the field of the most developed e-finance market, the market for online brokerage. Price differences and direct cross-border activities dispel illusions: although the internet is increasingly becoming an alternative distribution channel it does not by itself overcome the fragmentation of retail financial markets in the EU.

Furthermore, the burst of the tech-bubble on the stock markets has reduced risk preference and thus weakened consumers' and producers' efforts to look for opportunities cross-border. With market-led integration losing strength it becomes even more important that policy players become more active.

<sup>2</sup> The "Halbeinkünfteverfahren" reducing the capital gains tax by 50 per cent shall only be applied to funds with German domicile. In the meantime the German government – under pressure from the Commission through an infringement case – has announced that this discrimination will be abolished by 2004. For a comprehensive report on tax discrimination of funds in the single market see Price Waterhouse Coopers/FEFSI: Discriminatory tax barriers in the single European investment funds market: a discussion paper, Luxembourg 2001.

<sup>3</sup> Friedrich Heinemann and Mathias Jopp: The Benefits of a Working European Retail Market for Financial Services, Berlin 2002, Europa Union Verlag; Paul Cecchini, Friedrich Heinemann and Mathias Jopp: The Incomplete European Market for Financial Services, ZEW Economic Studies 19, Heidelberg 2003; London Economics: Quantification of the Macro-Economic Impact of Integration of EU Financial Markets, Final Report to The European Commission – Directorate-General for the Internal Market, 2002.



The substantial potential benefits for consumers and economic growth clearly show that it is worthwhile pushing hard for more integration of retail financial markets. Any integration strategy should aim to simplify direct cross-border contact between suppliers and consumers. This contact would speed up convergence of prices and promote a wider product choice everywhere in the EU. The need for political action also comes from the delicate fact that the "costs of non-Europe" are higher in smaller and poorer member countries than in the bigger and richer ones. While the Financial Services Action Plan and other legal initiatives properly address a number of integration obstacles, more needs to be done.

It is of essential importance to devote more effort to ending discriminatory tax practices that currently shelter some national retail financial markets from foreign competition, and which do not conform with the EU Treaty. Examples concern the markets for life insurance and investment funds. Since tax policy is a highly sensitive issue one misunderstanding must be avoided: ending tax discrimination would have nothing to do with a far-reaching tax harmonisation. Substantial differences in national tax systems are compatible with a high degree of integration since the end of discrimination against foreign products would not endanger national tax autonomy in general.

More harmonisation, however, is definitely required in the field of consumer protection. It is becoming more and more obvious that member countries use consumer protection or "general good" arguments to defend or even add to regulation that serves nothing else but protectionist purposes. This issue is a critical policy-induced obstacle and could best be addressed by the creation of a consistent uniform level of protection with harmonisation on that basis. In essence this would mean applying the successful 1993 approach of common minimum standards combined with mutual recognition to financial services. For financial services today mutual recognition is practically non-existent as can be seen from the following example. An investment fund registered for distribution in Luxembourg cannot be sold all over the EU without prior costly and lengthy registration and fulfilment of additional national requirements in each single target market. Often it even becomes necessary to establish a local representative or even to set up a new fund according to the rules of the target market before marketing activities can start. Because of these high entry costs for each member country many companies restrict their sales activities to a few big markets – leaving pri-

vate investors in small EU countries with little choice among some domestic suppliers.

A further specific field of necessary action for the promotion of financial market integration is supervision. In spite of the euro, supervision of financial markets and institutions is still a national responsibility. Differences in national administrative practice cause high costs for companies that are targeting at different national markets in Europe. At the moment the national bureaucracy is very keen to defend its autonomy against the option of a pan-European supervisory structure. However, a European structure would probably support market integration, so the option of a European supervisory agency should be considered more seriously.

These insights on the single market's imperfections and costs are hardly controversial. Neither could it be said that politicians are unaware of these advantages: the benefits of integration are frequently cited in official European declarations, for example in the ambitious Lisbon declaration on transforming Europe into the leading economic region in the world in the coming decade. However, the gap between rhetoric and action seems today to have widened considerably compared to the situation in 1993. Ten years ago the single market project was at the centre of economic policy programmes at the member country level, in particular in the leading EU economy, Germany. Today this is hardly still the case. An illustrative example was Chancellor Gerhard Schröder's programmatic speech of March on how to cope with the economic crisis in Germany. In this speech integration did not receive any attention. Also, in the public perception it appears as if open borders were detrimental to economic well-being. Without the principle consent of a majority of member countries the Commission is not strong enough to achieve substantial progress. One new discriminative element in a new national tax law does more damage to integration than the Commission can achieve through the onerous and lengthy task of realising the Financial Services Action Plan.

Ten years after 1993 the situation can be summarised in the following way. The completion of the single market is a never-ending story and generations of European politicians will have to devote time to this highly profitable project. Unfortunately, beyond the specific and often very technical integration problems there will be one major obstacle towards significant progress in the coming years: the lack of public awareness that integration is part of the solution and not the problem.