THE SINGLE MARKET 20 YEARS ON

SINGLE MARKET: INDUSTRIAL AND POLITICAL CHALLENGES

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Single market is again praised as one of the ways that could help overcome current economic crisis and ensure growth in the long term. The Tribune overviews the progress that has been achieved since 1992 and outlines the main challenges for today with a special emphasis on the industrial challenges.

Single market today is on the top of the European political agenda, praised as the strategy that could help overcome current economic crisis and ensure growth in the long term. Mario Monti's report of 2010, Commission's two single market acts and the conclusions of the latest European Council meetings emphasizing the importance of the single market – these are just a few examples of the rebirth of the project, which celebrates its 20th anniversary this year. Two decades on, the European single market is still incomplete and significant reforms are needed more than ever for the achievement of its full potential.

This Tribune gives an opportunity to step back and review the progress that has been made since 1992, the initial symbolic deadline for the completion of the single market. Significant achievements have been made and they should not be underplayed. Yet, with the benefit of hindsight, the lessons on the obstacles of further integration should be drawn too.

The Tribune thus consists of three parts. Firstly, the historical overview of the single market is provided emphasizing both the strengths and the weaknesses of the project. Secondly, the developments and the relevance of the single market today are analysed in the context of the economic crisis. Lastly, European industrial policy is given a special focus as the current economic mayhem may lead to the resurgence of protectionism in many forms and to the collapse of the single market as a whole.

1. 1992: a considerable, but mitigated success

The single market programme proposed by the Commission in 1985 had the purpose to fully implement the most important objective of the Treaty of Rome: the free circulation of goods, services, capital and people within the Community. It also wanted to provide a stimulus to revamp the competitiveness of the European economy that had been stagnating after the two oil shocks and was suffering from a disease labelled with contempt as "eurosclerosis". Consequently, the single market has been described as the most ambitious experiment in supply side policy ever attempted in industrialised world. As it happens, the project was a success. The single market programme was not the first time the Commission had attempted to go beyond the achievements of the customs union and the common agricultural policy; why, then, has it succeeded this time?

1.1. The key factors of success

A number of factors were at play, some of them inherent in the Commission's proposal. First of all, since the single market project was put forward as a comprehensive initiative of economic policy, the Commission insisted that the programme had to be agreed and implemented as a whole: governments should not be allowed to "pick and choose" among its components. Second, the Commission was able to convince the member states that the programme would lack credibility if the treaty provisions – that called for unanimity to apply to most of the proposals – remained unchanged. The Single European Act of 1986 took care of that; with admittedly important exceptions, most decisions could be taken by qualified majority.

Third, the Commission's lawyers based themselves on an extensive interpretation of the famous "*cassis de Dijon*" and other cases decided by the European Court of justice, whereby in many instances free circulation could be enforced on the principle of mutual recognition and did not require harmonization of national laws; this made it possible to reduce the scope for new legislation and made the programme manageable. Forth, the Commission built on the excellence of some member states (Germany, France and the UK) in standard setting. A coherent European system in this area as well as for product certification, driven by industry, was a cornerstone of the programme; the objective was to prevent governments from using divergent standards for protectionist purposes and to promote high-level European standards. Finally, having established a deadline for the completion of the programme (end of 1992), an element of urgency was introduced in the exercise.

However, this bold experiment would not have succeeded, had not other factors also come into play. The programme was able to fly on the prevailing political wind of the time, which was one of more liberalisation and less state intervention. The European business community had been the first to call for and to support enthusiastically the completion of the single market. A virtuous circle was in place. As soon as business accepted that the institutions were seriously committed, they started to anticipate the political process with their marketing and investment decisions; this, in turn, helped to overcome the remaining national, burocratic and sectorial obstacles.

All this change has brought an entirely new climate to Europe and helped to create the conditions for developments in other areas. First of all, more integrated market made anticompetitive behaviour by industry – as well as by governments under the form of state aids – less tolerable and gave new impetus to the Commission in it role of guardian of competition. Although the treaty left the issue of public ownership in the hands of individual countries, the competitive pressure of the markets and the Commission's new activism in the control of state aids were one factor that determined the massive privatisations of the '90s, particularly but not only in France and Italy.

Second, the impact of the restructuring taking place in European industry, together with the new situation created by enlargement to southern Europe, opened the way to the strengthening of the instruments at the disposal of the Community to promote solidarity and social cohesion. This took the form of limited but not insignificant measures to promote minimum social standards and a big increase of the structural funds.

1.2. The shortcomings of the initiative

The success of the single market project was significant, yet it was not full blown. The project was admittedly helped by the global economic expansion of the late '80s, but the completion of the single market has also contributed to create millions of new jobs. More importantly, it increased the growth potential of the economy and the consumer choice was greatly improved. However, the drawbacks were many. On one hand, speed is often the enemy of quality and some of the directives that were agreed under the pressure of deadlines were technically imperfect. On the other hand, national derogations were accepted that made the internal market less "single" that it should have been otherwise.

Under the treaty, single market directives had to take full account of environmental, consumer protection and safety concerns. However, with subsequent revisions, these policies were given their own treaty base. Single market directives normally aim at full harmonization as a condition for the establishment of a level playing field. Directives adopted in the other areas, normally limit themselves to the establishment of minimum standards that member states can exceed if they wish. This should not cause problems if the rational for choosing the appropriate base was clear. Unfortunately this is not always the case, particularly with respect to environmental issues; cases have been brought to the Eruopean Court of justice for clarification, but a uniform legal doctrine has not yet emerged. This has added to legal uncertainty.

As already mentioned, two legal instruments governed the system: mutual recognition and directives. The first option was clearly less intrusive and did not require political bargains. However, mutual recognition was also open to legal challenge in national courts as well as with the European Court of justice: a process that could prove long, unpredictable and expensive, particularly for SMEs. This is because national judiciaries do not always act under uniform principles, they are sometimes slow, inefficient and they were learning only gradually how to enforce and interpret European law. In addition, redress is not always easy across borders, even after a favourable judgment. For these reasons, business calls for as little regulation as possible, but it also seeks legal certainty; consequently, this situation has led to the paradox of industry requesting a directive in the cases where mutual recognition could have sufficed according to the Commission.

However, the legal certainty provided by directives is also not obvious. Even if the issues of imperfections in the texts or possible derogations are left aside, a directive has still to be transposed into national law, which can lead to significant divergences. In theory, the detailed nature of the directives should help to avoid this problem, but member states do not always implement them with the same speed and accuracy. As a result, a firm operating across the borders sometimes has to comply with as many laws as there are member states and with no absolute guarantee that these laws will be identical or interpreted in the same way. The Commission is, therefore, compelled to exercise a constant monitoring of the implementation and it also adds to the burden of the European Court of justice. One has to note that the European Court of justice has decided that directives can be enforced in court even in the absence of a formal transposition into national law; however, this, again, implies new legal challenges with all the inconveniencies that have already been described. For these reasons, harmonisation, or the replacement of national rules with one single text, can sometimes prove to be elusive. It could prove more efficient to use directly enforceable regulations rather than directives, but this would create constitutional problems in some member states.

A second reason why the single market programme, even if completed to a large extent, was not living up to its potential was the unanimity requirement, which prevailed in certain policy areas even after the adoption of the Single European Act. The most important of these areas is taxation. For example, the final compromise on the VAT regime applicable to trans-European transactions is still cumbersome, costly and not satisfactory for business. Another problematic area is the abolition of border controls for the movement of people (the "Schengen Agreement"). Originally, it was not an economic issue; actually, it was meant to show that individual citizens and not only consumers and firms, could derive visible benefits from the single market. Because it was subject to unanimity, the abolition of border controls was implemented much later and, to this day, it does not apply to all member states.

Eventually, however, of the "four freedoms", three (goods, capitals and people) had been properly addressed within the programme. The fourth freedom, that for services, was not. In part this depended on the insufficient recognition among the member states as well as within the Commission, of the growing importance of the service sector. A number of directives were adopted as part of the initial programme, or in the following years. However they were incomplete (banks and financial services), constantly struggling to catch up with technological developments (telecommunications), or insufficient (energy). In later years, the Commission tried to address the problem with a blanket initiative on services (the so-called "Bolkestein directive"): a text that was poorly drafted and the object of a disastrous failure of communication (the controversial "Polish plumber"). When it was eventually adopted it fell well short of its original ambitions and to dates it has not been fully implemented.

2. The single market today: time to act again

The developments and the relevance of the single market must now be analysed in the context of the economic on-going crisis. Many of its limits should be overcome by the adoption of the two new "single market acts".

2.1. Limits of the single market today and the European competitiveness

The single market programme was designed to increase the competitiveness of the European economy. However those who worked on it were well aware that the issues addressed on the European level were not the only ones affecting overall competitiveness. Some of them were firmly or primarily within the competence of member states: the functioning of labour markets, tax policies, the efficiency and integrity of public administrations and of the judiciary, the state of infrastructure, support of research and development as well as general education. For instance, in the US the effectiveness of a unified market is helped by a high degree of labour mobility; yet, labour is much less mobile in Europe due to linguistic and cultural barriers, not to speak about legal obstacles such as the limited portability of pension rights. If anything, the increased integration of markets has further emphasized the importance of these factors.

Europe did make an attempt to address these issues in the "Lisbon strategy" aimed at making Europe "the most competitive area of the world by 2010". The strategy included a number of worthwhile objectives, but it produced almost no results because its implementation was meant to be almost entirely intergovernmental (on the basis of the so-called "open method of coordination"). The Commission has attempted to tackle some areas in a more active way, but often to no avail. For example, the discrepancies between member states that exist in company taxation are a source of disruption and make it more difficult for multinational companies to operate throughout Europe in an efficient and transparent way. It is important to harmonise at least the tax base, but several attempts by the Commission have so far failed against the wall of the required unanimity. In the same manner, the poor interconnection of infrastructures (transport, as well as energy) has been addressed in a programme called Trans-European Networks (TENs), but lack of funding and political problems have produced only limited results. The common R&D budget has substantial resources but it lacks focus and is hampered by excessive bureaucracy. The same can be said of the structural funds.

Monetary union was agreed in part as a political project, but it was also an indispensable complement to the completion of the single market. As such, during the first decade after the introduction of the euro it offered European business the benefit of a stable monetary environment and low interest rates. The current crisis has changed all that. The fault lines of the system designed in Maastricht are well known; the "stability pact" was supposed to oblige member states to implement not only fiscal discipline, but also the structural reforms that were needed for the competitiveness of their economy. Only some of the member states obeyed the rules, though. Others, sheltered by the euro, by low interest rates and by the complacency of the financial markets, thought that they could get away without reforms. The failure of the "Lisbon strategy" has also played the role in growing divergences between the member states. As a result, the crisis unveiled a competitiveness and productivity gap that, in some cases, had become bigger than before the introduction of the euro. All this is now being at last addressed in the context of the measures discussed with the aim to reform the governance of the euro-zone, but it exceeds the scope of this analysis. Nevertheless, it is important to examine the impact of the crisis on the integrity of the single market.

2.2. Two "single market acts" launched in the context of crisis

When the crisis, which originated in the US, reached the European shores, the general fear was that of protectionism would resurface again. Fortunately, this has not happened on a significant scale, yet the crisis has produced other negative effects on the single market.

The most important area where integration has actually retreated is that of banking and financial services. During the last two decades European banks had not only increased their operations across borders, but also undertaken a process of consolidation that saw the emergence of a number of pan-European banks. A combination of market pressure and interference by national regulators has now led to an increasing fragmentation and re-nationalisation of the European banking system. The shortcomings of the rules that had been introduced to regulate the financial system were laid bare; the consequences for the future of European banks, the impact on sovereign debt and on the single market as a whole could be devastating. Again, this issue is addressed in the context of the reform of the euro zone and it exceeds the scope of this Tribune. It is nevertheless worth noting that the absolute imperative to deal with the euro zone crisis may not be easy to reconcile with the integrity of the single market for financial services in the Union as a whole.

A more general effect of the crisis has been to diminish the political appetite for integration. Even without becoming openly protectionist, member states are now clearly inward looking. A piece of anecdotal evidence, such as casual suggestions of supermarket stalls reserved for "made here" products, show to which point the countries may try to protect their national interest. The Commission has been alert to this problem and it has repeatedly reminded the member states that the single market is still an essential tool for competitiveness and growth. There is an additional problem. While the business community strongly supported, indeed initiated, the single market programme of the '80s, now they appear divided. When business leaders meet, they produce the usual piece of European rhetoric; they easily agree to blame the governments, but are rather short on specific suggestions. Industry's message seems to be that governments should restrain from interfering domestically, but be prepared to protect them from foreign (both non-EU and EU) competition.

For example, the Commission has asked the former Commissioner (now the Italian prime minister) Mario Monti to write a report on how to revive interest in the single market. In 2011 on the basis of this report, it produced a "single market act", followed by a second "single market act" in October of this year. The main focus of both initiatives is on services, energy, the digital economy and intellectual property. The priorities are well chosen. The first two, have not been adequately covered by existing legislation. The other two need a constant adaptation of the rules to a rapid technological change and the impact of globalisation. It could be argued, though, that in some cases the Commission's proposals lack ambition. Namely, energy policy requires a more comprehensive approach linking the organisation of the market inside the Union and a common policy towards outside suppliers. *Notre Europe – Jacques Delors Institute* has already produced detailed proposals to this effect[1]. Additionally, the development of an integrated and competitive market for telecommunication services would most probably benefit from a more centralised regulatory system that could include a common regulator.

The Commission's proposals raise broader questions. When the original White Paper on the single market was put forward in 1985, the main objective that the Commission pursued at the time was to create a sense of urgency. Many of the specific proposals on how to achieve the single market were already on the table. This, unfortunately, is not the case for the two single market acts. The specific legislative proposals included in the "single market act I" have been made, but none has been decided yet. None of the proposals included in the "single market act II" is already on the table and ready for discussion. Moreover, the European Council has never discussed these documents in a meaningful way and only paid lip service to them in the final communiqués. All this suggests that the needed sense of urgency is not displayed by the Commission itself this time around.

3. The single market and the "European industrial policy"

European industrial policy should finally be given a special focus, as the current economic mayhem may lead to the resurgence of protectionism in many forms and to the collapse of the single market as a whole.

3.1. The fragmentation of the single market: challenge for the European industrial policy

While it is true that the Union has so far avoided open protectionism, it faces an equally dangerous challenge, which, surprisingly, is not even addressed in the two Commission's documents on the single market. A market that has to function effectively across national borders requires producers to be organised across national borders; in order to maximise the benefit of the single market and compete with the rest of the world, industry must be allowed to restructure on a continental scale. It has happened to some extent in the manufacturing sector, but much less so for services.

These questions take us into the much-debated question of "industrial policy". Industrial policy has always been a contentious subject in the EU, with industrial traditions ranging from the laissez-faire approach of the UK, to the extensive public ownership of Italy and to the interventionist policy of France. Thanks to the effect of market integration and to the more liberal wind prevailing in the '80s and '90s, the Union seemed to converge towards a common approach that the role of the public sector should be limited to those factors that can promote competitiveness (such as R&D, corporate governance, sound regulation, efficient financial markets, taxation and the labour market) without interfering with the way companies are run. In reality, however, many governments have never abandoned the concept of "national champions" and the crisis has made things worse.

The obsession with ownership has now been compounded by the more understandable concern of employment. The two catchwords are "control" and "relocation". The official rhetoric describes those concerns primarily in terms of unfair competition from emerging countries. In reality most European investment in the developing countries is motivated by the objective of conquering their markets, while cost-induced delocalisation very often takes place within the Union itself – mainly towards Eastern Europe. For these reasons, the new members risk to be denied the main benefit of EU membership: the ability to use cost differentials to attract foreign investment.

Control is an elusive concept in a context of open financial markets. However, all member states – in a more or less subtle way – have acted to retain "national" control and national jobs in industries that they consider for some reason "strategic"; the means vary, but the result is the same. The examples are too many to list them all: among others, Alitalia, Telecom Italia, Danone, France Telecom, Opel and the recent failure of the merger between BAE and EADS. Even when consolidation is eventually allowed to take place, political interference makes it less efficient than it could have been under normal market conditions. The importance of one specific European problem is often overlooked. In a process of consolidation, mergers of equals fail in most cases, particularly when governments retain an important position as shareholders. Even when mergers happen around one dominant player, managerial culture is a key factor. We all know how difficult it is to politically unite countries with different traditions, history and language; the same is true for firms. American managerial culture is strong and global in character; it can easily co-opt foreign managers and bring them to the top. In general, the same is not true in Europe where the managerial cultural resistance is stronger and can be easily exploited for political purposes. European acquisitions by American firms are often more successful than the opposite; in one case the managerial culture is global, in the other it is national.

This state of affairs may have long lasting effects for the competitiveness of the European industry and a devastating impact on some sectors, like telecoms and airlines, that are faced with fierce global competition and that badly need to consolidate outside their borders. Defence is a special case. One can understand that, in the absence of a common defence policy and a political authority to preside over it, governments want to retain some influence over "their" defence industry; however, if political concerns stand in the way of a restructuring process that is vital for such a fragmented industry, the impact on the long term development of the European defence capability could be serious.

Confronted with this challenge, the Commission does not have many weapons: mainly competition policy and the protection of freedom of investment. They are powerful instruments, but governments have learned how to circumvent them. Furthermore, companies themselves are often reluctant to confront a hostile government and risk a lengthy and uncertain legal battle. The odds are that, under the pressure of globalisation, consolidation will eventually take place, but that it will be more costly in economic and social terms and it will benefit non-EU competitors more often than it should have been the case had the companies been allowed to decide their own future.

3.2. European industrial policy: what content?

Is that all the Union can do? In the present institutional, financial and legal framework the answer is probably yes, but with an important complement. In normal circumstances, an industry that is confronted with structural problems, should take full responsibility for its own restructuring and the role of governments should be limited to coping with the social implications. However, there are cases when this is not possible politically because governments will not refrain from intervening to save "their" producers and "their" jobs. This is particularly true when the structural problem is linked to an important excess of productive capacity and each government is tempted to export the cuts somewhere else. Theoretically, the Commission could always use the control of state aids to punish such behaviour; but when the public intervention is massive, widespread… and politically popular, repression of abuses may not be enough.

A less costly way – politically, socially and economically – to deal with these cases is to organise a "crisis cartel" under public control that would preside over an orderly reduction of capacity, with or without an element of public financial support. Such an approach was implemented in the '80s and '90s for the crisis of the steel industry; it was painful and difficult, but it was a success at least in the sense that it avoided greater pain.

The automotive industry now faces a structural problem that is to some extent of the same nature. In November 2012 the Commission has published the study "CARS 2020"[2]. It contains a comprehensive analysis of the automotive sector and a number of policy guidelines. These include: technological development, fuel efficiency, vehicles and road safety, sustainable mobility, regulatory stability and the integrity of the single market. However, while they are a useful restatement of existing policies and projects that can be of interest to this sector, they offer little new initiatives. They address important long term problems, but leave the key immediate issue of overcapacity to industry and, implicitly, to the member states. In the meantime, the US have successfully restructured their industry with public support, while in Europe the situation is further deteriorating, a costly price war is under way and governments continue to interfere with the decisions of individual companies; distortions of competition are increasing. This approach may prove to be too complacent and the Commission risks, as the crisis worsens, to fall into the "state aids trap" described above; the determination to intervene when distortions are already in place may be legally correct, but politically ineffective. In 2009 *Notre Europe – Jacques Delors Institute* published a Policy Brief[3] suggesting, as a way to avoid the trap, that the Union examines the possibility of a "crisis cartel" for the automotive sector. Neither the Commission, nor governments, nor indeed the majority of the companies involved have until now explored this solution.

Standard setting is at the same time a tool to open markets and an instrument of "industrial policy". The excellence of European standards has spread around the world and helped European exports. The most notable example was the global success of the GSM and of the SIM card. The European market for mobile telephony developed much faster than in the US and many remember the small, elegant and user-friendly European devices at a time when those available to US consumers were heavy and cumbersome. In more recent times the system has worked less well. Europe's standard setting is more open, transparent and inclusive than that of the US. However, it is also slower and less flexible: a disadvantage when technology moves fast and the most dynamic markets are somewhere else. This has proved to be a handicap particularly in the crucial field of information technologies. The GSM's successors, G3 and G4, are not specifically European. Our industrial strength is traditionally in mobile handset and equipment manufacturing. New standards increasingly depend on the convergence between handset manufacturers, computer manufacturers, telecom operators, and providers of internet-based applications as well as of content. In some of these areas Europe is lagging behind the US and Asia. However, Europe is not the most dynamic market for this products and profitability has shifted to segments of the value chain where we are not strong. Our equipment manufacturers – some of them still world leaders – are struggling and this should be a cause of concern. Governments and regulators should take note.

The establishment of the single market has contradicted fears and expectations that Europe would be transformed into a "fortress"; the Commission, the majority of governments as well as of European business have remained solid supporters of free trade. However, globalisation, the crisis and the failure of the Doha round have brought new challenges that come primarily from the emerging countries. They are perceived at the same time as disruptive low cost exporters, potential new markets whose growth is bigger than ours, interesting destination for investment, possible source of desirable inward investment but with an element of political risk. These perceptions are not equally spread across the Union and its industry; we have a common commercial policy, but not a common approach to globalisation. Not only European industry, but also governments compete with each other when they visit foreign countries.

One area where the problem impacts on "industrial policy" is that of inward investment from emerging countries; they are market economies, at least nominally, but they are all characterised at various degrees by a level of protectionism and political interference that is higher than in the west. Some of them have accumulated huge surpluses that look for profitable investment, also in Europe. On the one hand, this investment is desirable, indeed it is badly needed; on the other, some of the funds and companies that are the source of it, particularly in China and Russia, are legally or de facto under political control. The reaction of member states to this dilemma as well as their geo-political sensitivities, tend to differ and create divergences that compound the difficulty to deal with the tendency to defend "national champions". It would be useful if the Union could establish a mechanism on the lines of the CFIUS that operates in the US and that would allow, under the control of the Commission, a joint examination of these investments on the basis of commonly agreed criteria.

Conclusion

The European single market programme has been conceived in the context of stagnation on the continent 20 years ago. Today again Europe is facing serious challenges coming both from inside the Union and from the outside world through globalisation. Despite the progress made, the single market has not been completed yet for the reasons evoked in this tribune. Undoubtedly, however, further integration provides numerous opportunities for growth and stability that are so much sought after in Europe today. European leaders should draw on the lessons of the past decades, resist the temptation of resorting to pitiful protectionism and courageously proceed with the creation of the fully functioning free circulation of goods, persons, capital and services.

1. Sami Andoura, Leigh Hancher and Marc Van der Woude, "Towards a European Energy Community: A Policy Proposal", on a proposal by Jacques Delors, *Study No. 76, Notre Europe*, March 2010.
2. European Commission, "CARS 2020: Action Plan for a competitive and sustainable automotive industry in Europe", *Communication COM (2012) 636 final*, 8.11.2012.
3. Ricardo Perissich, "A Rescue Plan for the European Automobile Industry?", *Policy Brief No 10, Notre Europe*, April 2009.

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