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A Single Market for Europe?

January 1, 1993 marked the scheduled completion date of the European Community's Single Market Program, an ambitious plan to remove most of the remaining internal barriers to trade among its current twelve member countries. The new year was awash with stories heralding the removal of border check points within the Community and of happy Europeans traveling across national borders to take advantage of shopping bargains. But how far has the Single Market Program proceeded? Is Europe now operating as a single integrated market encompassing roughly 350 million consumers and a quarter of the world's economic output? This *Letter* gives an update of the progress of the Single Market Program.

Single European Act

The achievement of closer economic integration has been a long-term goal of the member countries of the European Community (EC) since its establishment in 1958. Significant progress toward this goal was achieved in 1968 with the full elimination of tariff and quantitative restrictions to trade in goods and services within the EC. A program for eliminating all remaining restrictions on intra-Community movements of goods, capital, and labor was presented in the 1985 White Paper Report "Completing the Internal Market" and subsequently incorporated into the EC Treaty via the Single European Act. The program proposed almost 300 specific steps or directives designed to help create a single European market by eliminating physical barriers (such as customs and passport border controls), technical barriers (such as product, health, and safety standards), and fiscal barriers (such as different taxation, subsidy, and public procurement policies) among member countries with a target date of completion by the end of 1992.

Why the desire for a single market? The foremost reason is the economic efficiency benefit such a market would provide. Reduced physical, technical, and fiscal barriers to cross-border trade should improve resource allocation and lower operating costs within the EC. A report prepared for the European Commission (the Cecchini Report) in 1988 estimated that the internal market program would raise the EC's *level* of output by 2.5–6.5 percent compared to what would otherwise have happened. Other estimates taking a more dynamic perspective suggested that growth *rates* might be permanently increased by firms operating with larger scale economies in a unified market, and indicated a medium-term GNP effect roughly double the Cecchini estimate within 10 years of completion of the internal market. Needless to say, there is little consensus among analysts over the ultimate growth effects from the single market program, but most view them as fairly substantial.

Another anticipated benefit of greater market integration is enhanced global competitiveness. Improved resource allocation and economies of scale should allow European Community-based firms to compete more effectively with their North American and Japanese counterparts. Awareness of the competitive advantages associated with a large home market provided to American and Japanese firms has been fundamental to the support of European business for the internal market program.

In addition, many believe that closer market integration will encourage stronger political relationships among members, a long-term goal of the founders of the European Community. The Maastricht Treaty drafted in December 1991 seemed to confirm this view, as far-reaching common ground was reached on issues ranging from an EC defense policy to a single central bank.

Of course, the transition toward a single market is not without costs. The opening of national borders is expected to result in the widespread relocation of firms and workers within the EC. Indeed, the achievement of economies of scale in production entails the concentration of production facilities. More competition also may mean fewer firms in any given industry for the EC as a whole. In addition, as long as national differences in tax rates and labor costs remain, resource movements are likely to increase as it becomes easier for firms to search for low-cost production sites,

for workers to look for high-paid jobs, and for consumers to seek low tax rates on purchases.

Progress to date

By the beginning of this year, the EC Council of Ministers had formally adopted 95 percent of the directives suggested in the 1985 White Paper for market integration. At the national level, most of the adopted directives have been implemented into law, ranging from Denmark's 81 percent implementation rate to Italy's 73 percent rate. Although not meeting the January 1st goal for all of the directives, the steps taken so far represent a considerable achievement. Many trade barriers have been removed, while others have either been reduced or are soon scheduled to fall, and the effects are being felt throughout Europe.

Perhaps most striking is the removal of border controls for travel within the EC. Cargo trucks carrying goods which used to stop for time-consuming administrative checks at each border-crossing now in principle may drive from Denmark to Portugal as easily as one may travel from New York to California. Administrative formalities are now handled at the beginning and end of transport journeys. Cross-border shoppers are able to take home virtually unlimited quantities of goods for personal consumption as long as they pay the value-added tax (VAT) and excise duties where the goods are bought. With prices on such products as electronic goods, clothing, and food varying as much as 50 percent from one country to another, incentives for cross-border shopping abound.

The cross-border flow of goods also has been promoted by the recent adoption of a Common Customs Code that standardizes and streamlines customs procedures and by significant progress toward the harmonization of safety, health, and environmental product standards. This helps facilitate the import of goods from third countries. By accepting each other's technical and product safety standards, once a product enters the EC it may in principle be transported freely into all twelve member states.

The elimination of border controls also applies to services, capital, and people. Controls on the movement of capital, such as bank deposits, bonds and stocks, and so on, were in large part eliminated by mid-1990 in most EC countries. Exceptions were granted to Greece and Portugal until 1995. Troubles in Europe's exchange rate mechanism last fall led Spain and Ireland to invoke an escape clause and temporarily reimpose some exchange restrictions. (See the *Weekly Letter* of October 16, 1992.)

EC members have agreed that banks can now operate throughout the Community on the basis of a single "passport" issued by their home-country regulator. The introduction of single operating licenses should facilitate greater competition for financial services and provide consumers a larger selection of products and service providers. Consumer benefits will be greatest in countries where banking markets are currently relatively less competitive, for example, Belgium and Italy.

Shortcomings

Market integration is well short of being complete. For example, the goal of unrestricted travel is yet to be achieved. Residents and visiting foreigners traveling within the Community will have to present passports at airports until December 1994. The U.K., Ireland, and Denmark intend to make passport and baggage checks beyond this date.

A number of exceptions or delays in implementation to market integration have been granted to various industries. Perhaps most visible are the exceptions in the automobile industry. Currently, European car prices vary enormously, by as much as 50 percent, because of national tax rate differences, exclusive dealership practices, and remaining document requirements and technical standards that inhibit cross-border importing of cars. While Community law says the consumers should be free to buy goods in any EC country at local prices, automobiles (as well as boats and aircraft) are covered by a separate law where consumers will continue paying taxes at the rate charged by the importing, not the selling, EC-member country. Moreover, exclusive dealerships which give automobile manufacturers greater influence over dealer pricing will continue to be allowed at least until 1995. In addition, an EC-Japan agreement which allows a phased-in opening of the single market to Japanese automobiles between 1993 and 2000 is already being questioned by Italy, which has largely closed its border to the importation of Japanese automobiles from other EC-member countries.

In the financial arena, there are also delays in implementation. Common licensing of insurance companies is not scheduled until mid-1994; for investment and stock brokerage firms, not until 1996. Moreover, the branches of foreign banks will not be allowed access to stock exchanges in Spain, Portugal, and Greece until 1999.

The EC also has a long way to go before it ends state monopolies and allows cross-border com-

petition in such traditionally protected sectors as telecommunications, postal, and energy services. A telephone call that crosses a national border within the EC costs on average three times more than a call over the same distance inside a single country. There is no single EC electric plus or phone jack, let alone a television broadcast standard.

Progress toward fiscal harmonization, particularly of taxation, generally has been slower than the removal of physical and technical barriers. Disputes about taxation policies are by their nature often politically contentious because they may reflect differences in social and economic philosophy and can be perceived as limiting national sovereignty and discretionary policymaking. Moreover, under current EC rules agreements on taxation require unanimity among all EC members, unlike the case in most other areas affected by the Single Market Program.

Nonetheless, in an attempt to limit tax flight through cross-border shopping, minimum value-added tax rates (VAT) have been agreed upon in the EC, effectively narrowing national differences. But divergences remain large: Germany, Spain, and Luxembourg maintain the minimum VAT rate of 15 percent, in effect since January 1, while Denmark maintains the highest rate in the EC at 25 percent. To avoid losing tax revenue, Denmark as passed controversial laws restricting its residents from purchasing goods in Germany. Similarly, postal mail-order business in the EC has become more, not less, restrictive in an attempt to avoid tax flight in response to VAT rate differentials.

In the case of corporate income taxes, there also has been some convergence. Most countries maintain corporate tax rates between 33 percent (U.K.) and 40 percent (Ireland). Efforts are underway to eliminate the withholding of taxes on cross-border payments and ending double taxation on distributions to their parent firms in other member states. Pressures may build for more convergence of both VAT and corporate tax rates if tax flight proves to be a major problem. In addition, pressure for tax convergence may arise from the governments of those countries with relatively high expenditure and debt levels, such as Italy, Belgium, and Greece.

There are other areas in which the need for action at the EC level remains. For example, company law and intellectual property rights are remaining issues which are not likely to be resolved soon. Thus, for example, there are no common rules on establishing an EC corporation or on attempting a hostile takeover, nor is there a common trademark standard.

Outlook

On balance, great strides have been taken toward a unified single European market. However, there is still the need to translate all EC directives which have been accepted at the Community level into national law. To prod governments and speed up the process of implementing the EC directives into national law, the EC Commission is considering starting emergency complaint proceedings before the European Court of Justice on any directive where a member state has not met the January 1 deadline.

The success of the single market program also will depend on the power to enforce single market rules. Currently, governments that violate single market rules can be taken to the European Court, but enforcement power is limited. Numerous court rulings against EC governments remain unenforced. The Maastricht Treaty, if ratified, would enhance Court enforcement powers by allowing it to levy fines on national governments. Ultimately the directives agreed to and the laws passed are only as good as the willingness of governments to live up to the spirit, as well as the letter, of a barrier-free internal European market. Experience shows governments worldwide are enormously creative in circumventing those parts of international agreements that are unpopular at home. Many politically difficult steps lie ahead if EC governments are to integrate their economies fully into a unified market.

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