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The EC's Internal Market: Implementation, Economic Consequences, Unfinished Business

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THE EC'S INTERNAL MARKET : IMPLEMENTATION, ECONOMIC CONSEQUENCES, UNFINISHED BUSINESS

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THE EC'S INTERNAL MARKET : IMPLEMENTATION, ECONOMIC CONSEQUENCES, UNFINISHED BUSINESS

This paper summarizes the content of the EC's internal market programme and progress made in its implementation. It analyses the mechanisms which should lead to welfare gains, and reviews a wide variety of micro- and macroeconomic indicators in order to ascertain whether integration has proceeded since the mid-1980s. Policy issues, which are more or less closely linked to the success of the internal market, are also addressed here.

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Cet article résume le contenu du programme du marché unique de la CE ainsi que les progrès accomplis dans sa mise en oeuvre. Il analyse les mécanismes qui devraient conduire à des gains de bien-être, et essaye de juger si l'intégration s'est poursuivie depuis le milieu des années 1980 à l'aide d' un grand nombre d'indicateurs micro- et macroéconomiques. Il discute aussi les grands dossiers de politique économique, qui sont plus ou moins liés au succès du marché intérieur.

Table of contents

Tables

Diagrams

THE EC'S INTERNAL MARKET: IMPLEMENTATION, ECONOMIC CONSEQUENCES, UNFINISHED BUSINESS

Peter Hoeller and Marie-Odile Louppe[1]

Introduction

The Treaty of Rome laid down the goal of creating a common market in 1958, and integration proceeded quickly until the early 1970s. However, the momentum towards further integration was subsequently lost and macroeconomic performance deteriorated. As a reaction, the internal market initiative aimed at boosting growth prospects by removing remaining fiscal and quantitative barriers to trade and market access restrictions, and by lowering border and administrative costs. The EC's internal market programme is the world's most ambitious regional integration scheme, as it has carried integration well beyond mere trade preferences for goods, by also encouraging trade in services as well as labour and capital mobility. The EC's legislative programme, implementation at the Member country level and the EC's medium-term programme towards ensuring that the internal market becomes a practical reality are reviewed in Sections I and II.

The renewed effort towards closer integration led participants to have high expectations. A vast research programme by the Commission concluded that such expectations were well founded, as did most independent assessments. Lower costs, stronger competition and a better exploitation of scale economies were all thought to contribute to substantial welfare gains. The mechanisms leading to welfare gains and results of quantitative research on the economics of "1992" are summarised in the first part of Section III. A much less well researched topic is tackled in the second part: has integration proceeded and what are the signs that gains have already materialised? While it is too early to provide any definitive judgement, a large number of micro- and macroeconomic indicators are reviewed to shed light on this question.

The internal market initiative has raised many policy issues which are more or less closely linked to its success. Competition policy and the liberalisation of still highly protected sectors are most prominent among them. Related to competition policy are issues concerning the desirability of further tax harmonization. The EC's programme not only aimed at realising the internal market, but stressed the need to foster economic and social cohesion. Regional policies at the EC level were significantly strengthened, and plans towards developing EC-wide social policies received new impetus. Finally, whether EC and non EC countries gain or lose from further EC integration is influenced by the EC's foreign trade policies. These policy issues are reviewed in Section IV. A last section summarises the paper's findings.

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I. The internal market programme: an overview

During the first ten years of its existence, the European Community took a major step to liberalise intra-Community trade by achieving the Customs Union[2] in 1968. Subsequently, the impetus towards effective implementation of the four freedoms as laid down in the Treaty of Rome lost momentum. A host of barriers to trade and personal mobility remained and even tended to increase. Europe's weakening competitiveness in certain sectors and rising unemployment from the mid-1970s strengthened awareness that the Community could gain from further market integration. In response, the Commission issued a White Paper in 1985 (EC, 1985), listing approximately 300 proposals for implementing the internal market. This programme was formalised in the Single Act, which was ratified in January 1987.

Trade theory distinguishes among different degrees of regional integration: free trade agreements, customs unions, common markets and economic unions. The internal (common) market is defined as "an area in which freedom of movement for goods, services, people and capital is guaranteed". It goes beyond a customs union in that it provides for the abolition of non-tariff barriers in all areas and not just in visibles trade and also provides for free factor movement. The single market is also much more ambitious than free trade agreements such as the European Free Trade Agreement (EFTA) and the North American Free Trade Agreement (NAFTA), which abolish tariffs and quotas between Member countries, but which allow each country to protect itself against non-member countries as it sees fit. Within the limits of the powers conferred by the treaties the EC also provides for EC-wide legislation, which is interpreted by a Court of Justice. Finally, EC policies already contain elements of an economic union, as harmonization of economic policies has advanced outside the single market agenda. Economic union will go a significant step further after the third stage of the European Monetary and Economic Union (EMU) is achieved.

The Single Act contained two additional important elements:

-- It set the Community a precise deadline, namely the introduction of an internal market with no national frontiers with effect from 1 January 1993.

-- It changed the decision-making process, especially in the case of the Council, whose decisions would henceforth be taken on a qualified majority basis for everything to do with freedom of movement and the completion of the internal market; tax questions still require unanimity.

The Commission considered that this programme of action would pose three major challenges and that accompanying policies needed to be strengthened:

-- First, competition policy should ensure a level-playing field for the business community.

-- Second, growth due to better resource allocation could be unevenly spread and result in undesirable regional imbalances. The Single Act therefore introduced the notion of "economic and social cohesion", made the narrowing of income gaps between regions an explicit objective and doubled the structural funds over five years.

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2. All customs duties and quantitative restrictions on trade in industrial products between the original six Member countries of the Community were lifted as of 1968. However, non-tariff trade policies were only unified recently.

-- Third, while the Community programme only refers to a limited number of social measures (such as developing the dialogue between social partners), a more comprehensive Social Charter complemented the Single Act in 1989. More recently, there was concern that increased competition could result in "social dumping", with progress on the social front being halted in the least-advanced countries and eroded in the wealthiest.

The single market agenda should be seen in a dynamic context. In the early days attention concentrated on establishing the common customs tariff. That task achieved in the late 1960s, the agenda turned to indirect taxation. After initial progress, momentum towards harmonization in this area was lost in the mid-1970s. The slow growth phase after the first oil price shock brought additional problems. Originally it was assumed that non-tariff barriers were of limited importance as compared with duties. But they tended to multiply as each Member State attempted to protect its industries not only against third countries but also against fellow Member countries. National industries were also increasingly protected by public funds to aid and maintain non-viable companies. In addition, the EC Treaty provision that restrictions to the provision of services should be progressively abolished during a transition phase was only partially implemented and over important areas not at all.

During the early 1980s, the case for moving ahead with the completion of the internal market became accepted by the governments of the Member States. The legislative agenda to establish the four freedoms is now largely complete. However, part of the reforms have to be brought to their conclusion and current arrangements can be improved. In addition, the adoption of Community-level legislation alone does not lead to the establishment of the internal market. It also involves changes in the legal structure and administrative practices at the national level, changes in attitudes and behaviour of market participants and the further development of flanking policies at the Community and Member State level. In many respects, the 1st January 1993 represented the beginning, rather than the end, of this process.

II. Completing the internal market

The 1985 White Paper programme embodied 282 proposals which aim at doing away with the most onerous obstacles to trade and mobility, such as remaining fiscal and quantitative barriers to trade and market access restrictions. They were drafted by the Commission in the form of regulations, directives, and decisions, which were then approved by the Council (see Box). Between the adoption of the Single European Act in 1987 and April 1994, the Council took action on 95 per cent of the 1985 White Paper programme (266 final adoptions and 1 joint position). By April 1994, 86 per cent of the total number of pieces of national legislation required as a result of Council measures had been taken by Member States. However, only about half of the EC legal acts had been incorporated in the domestic legislation of all twelve Member countries[3] (Diagram 1). According to the Commission, delays in transposition into national legislation have been particularly noteworthy in the areas of public procurement, insurance and company law, and intellectual and industrial property. The Commission has recently published the first annual report concerning internal market issues, which covers the agenda in a comprehensive way (EC, 1994a). It is a response to a request first formulated in the Sutherland Report on the "Internal Market after 1992, Meeting the Challenge". This annual report is intended to be a means of assessing to what extent the Community has achieved its objectives and of identifying priorities for future action.

Free movement of goods

The Treaty of Rome envisaged the creation of a single integrated market from the outset, which would be free of restrictions on the movement of goods. After the establishment of the common customs tariff, momentum was lost partly due to the multiplication of non-tariff barriers in the wake of the first oil price shock. Physical controls of goods at Member States' borders remained due to the disparity of technical rules across EC countries and differences in national regulations aimed at protecting the general well-being (for instance, health or environmental regulations). Furthermore, obstacles to the free movement of goods stemmed also from differences in transaction taxes (VAT and excise duties).

Once the ultimate goal of free circulation is achieved, any product meeting legitimate national objectives in an appropriate and satisfactory way may be sold in another Member State under the same label without further modification, testing or certification. Ways of removing technical obstacles include either setting EC-wide rules or mutual recognition of national rules, or a combination of both. The principle of mutual recognition means that Member States, when drawing up commercial rules, may not adopt an exclusively national outlook (EC, 1994a). It applies to standards for about three-quarters of intra-Community traded goods. Mutual recognition also implies that a Member State may not prohibit the sale of a product distributed in another EC country, even though it does not comply with technical or qualitative standards prevailing in the country where it is sold. The burden of proof in legal disputes lies with the authorities, and disputes are resolved by the EC's Court of Justice or by reaching consensus on redefining existing standards. In 1991, of the more than 1 500 cases involving technical barriers handled

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3. Timely implementation of EC laws is facilitated in Member States that develop early a broad consensus by soliciting views of ministries, Parliament and the private sector during the legislative process in Brussels (USITC, 1994). Delays usually occur due to lack of administrative resources and the complexity of legislative processes in some Member countries.

by the Commission, several hundreds were reported to have been resolved by applying the principle of mutual recognition (EC, 1992a).

If mutual recognition does not apply, national rules are harmonized. This is largely the case if national requirements, for instance for health and safety, are seen to be very important and diverge markedly. "Old approach" harmonization, defines technical specifications precisely, rather than setting essential requirements. In general, however, the Community aims at "minimal" harmonization, which confines EC legislation to laying down essential requirements, such as health, safety and environmental objectives, and on the drawing up of harmonized standards by the European standards bodies ("new approach"). The new approach will be the preferred approach in future harmonization legislation and used where possible.

"New approach" directives allow manufacturers to retain flexibility in choosing technical means, but conformity with the technical requirements has to be demonstrated. In practice, the national standardisation bodies often formulate technical specifications, which are developed in the context of the European standard-making bodies (such as the Comité Européen de Normalisation Electrotechnique (CENELEC) and the Comité Européen de Normalisation (CEN)) and then transposed into national standards. Such standards are voluntary.

Major examples of the progress made in harmonizing technical specifications are discussed in Annex 2. For CEN, 1200 standards had been ratified by 1993 (400 during 1993, compared with 200 during 1992 and about 20 during 1985), 2000 were being finalised and 7000 were in the course of production and, of the approximately 3500 standards covered by CENELEC, only 1400 were in place in 1993[4], and fewer than 600 in 1987. Conformity with many international norms of the International Organisation for Standardization (ISO) and the International Electrotechnical Commission (IEC) favours international trade.

Progress on technical harmonization tends to be jeopardised by the emergence of new barriers to trade in the form of new national legislation (EC, 1993a). Furthermore, technical progress leads to the need to continuously modify or introduce new standards. In order to extend and define more precisely the scope of the obligation for Member States, introduced in 1984, to notify information on draft measures in the field of technical standards, the Council modified the notification procedure in 1988 and 1994. In the obligation to notify, for instance, the definition of *de facto* technical regulations would also include other requirements imposed on the product after it has been marketed, as well as voluntary agreements, tax incentives and financial measures. Action has also been taken to bring about convergence in testing and certification procedures. Specific action includes, for instance, the setting up of the European Agency for the Evaluation of Medical Products which will, however, not be operational before 1995. Decisions are still pending on pricing and other measures designed to ensure a level playing field in the pharmaceuticals market.

On the other hand, the lifting of border checks has progressed very rapidly since 1991. Controls on transport vehicles were abolished in March 1991, and transit arrangements between Member countries were terminated. Veterinary checks at frontiers between Member States were discontinued in January 1993. Similar controls for plant health were dismantled in June 1993 and a "plant-health passport" was introduced. With the abolition of the "single administrative document" in January 1993, no document has to be shown at frontiers between Member States. However, for certain categories of goods, customs checks have been replaced by in-land controls, common to imported and domestically-produced goods.

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4. This delay is in part attributable to the need to bring standards from a number of differing systems into line. Furthermore, lengthy discussions are needed to lead to converging technologies, leading to higher cost of establishing a European standard than a domestic standard (in France, for example, the Association française de normalisation (AFNOR) calculates that a European standard costs between FF 3 and FF 5 million, as against FF 1 million for a domestic standard). The higher overall costs are, however, shared by all the Member States.

The legal basis of the single market initiative

Legal acts are nearly exclusively proposed by the Commission. They are generally adopted by the Council, with a qualified majority. Regulations, directives and decisions are formally and substantially distinct:

-- A directive may be addressed to one or more Member States. It is binding as to the result it is intended to achieve. Each Member State is free to choose the form and method of implementing a directive. Directives generally produce a high level of uniformity in laws across Community jurisdictions.

-- A regulation has general application throughout the Community, it is binding in its entirety and directly applicable in all Member States.

-- Decisions are binding in their entirety for the party or parties to whom they are addressed, and are directly applicable. They may be addressed to private parties as well as Member States.

The criteria for adoption of a particular legal instrument are not specified. However, since the harmonization of provisions of national laws is, in many areas, the objective of the White Paper programme, directives are de facto the most usual instrument to set up the legal framework for the internal market (Eskey, 1994).

The Treaty of Rome did not specifically address the priority between community and national law in the event of a conflict, nor did it specify the conditions under which the provisions of EC law would give an individual rights before national courts. However, the EC Court of Justice developed two essential doctrines concerning the effect of community law. The first is the principle of supremacy of community law, which holds that all provisions of community law must be given priority over all conflicting provisions of national law, largely in order to preserve uniformity in community law. For example, national courts should refuse to apply national measures which conflict with community law. However, they might disregard provisions of an EC directive which is not yet implemented in national law. In such a case, individuals may, subject to various conditions, appeal to the EC Court. The Court then states that effective and speedy implementation measures should be adopted. Breach of this obligation may give rise to remedies against defaulting Member States, including actions for damages resulting from the breach[5] and the Commission may make a proposal to the Court as to the sanctions to be applied to a Member State breaching its obligations.

5. In the joined cases of Francovich and Bonifaci versus Italy, the basis for the development of such jurisprudence, the Italian government failed to implement provisions of a directive (council directive EEC, no. 80/987) designed to provide a minimum level of protection of wages owed employees when their employers become insolvent. The EC Court (November 1991) concluded that a Member State is required to make good for damages suffered by individuals as a result of violations of Community law.

Substantial progress has been achieved in adopting directives for the public procurement sectors[6]. Public procurement accounts for some 15 per cent of Community GDP (of which 9 per cent for general government and the rest for public enterprises). These directives aim at harmonizing tendering procedures and appeal systems in Member countries, and at making these procedures more fair and transparent. The EC Council has adopted all of the seven relevant directives. Public works and supply contracts by public administrations have been opened up to non-national bidders and, to a lesser extent, to non-EC countries. The publication for tenders in excess of ECU 5 million for public works (building and civil engineering) and ECU 200 000 for supplies have been made compulsory, and, should rules be infringed, a number of directives make legal remedies available to tenderers. With regard to entities operating in the water, energy, transport and telecommunications sectors (previously called the "excluded" sectors), all measures have been adopted by the Council. However, major derogations have been obtained by Greece, Portugal and Spain for the utilities sector and bids for supply contracts may be rejected if more than 50 per cent of the value comes from non-EC countries which are not party to market access agreements with the EC or non-EC Member State concerned. If retained, such bids are subject to a 3 per cent price preference. While the EC's legal programme is complete, some directives are only partially in force, and full compliance with their requirements has not yet been achieved. There is little quantitative evidence to show whether public procurement sectors have opened up to competition, as the information systems provided for in the directives have been installed only recently.

The internal market programme also involved harmonization of taxes on goods and services (VAT and excise duties). This was to avoid large-scale shifts in shopping patterns to low-tax countries and tax-base erosion due to tax competition. A series of directives were adopted between end-1991 and end-1992, which, as regards VAT, leaves the destination principle intact for the business sector (taxes are levied where the good is consumed), but moves to the origin principle for individuals (taxes are levied where the good is bought). As a result of harmonization, the increased VAT rate was abolished (but still exists in Portugal), the standard rate must be equal to or greater than 15 per cent, and one or two reduced rates are allowed, which must be equal to or greater than 5 per cent (Table 1). In addition, Member States can maintain super-reduced rates (1 to 4 per cent) and zero rates on products subject to those rates before 1991. Decisions were also taken on minimum levels for excise duties. However, their dispersion remains very large, even after this first attempt towards harmonization. There are a few major exceptions to the current scheme. In order to avoid too much fiscal competition, there are special schemes for the purchase of new vehicles and distance sales[7]. As a consequence of the change in the tax regime, border tax and customs formalities have been replaced by a quarterly statement indicating aggregate sales to traders in non-EC States.

A definitive VAT system, aiming at the full application of the origin principle, will be established by 1997 at the earliest, requiring an unanimous vote in the Council on the basis of a report and proposals to be prepared by the Commission. The structure of the definitive system will depend largely on the extent to which rates are harmonized by then (in early 1993, the standard rates ranged from 15 to 25 per cent). It will also depend on how successful (in keeping fraud and administrative cost low) the transitional period has been, which is directly linked to a smooth co-operation between the different tax authorities. The

6. Although they also concern service inputs, procurement contracts are dealt with here under the heading of goods. These directives do not aim at liberalising outputs of the public utility sector. Attempts towards their liberalisation are a later development and discussed in Section IV.

7. For sales of new vehicles to individuals, the principle of payment in the country of destination is kept. For distance sales, the origin system can be applied up to a ceiling (ECU 100 000 for most EC countries), but tax is paid in the country of destination for sales above that ceiling. Companies involved in distance selling tend to cap their sales to below the ceiling in order to simplify paper-work and limit transactions costs. These companies may have their distance sales taxed in the country of destination.

Commission has set up a computerised network with Member countries (VIES, VAT Information Exchange System), involving VAT identification numbers, new accounting software and electronic exchange of data. A number of problems arose in the first few months of 1993: delays in distributing VAT identification numbers to businesses, late recording of intra-EC trade statistics and confusion in the case of certain triangular transactions. These problems seem to have been largely resolved.

Free movement of people

The share of EC citizens living in other EC countries is relatively small, largely due to language and cultural differences (see below). The high degree of labour market segmentation also reflects the remaining barriers to the free movement of individuals. According to the 1985 White Paper, free movement of persons, which was established by the Treaty of Rome (1958) and further legislation in 1968, should enable every person to cross borders freely. In addition, and economically more significant, it grants the right to EC citizens to live and work in another Member State, without any discrimination. Mutual recognition of diplomas and qualifications, the lack of which had impeded labour mobility, has progressed for many professions, and has been followed by the adoption of two directives extending recognition to all regulated professions. However, mutual recognition of qualifications could still be improved, notably as regards the establishment of lawyers under their home-country professional titles. In the framework of the single market programme, a number of directives have extended the right of residence to students, retired persons and other members of the non-working population.

Although customs checks on individuals at internal borders were abolished from 1 January 1993, identity checks still exist. The Schengen Convention is an inter-governmental agreement and its provisions are not part of Community law. It stipulates systematic checks at external frontiers in exchange for freedom of movement within the Schengen area[8] and was signed in two steps (1985 and 1990) by 9 Member States. Although put in place by 7 Member countries it has not yet been applied as the Schengen Information system (SIS) is not operational[9].

A number of issues have not been resolved:

-- The Dublin Convention, which determines the State responsible for examining applications for asylum, has been ratified by seven Member countries (Denmark, France, Greece, Italy, Luxembourg, Portugal and the United Kingdom). The Council adopted a resolution concerning the harmonization of the right of asylum and related policies.

-- Nationals of third countries still have no right to move freely within the Community. Legislation on the right for non-EC citizens to travel within the EC will be put forward by the Commission in the next few months. The 1992 Agreement on a European Economic Area does, however, confer on nationals of the EFTA countries the same status as that of Community nationals[10].

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8. These countries are Belgium, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Portugal and Spain.

9. These are the Schengen countries, excluding Greece and Italy.

10. The EC/Maghreb, EC/Turkey and EC/ACP (African, Caribbean and Pacific States) Agreements extend the right to non-discrimination with regard to working conditions and wages. Under the 1991 European Agreements, Polish, Hungarian, Czech and Slovak nationals are, in addition, entitled, under certain conditions, to free provision of services within the Community.

In an attempt to solve these problems, the Commission adopted in 1993 a proposal for a Council Decision on a convention on controls of persons crossing the external borders of the EC. Furthermore, a proposal was adopted for a regulation to determine the third countries whose nationals must have a visa to enter the EC. Another proposal on a uniform visa model is under preparation.

Unrestricted provision of services

The programme for the completion of the internal market attaches particular importance to liberalising the provision of services as trade in this area was considerably lagging that in goods. First, measures have been taken for the mutual recognition of qualifications for many professions, for both employees and the self-employed (see above). Second, a series of sectoral measures have been introduced with the objective of removing restrictions in certain priority sectors: financial services, because of their close links with the liberalisation of capital movements, transport and communications.

In the banking sector, the Community has adopted legislation which is based on the principle of a single licence and with prudential control exercised solely by the Member country in which the bank has its head office. Mutual recognition of the approval given by Member States means that a bank authorised in one country can provide direct customer services in other Community countries. The measures concerning the monitoring and surveillance of large exposures of credit institutions were adopted in December 1992 and a common position on the proposal on the deposit guarantee schemes was passed in 1993. As regards securities, Community regulations governing undertakings for collective investment (UCITs) came into force in October 1989, and a directive on insider trading has been adopted. Two other directives were adopted in 1993, one on capital adequacy and the other on investment services.

Where insurance is concerned, the principles guiding services provision are the same (for instance, the single licence principle) but progress in implementation has been slower. The first insurance services to be freed covered industrial risks and, under some conditions, life contracts. They were followed by two directives adopted in 1992 covering all other risks, which will come into operation in 1994. A directive concerning pension funds is under preparation.

Among the service sectors, liberalisation of the transport sector, which was heavily regulated, has made most progress. The Council had adopted all the measures in the White Paper by October 1993. Three sets of air transport liberalisation measures, taken in 1987, 1990 and 1992, introduced greater flexibility with regard to tariffs, airline licensing and access to regular domestic routes for carriers, sharing of passenger transport capacity and implementation of the rules of competition. However, air cabotage (the right of an operator in one Member State to carry out a transport operation between two points in another Member State) is not due to be fully operational until April 1997.

Bilateral road transport quotas (concerning the number of trucks) were abolished on 1 January 1993. The definitive regime of cabotage in road transport of goods has recently been adopted, following an agreement on taxation issues (in particular VAT and road tolls). Cabotage is being phased in and full liberalisation should be achieved by July 1998. According to estimates of the European Conference of Ministers of Transport (ECMT), about 30 per cent of all truck journeys in Europe are still carried out by empty trucks. Passenger road transport by bus has been liberalised, but some areas, in particular where public service issues are involved, are not fully liberalised. Restrictions for Community ship owners, either by unilateral measures or bilateral cargo-sharing agreements, were removed by early 1993. Many Member States have not yet adopted a number of bilateral agreements and unilateral restrictions are still in place. A proposal to introduce maritime cabotage was adopted in December 1992. In the case of rail transport, which is usually run by national monopolies managing both the services and the infrastructure, introducing the principle of cabotage was impossible under the traditional railway structures. Separation of management of railway companies from the ownership of infrastructure, together with access to the latter for companies willing to offer railway services, might make cabotage possible in the future. Views on how to proceed with deregulation still differ widely among Member States.

Substantial progress has been made in the advanced technology sectors. In the audio-visual field, the "directive on the free supply of television programmes" ("television without frontiers") was implemented in October 1991. It harmonizes national rules on advertising, sponsorship, the right of reply and the protection of minors, and introduces measures to promote/protect European programmes. A common position has been adopted with regard to a directive on intellectual property and on satellite and cable broadcasting. In May 1992 the Council proposed a satellite broadcasting standard with a view to developing high definition television in Europe. For the time being, however, there is no European technical standard for equipment.

In telecommunications, two directives resulted in the opening up of terminal services (1988) and the supply of open networks (1990), on the basis of the principle of mutual recognition. Under the provisions of the latter directive, Member countries were obliged to abolish exclusive or special rights with regard to the provision of telecommunication services (other than voice telephony) and, in particular, packet or circuit-switched services. These reforms obliged the three traditional sectors (post office, telecommunications and postal banking services) to split up into separate enterprises. Regulatory and operating responsibilities were also separated. Concerning telephone services, competition has been opened up only for value-added services. The voice telephone monopoly, except for mobile telephones, is still allowed. However, in April 1993, the Commission recommended complete liberalisation of telephone services in the Community as from 1998.

Liberalisation of capital movements

A number of Member States had already abolished all exchange controls, and capital transactions directly necessary to the exercise of other freedoms were liberalised in the early 1960s. The complete liberalisation of capital movements was achieved rapidly after the adoption of the capital movements directive in 1988. Remaining restrictions, essentially on short-term operations, were removed by July 1990. Rapid progress was also made in those countries having transitional periods for the implementation of full liberalisation, with Ireland, Portugal and Spain achieving full liberalisation by end-1992 and Greece by May 1994.

Finalising and developing the internal market initiative

Most of the legal agenda has been passed -- Stage I of the internal market initiative -- but several legislative proposals from the 1985 White Paper are still awaiting approval by the Council. While some progress has been made in framing company law, no agreement has been reached on a European Company statute, so that mobility of companies within the internal market is still hampered. Concerning intellectual property, decisions on the legal protection of inventions in several areas are still outstanding. Also legislation for indirect taxation and a small part of financial services is not yet complete. Finally, identity controls at internal borders have not yet been lifted.

Stage II of the single market programme has now started. During this stage remaining legislation needs to be adopted and Community laws adequately applied, and the efficient operation of the internal market ensured. The Commission has thus proposed a Strategic Programme: "Making the most of the Internal Market" focusing on the following major challenges (EC, 1993a):

-- Conformity and transparency in the transposition of Community directives into national law need to be assured. While this appears straightforward at first sight, it is in fact demanding and complex because i) directives allow flexibility in enacting "transposition" measures,

ii) legislative techniques differ across countries, iii) the subject matter often has great technical complexity, iv) Community legislation is sometimes voluminous, v) many national laws may have to be changed, even if directives are short, and vi) new Member States will increase the workload.

-- Community law needs to be enforced in an effective and even-handed way. As enforcement falls within the competence of Member States, consumers, for instance, need to be confident in the enforcement of animal and plant health control and, in case of a problem, a quick community-wide response is often needed. Co-operation between administrations, which already exists in many areas, is vital in this respect and will be expanded.

-- Legal access needs to be improved. In order for businesses and individuals to be able to enforce their rights and seek redress where the former are infringed, the Commission attaches considerable importance to the area of access to justice and judicial co-operation. Planned information and training programmes are designed to enhance the ability of national courts and legal professions to apply Community law.

-- The erection of new barriers needs to be prevented. National legislation could hamper the free circulation of goods, persons, services and capital. In order to minimise such a risk, procedures have already been put in place which require notification of legislation or standards which could have implications for the free movement of goods. The coverage of these procedures has recently been extended, and the Commission considers currently whether similar procedures may be needed in some service sectors. It also made a proposal for exchanging information in cases where Member States refuse to accept goods coming from another Member country.

-- Evaluation of the internal market legislation will be stepped up. It will partly concern physical impacts, for instance, in the animal and plant health areas. But the importance of economic evaluation will also increase: costing of legislative alternatives and cost-benefit analysis will be used more often in order to determine the most cost-effective way of harmonization and to ensure balance between regulatory intensity and economic benefits.

III. The economics of the single market initiative

The economics of "1992" have been researched intensively, an important contribution being the Commission's own work on the "Costs of non-Europe" -- the so-called Cecchini-Report -- (Cecchini, 1988, Emerson *et al.*, 1988), which pointed to EC-wide economic gains of 3 to 7 per cent of GDP. In addition, the EC provided follow-up reports (EC, 1990a and EC, 1993c), which were complemented by the CEPR's work programme on the European internal market and resulted in numerous Working Papers and conference volumes (Winters and Venables, 1990, and Winters, 1992).

The welfare effects of freer trade

Studies on the cost of non-Europe have focused on the following welfare-enhancing mechanisms of freer intra-EC trade:

-- the initial reduction in costs due to the dismantling of trade barriers and customs formalities;

-- lower costs due to economies of scale and learning;

-- reductions in price/cost margins due to stronger competition; and,

-- welfare gains due to non-price effects, such as enhanced innovation, a wider product range or organisational changes[11].

The Cecchini Report provided partial estimates (by type of barrier and industry) for these effects, as well as macroeconomic model evaluations based on data for seven Member countries; and two issues of the publication *European Economy* (EC, 1990a and EC, 1993c) were devoted to the assessment of sectoral and national effects for all Member States. The major findings are summarised briefly in the following paragraphs.

In the Cecchini Report, the initial reduction in cost due to the dismantling of customs procedures was estimated to amount to just under 2 per cent of the value of goods traded. This is only a fraction of the cost reduction due to tariff cuts during the 1960s, the reductions in terms of tariff equivalents ranging between 16.1 and 6.8 per cent for France and Germany, respectively (Flam, 1992). Potential cost reductions almost treble, if technical barriers, public procurement and the abolition of fiscal frontiers are included. Cost reductions from all these sources could amount to about 2 per cent of companies' total costs, even though this might be an underestimate as identification of such barriers is difficult. An estimated 100 000 technical standards, for instance, existed in the Community prior to the single market initiative.

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11. The basic studies for the Commission's assessment varied according to the area analyzed. The four large Member States were always included and in some cases also Belgium, Luxembourg and the Netherlands. Peripheral Member States (Denmark, Spain, Greece, Ireland and Portugal) were seldom included. As the less-advanced Member States were analysed rarely, increased exploitation of comparative advantage did not play a role in assessing overall welfare gains.

The expansion of output may entail gains from scale economies in the short run, if marginal costs are falling, and in the long run, if fixed costs can be reduced owing to a larger plant size. Potential gains from increased scale economies appear to be important in many European industries, especially transport equipment, chemicals, machinery and instrument manufacturing, and paper and printing (Pratten, 1987). The Cecchini Report concludes that about a third of industry could benefit from cost reductions varying from 1 to 7 per cent, yielding overall savings of 2 per cent of GDP. Given the mixed evidence on the existence of increasing returns to scale in services industries the Cecchini Report disregarded such gains in these sectors.

Removing barriers is likely to induce increased competition, causing prices to converge towards levels more consistent with economic and technical efficiency. The potential gains from increased competition can be gleaned from international price comparisons. According to Emerson *et al.* (1988) price dispersion for many equipment goods was already low in 1985, but was high for products mainly purchased by governments or public sector enterprises or for goods where sizeable differences in technical regulations or standards applied. In addition, price dispersion increased somewhat in sectors where non-tariff barriers applied between 1975 and 1985, while it fell considerably in sectors more open to competition. Differences in price dispersion can also be linked to the level of concentration in the different sectors, the correlation coefficient between price disparities and degrees of concentration being 0.82 (Emerson *et al*., 1988).

Emerson *et al*. (1988) calculated that leaving current quantities purchased unchanged, shopping at the lowest price in the Community would yield a potential gain of close to 8 per cent of GDP. If prices currently above the EC average converge towards the average, the gain would still amount to 2 per cent of GDP. While such a mechanical exercise is illustrative, modelling the effects of enhanced competition is complicated as current market structures differ widely across sectors and parameter estimates and the degree of remaining market power are inherently uncertain. The latter depends on the assumptions about exit and entry of firms, the degree of product differentiation and pricing strategies. Modelling the latter usually proceeds along the lines of two simple hypotheses: Cournot competition, where price-cost margins depend on market shares, or Bertrand competition, where price-cost margins only depend on the degree of product differentiation.

The precise assumptions adopted in such modelling exercises bear heavily on the results. Partial equilibrium simulation exercises by Smith and Venables (1987) for 10 industrial sectors using a variety of different assumptions come to a wide variation in quantitative results: for the same initial shock, welfare gains (including scale economies) could be anywhere between ½ and 4 per cent. The adjustments needed in order to achieve large gains are impressive in many sectors, and will often imply a large relocation of production among Member countries. Also the number of firms operating in a sector could be significantly affected. Similar results have been found in more recent studies, which use a general equilibrium framework (see, for instance, Burniaux and Waelbrook (1993) and Mercenier (1993)).

Table 2 summarises the Commission's assessment of the economic gains[12] from completing the internal market, based on an aggregation of partial equilibrium results. The direct costs of barriers were estimated to amount to 2.2 to 2.7 per cent of GDP, while indirect effects (scale economies and increased competition) could add another 2.1 to 3.7 per cent. The mid-estimate would give an income gain of $810 per-capita. Simulations using EC's Hermes and OECD's Interlink macroeconomic models corroborate

12. The different studies reviewed in this paper use different concepts to measure gains from integration: the best one would be some concept of economic welfare, such as the Hicksian equivalent variation. It can only be provided by simulations with general equilibrium models and measures the change in income that a consumer would need after a policy change in order to restore its earlier welfare level. Partial equilibrium analysis, on the other hand, usually provides measures summarising changes in consumer and producer surpluses, while macroeconomic models can give results only for production-side measures such as GDP.

the orders of magnitude, with overall gains of 3.2 to 7.5 per cent of GDP, depending on policy assumptions (Catinat *et al.*, 1988). The simulations are based on initial reductions in import prices due to lower costs of border controls, lower prices for public procurement and financial market services, and efficiency gains from the exploitation of scale economies (Table 3). The macroeconomic models also predict a 4 to 6 per cent fall in prices and a gain of between 2 and 5 million jobs[13].

More recent research sponsored by the Commission (EC, 1990a and EC, 1993c), focused on 40 industrial sectors and a number of service sectors. Though falling short of producing any aggregate numbers for output or employment, these studies attempted to assess changes in the growth potential of different sectors and locational changes across countries. The 40 industrial sectors selected are those where the impact of the internal market was expected to be strongest, e.g. where non-tariff barriers and public procurement play an important role. Sectors were identified by using several indicators: the level of non-tariff barriers, the level of penetration of intra-Community trade, the price dispersion between Member States and the potential for scale economies (Table 4). In order to highlight weaknesses and strengths of different industries in Member countries, levels and changes of intra- and extra-Community coverage ratios[14] and an export and production specialisation index were calculated (Buigues *et al.*, 1990). Relating employment to the ranking of industries, Germany and Italy appeared particularly well-placed to take advantage of freer trade, while Greece seemed at a disadvantage. This study also points to the need for considerable industrial restructuring. For the most industrialised Member States, this would largely imply intra-sectoral adjustment, as specialisation is already very high. For the least developed countries, adjustment scenarios have focused on the possibility of specialisation on labour-intensive products or increased intra-industry specialisation. In practice, some combination of the two is the most likely outcome and development patterns among countries like Greece and Spain have indeed diverged.

Focusing on a broad range of private service sectors Buigues and Sapir (1993) and Buigues (1993) identify three groups of countries: those having opened many service sectors to a high degree of competition (the Netherlands and the United Kingdom) and which are at the frontier of introducing most advanced technologies and marketing techniques, an intermediate group (Belgium, France and Germany) and a lagging group (the Southern Members), where services remain fairly closed and new practices have been diffused only slowly[15]. The Southern Members would face the greatest need to restructure, but may also benefit most from strong demand growth. Gains in the Northern countries should be limited, especially in those countries where service sectors are already very efficient.

Regional aspects are also important, as the benefits of the single market programme may be unevenly distributed. Even a loss for some countries cannot be ruled out *a priori*. However, the work by the Commission and virtually all other studies predict welfare gains for all EC Member countries (see Ohly (1993) for a survey of results). As with the sectoral studies, the size of gains across Member countries

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13. As with the single market, the Commission (EC, 1990b) has attempted to evaluate further efficiency gains emanating from the introduction of a single currency. The Commission expects that the elimination of exchange rate related conversion costs, reduction in transaction costs and reduced uncertainty about exchange rate variability could yield an overall gain of about ½ per cent of EC GDP. There is, however, considerable controversy about the potential cost to individual countries of losing the exchange rate adjustment mechanism as a response to asymmetric shocks (Englander and Egebo, 1993).

14. Ranking of weak and strong sectors follows a score board approach. For instance, if exports covered imports by less than 90 per cent, a score of -1 was attributed, a 0 for a coverage between 90 and 110 per cent and a score of +1 for a coverage above 110 per cent. Indicator scores were summed over industries in order to arrive at an aggregate ranking.

15. Not all EC Member countries were included in the study.

strongly depends on modelling assumptions. There is, however, a tendency to predict larger gains for the smaller Southern countries, largely because they have greater scope for exploiting scale economies.

Recent studies (Ohly, 1993) have, by and large, confirmed the Commission's findings[16], and projected growth effects have usually been within the range estimated earlier by the Commission[17]. Notable exceptions are Baldwin (1992) and Harrison *et al.* (1994), who argued that growth effects could be much larger: the Commission's estimates show once-and-for-all increases in output spread over several years, even though permanent growth-enhancing effects due to the promotion of technical progress and diffusion of innovation are acknowledged. An additional source of growth may come from an increase in the productivity of capital, which, by inducing higher savings, should lead to a higher capital stock. Baldwin and Harrison *et al.* find that such a secondary effect could almost double static welfare gains.

The reduction in trade costs within the Community will shift demand from outside to intra-Community suppliers. The Cecchini Report contained little material on external effects due to the completion of the single market. Partial equilibrium analysis suggested that extra-EC imports might fall between 2 and 8 per cent due to the removal of intra-EC barriers. However, these calculations were based on EC-wide output increases which are only a fraction of the overall effects quoted above. Stronger intra-EC income increases would spill over into stronger extra-EC demand. Also terms-of-trade changes are likely to be of minor importance (Gasiorek *et al.*, 1992 and Mercenier, 1992). At the least, the modelling exercises suggest that trade diversion and creation effects of the single market would roughly balance for non-EC countries.

Given the uncertainties about the pace of implementation, the Commission's work has also focused little on transition issues. Some aspects seem important, but difficult to quantify:

-- Gains from the internal market initiative may materialise more slowly as compared to earlier integration efforts, as it involves learning-by-doing (as with adjustment to new standards and markets), a massive amount of restructuring (which may imply up-front costs) and the political will to enforce competitive pressure, which might be difficult to muster quickly.

-- Cyclical problems of adaptation must be overcome. The shift in the aggregate supply schedule needs to be accompanied by increased demand (Dornbusch, 1989). In the Commission's modelling work this happens partly through an easing in macroeconomic policies, which are allowed to exploit an improved inflation-output trade-off. In this respect, recessionary forces in recent years could have meant that gains have only materialised slowly.

-- In order to reap the gains from the single market programme in the medium-term there must be a smooth adjustment in the use of factors of production. Unfortunately, labour market performance in Europe points to problems in this respect. While labour markets in EC Member countries are likely to have become more flexible over the last decade, they still appear to remain rather rigid in terms of labour standards, wage flexibility and mobility as

16. However, macroeconomic simulation exercises often did not produce employment gains, but pointed to stronger productivity growth.

17. There was no lack of initial criticism of the Commission's work concerning methodology or the estimated size of the gains, which were thought to be on the high side (see, for instance, Grossman (1990) and the contributions to the Brookings Panel's "Symposium on Europe 1992" (BPEA, 1989)).

compared to the United States and Japan[18]. Relatively rigid labour markets are likely to delay the structural adjustment following freer trade and will not provide for a smooth reallocation of resources. Part or all of the efficiency gains may be lost due to higher unemployment during a lengthy adjustment period (Burniaux and Walbroeck, 1993). The interaction between labour market policies and the single market initiative are discussed further below.

Are there already signs of enhanced market integration?

Virtually all estimates of the gains from achieving the internal market were very promising. It is, however, difficult to provide an ex-post quantitative assessment of the effects of the single market programme:

-- The programme has not yet been fully implemented and some measures have only been taken recently.

-- Apart from the legal changes, behavioural adaptation, the penetration of new markets and restructuring will take time.

-- It is almost impossible to construct an unbiased baseline scenario, excluding the effects of the internal market on economic developments. In addition, there is no agreed method to disentangle trend and cycle, and economists are often less able to understand trend changes than cyclical developments.

-- Aggregate welfare changes are difficult to measure in an unambiguous way[19].

-- Several factors, which are difficult to isolate, affect trend developments. European integration, for instance, was not only boosted by the single market programme but also by the accession of Spain and Portugal and by the unification of Germany. In addition, variables such as output, prices, employment and trade were also affected by other developments, such as the fall in oil prices in the mid-1980s, the further easing of monetary policy after the 1987 stock-market crash and changes in microeconomic policies at the Member country level. Countries were affected by these developments to varying degrees.

While economists are firm believers in the realisation of gains from integration, public expectations have changed drastically from optimism in the years of strong growth during the late 1980s to the pessimistic mood of the recent recession. For instance, the Eurobarometer's question about hopes and fears concerning the single European market yielded net positive answers of 43 per cent in mid-1988, the number falling to only 17 per cent by mid-1993 (EC, 1993d). Similarly, while the business community was rather enthusiastic about the single market programme early on, recent surveys concerning the perceived overall gains show a vast majority seeing no or only minor effects (*Financial Times*, 24 February, 1994). Recent assessments are likely to be coloured by weak activity, and answers concerning the effects of internal market provisions on their own activity were generally more positive.

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18. On the other hand, the process of integration should improve wage flexibility by reducing insider power.

19. Peace in Europe, for instance, is often seen as a major benefit of European integration.

Microeconomic evidence

Sectoral evidence

International price comparisons can shed some light on the progress achieved in reducing trade barriers and harmonizing indirect taxation. While the extent of price convergence depends on the characteristics of goods and services considered, such as tradeability and homogeneity[20], the Commission's assessment of the economics of 1992 pointed to high levels of price dispersion, which it was thought would fall considerably due to the single market programme. Coefficients of variation for broad groups of goods and services point to a high level of price dispersion for the EC-12, which came down somewhat between 1985 and 1990 (Table 5). For the EC-9[21], on the other hand, little has changed since 1985, but initial price dispersions were already much lower than for the EC-12. Even though much lower initially, price dispersions for the EC-9 have remained high for a broad range of goods. However, virtually no effect of the internal market initiative should have been expected by 1990.

Correlation coefficients across about 130 tradeable goods[22] among country pairs, the so-called similarity indices, provide further evidence on the level of integration and its changes between 1985 and 1990 (Table 6). For 1985, these correlation coefficients (the upper triangle) are high among the rich EC Member countries and usually even higher for neighbouring countries. The latter is also true for the United States and Canada and to a lesser extent for the Nordic countries. Changes in the correlation coefficient between 1985 and 1990 (shown in the lower triangle) show a mixed pattern for the richer EC Members. Clear signs of a convergence in price structures are visible for Greece, Portugal and Spain, however. Integration effects are most visible for the countries which have acceded most recently.

International price comparisons have their limitations, especially if comparisons are made between two points in time. Another limitation in this particular case is that price data include VAT and excise duties and that the latest available are in 1990[23]. Clearly little impact of the internal market would have been felt by 1990 and VAT rates had converged little. A similar problem of data availability arises if other sectoral characteristics are analyzed on an internationally comparable basis[24]. In a recent study of the textile, clothing and footwear sectors, Flochel (1993) can only provide data up to 1990 (except for trade data). He argues that restructuring of these sectors is underway, but largely due to changes in international competitiveness and the EC's foreign trade regime. Import unit values, for instance, have shown a tendency to converge. Consumers of these goods should still benefit from the single market in the future, as the tendency towards convergence for consumer prices was much less evident.

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20. Even in well-integrated markets price differences will remain substantial for goods and services which are not easily traded and for which variations in taste matter. In addition, transport, arbitrage or relocation cost influence regional price differences.

21. The EC-9 group of countries excludes Greece, Portugal and Spain.

22. Defined as food, consumer durables and machinery and equipment products. Similarity indices for all 200 goods in the international price comparisons project are usually lower than those for tradeables, especially for the poorer EC Members.

23. This is the publication date, data having been gathered earlier. A quarterly survey of car prices by the Commission, however, suggests that price dispersion remained very high until recently.

24. For the same reasons the Commission's research on service sector integration (EC, 1993c) contained little quantitative analysis of the impact of the single market programme.

Factor mobility

Cross-border residence of EC and non-EC nationals is very low as evidenced by the shares of EC and non-EC nationals in the EC population : in 1991, the former was only 1.4 per cent, mainly from Italy, Portugal and Spain, and the latter 2.8 per cent, mainly from Turkey. Three-quarters of non-nationals -- other Community residents and non-EC nationals -- were resident in France, Germany and the United Kingdom. Migration flows across Europe were considerably stronger in the 1960s, before major Member countries, particularly France and Germany, drastically tightened their immigration rules in the early 1970s. Net migration in EC countries resumed in 1985 and accelerated with the unification of Germany. In 1988-90, some 1¾ million Ethnic Germans immigrated to Germany from East Germany and Eastern Europe[25]. In 1991, net migratory flows to the EC were positive to the tune of almost 1 million people, 0.6 million of whom went to Germany (Diagram 2).

While the cross-border flow of people has remained very low, capital flows have surged. Foreign direct investment (FDI), for instance, has grown much faster than GDP and trade. Such a rapid increase since the mid-1980s has largely reflected the globalization strategies of multinational companies and has been facilitated by the deregulation of financial markets and more liberal global policies on foreign direct investment. Although remaining by far the leading investor in terms of the stock of foreign-held capital, the United States was overtaken in the second half of the 1980s by the United Kingdom as the largest direct investor in the EC in terms of flows (Diagram 3 and Table 7)[26]. The EC as a whole is the largest source and recipient of FDI. It has remained a net investor abroad (excluding intra-EC flows), but the margin has narrowed since 1987. Inward FDI has grown steadily over the last decades, with marked increases associated with market enlargement and market deepening, notably the single market programme. As a result, inward investment grew rapidly, notably from Japan as of 1988, investment being concentrated in the United Kingdom and the Netherlands. Since the mid-1980s, major recipients of FDI (as a per cent of GDP) have been the United Kingdom, Belgium[27], Portugal, Spain and the Netherlands. The destination of extra-EC FDI has remained stable, with the United Kingdom taking the lion's share followed by France, Spain and Belgium-Luxembourg.

Major reasons for undertaking FDI are to be found in the need for a firm to accompany trade with services and marketing and to gain a competitive advantage, which is not available to actual or potential competitors and cannot be easily reaped by trade. Competitive advantage results from intangible assets such as knowledge, brand names or managerial capacities, that a firm prefers not to licence. The host country could also have a specific advantage, for example, in terms of infrastructure or low labour costs. In addition, since the mid-1980s firms have positioned themselves to take advantage of the single market programme[28]. However, trade-related investment measures may have also played a role for non-EC firms. Survey results (EC, 1993e) and regression analysis (Buigues and Jacquemin, 1994) suggest that such

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25. Movements of East-Germans into West Germany are not counted as international migratory flows from 1991 onwards, but are regarded as part of internal German migration. Migration of East Germans to West Germany amounted to 725 000 in 1989-90.

26. Since 1985, the United States, the United Kingdom and Japan have accounted on average for some 60 per cent of total outward investment.

27. The data for Belgium are likely to exaggerate the extent of actual foreign investment. Many multinational enterprises have their headquarters there, so that financial flows adjacent to direct investment are booked in Belgium, with the actual investment taking place elsewhere.

28. Thomsen and Nicolaides (1991), however, argue that only the timing of such investment has been affected, not its long-term level.

measures as voluntary export restraints and anti-dumping actions were an important consideration, at least for Japanese direct investment in the EC[29].

Mergers and acquisitions surged in tandem with foreign direct investment flows (Table 8). Transnational mergers and acquisitions, which became more important than large national ones by the end of the 1990s, are a strategic reaction to the internal market programme as they allow to reach new markets quickly. While they were still largely motivated by the desire to rationalise in the mid-1980s, expansion and a stronger international position became the principal motivation by the early 1990s. Between 1986 and 1992, British and, to a lesser extent, French enterprises were the most active buyers, while Spanish, Portuguese and German enterprises (partly reflecting the East German privatisation programme) were most often purchased. Mergers and acquisitions have led to a considerable rise in concentration ratios in some sectors (EC, 1994b). Such concentration ratios show that the share of the largest enterprises in a sector's value added has risen. Any impact on competition needed to be examined on a case by case basis.

Financial market integration has also proceeded swiftly in a number of Member States (Gual and Neven, 1993 and Bisignano, 1993). There was little to be expected in the financial markets of Germany, the Netherlands and the United Kingdom, which were already lightly regulated at the start of the 1980s. Overall performance, measured by several cost and efficiency indicators, which was already high, has changed little since then. Where restrictions were still severe, integration was driven by domestic deregulatory moves during the 1980s, partly in anticipation of the single market directives. Significant deregulation has occurred, for instance, in Belgium, France and Spain, and bank behaviour has changed considerably as a result: banks' margins have been reduced, productivity raised and labour costs better controlled. Italy appears to be an outlier in this respect. It had the most restrictive banking regulation in the early 1980s, and deregulation has proceeded only slowly. As a result, its financial market has remained relatively inefficient and closed.

Macroeconomic evidence

Judged by OECD data on potential output, growth performance of the EC since the mid-1980s has not strengthened, if compared to a longer historical period (Diagram 4). This feature is shared with most other countries. Growth has been higher if compared to developments since the mid-1970s. However, even this gain appears to remain within the margin of error of constructing such data and comparable gains were also recorded in other regions of the OECD. Similar conclusions can be drawn about productivity developments. Labour market performance has clearly remained disappointing (Diagram 5). Since 1985, overall employment growth has been positive in only three years and the unemployment rate has again moved above its earlier cyclical peak and is higher than in other OECD regions. These macroeconomic indicators do not provide evidence of any major structural break in macroeconomic time series due to the single market initiative.

"Eyeballing" macroeconomic variables in isolation can be informative, but leaves analysis of the forces affecting growth aside. Recent research attempting to disentangle different sources of output growth find that increased trade and trade integration have contributed to growth (Coe and Moghadam, 1993, and Italianer, 1994). In regressions explaining output growth, the studies show changes in the share of intra-EC in total EC trade has contributed 0.3 per cent to French and 0.4 per cent to EC-wide potential output growth, respectively, in recent years. Italianer (1994) does not find an integration effect, however, if integration effects are measured at the level of the EC-6. Both studies show that the contribution of European trade integration was stronger over the whole sample period than in recent years. Italianer (1994) also includes a measure of overall EC openness, which had some positive impact between 1961 and 1992, but did not provide an impetus to growth over 1987 to 1992. According to these exercises, the single

29. Buigues and Jacquemin (1994) do not find such an effect for US direct investment but a strong complementary effect between exports and FDI for both countries (EC, 1993e).

market is likely to have had only a small effect on growth so far, of the order of perhaps ¼ per cent per year or somewhat more than 1 per cent of aggregate output since 1987[30].

The single market initiative should have had a strong impact on trade flows. The extent of regionalisation is commonly measured by the share of intra-area trade in total trade. Trade integration was certainly an important factor in promoting a rapid increase in intra-EC trade. Between the late 1950s and the early 1990s, the share of intra-EC exports and imports in the respective EC totals (for all current 12 Members) rose considerably, from about 35 per cent to close to 60 per cent. The share of trade with the EFTA countries remained rather stable over this period, but that with other regions fell significantly. Trade shares with industrial countries (excluding EFTA members) declined up to the mid-1970s and have since remained roughly unchanged (Table 9). Since the mid-1980s, intra-EC-12 trade shares have risen further, by about 6 percentage points for both exports and imports (Table 10). Increases were spectacular for Greece, Portugal and Spain, where most of the ratios advanced by 10 to 20 percentage points. Clearly, accession to the EC has also played a role in fostering trade integration. On the other hand, shares of trade among the EC-6 and EC-9 have risen by less since the mid-1980s. Data spanning a longer time period suggest that integration has proceeded faster in recent years than over the 1970-85 period, but more slowly than in the early integration phase[31]. In most Member States, intra-industry trade specialisation has also advanced over recent years (Table 11).

Assessing OECD-wide trade implications is more difficult, but conclusions can still be drawn about the impact of the internal market on trade creation and diversion. Trade openness, as measured by the average of extra-EC nominal goods exports and imports as a per cent of GDP, was about 9 per cent in 1992, up from 7 per cent in the early 1960s (Diagram 6). The United States and Japan show currently somewhat lower trade shares in GDP, with the United States advancing faster from a low level. Since the mid-1980s, trade shares have shown a decline everywhere. However, while often used, such trade openness measures can give a misleading message. Between 1985 and 1993, volume imports of goods and services in the EC (non-consolidated), the United States and Japan, for instance, have risen considerably faster than GDP and extra-EC volume imports of goods have expanded at about the same rate as internal trade since the mid-1980s. Differences in relative developments of aggregate and goods import prices were clearly important, and results are different if energy and raw materials are excluded. Looking at shares of intra- and extra-EC imports in apparent consumption for an EC-9 aggregate, Sapir (1992) shows that both shares rose by about 2 percentage points between 1985 and 1991[32]. For the EC-9, trade creation has outweighed trade diversion, thus confirming that trade creation in the context of the EC integration process has remained important. The extent of trade diversion partly depends on foreign trade policies, a subject discussed further below.

Neo-classical theory predicts that trade integration will lead to a tendency towards convergence of relative prices, price levels and per-capita incomes. Evidence on convergence of the relevant variables is shown in Diagrams 7,8,9 and 10[33]. For countries such as Belgium, Denmark, France, Germany and the

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30. The estimates quoted above also include the integration effects from the accession of Spain and Portugal. They are therefore likely to be higher than estimates of the impact of the single market programme alone.

31. Changes in trade shares were also influenced by the oil price shocks and sharp swings in effective real exchange rates over the 1980s.

32. This is not true for processed agricultural goods, where some internal trade creation went hand in hand with external trade diversion.

33. Aggregate income and price level data are better measured than the data presented on compensation per employee in the business sector and productivity levels, as data on the

Netherlands, relevant macroeconomic variables were already closely aligned in the early 1970s. Other countries, such as Ireland, Portugal and Spain, made progress in catching-up. Greece is a notable exception and appears not to have benefited from the integration process so far. The evidence assembled in the diagrams points to some convergence overall, the convergence process being, however, rather slow. If Portugal, for instance, were to continue at the rates of catch-up achieved between 1986 and 1993 it would still take decades to reach the EC average income level[34].

Most studies predicted that the internal market programme would lead to a lower overall price level due to enhanced competition. Overall profit margins have, however, tended to rise substantially since the early 1980s. Despite the recessionary forces in recent years, they have remained surprisingly high in most EC Member countries (Diagram 11). There is evidence, on the other hand, that sectors having enjoyed rents have seen a fast erosion in margins following moves towards deregulation. This is the case, for instance, in the airline industry.

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self-employed and government employment are not standardized in some countries.

34. It would take a growth differential of 3 per cent per annum over 20 years for Portugal to converge from 50 per cent to 90 per cent of the average income level.

IV. Policy issues

The evidence gathered above points to some gains from the single market initiative. However, they would seem to be rather limited so far. It is important that policies conducive to reaping further, possibly substantial, gains be put in place at the EC and Member country level. Most important among these are many aspects of competition policy. A significant part of the predicted gains from the single market initiative stem from enhanced competitive pressure, and a strong competition policy will need to ensure that restrictive business practices remain a low risk. In addition, subsidies can distort decisions in the same way trade policy instruments do. Other policy areas might also influence or be influenced by further market integration. The Single Act, for instance, stressed the need to strengthen social and regional cohesion. Last but not least, foreign trade policy aspects are of great importance to non-EC countries.

Among the policy issues reviewed below some show a strong complementary to the internal market project and fall within the competence of EC institutions. Such policy areas are, for instance, competition policy or the further liberalisation of still highly protected sectors. Other policies are flanking the internal market initiative. Those concern mainly regional or social policies. The latter is largely within the remit of Member States, while regional policy objectives are pursued by the EC and to varying degrees by Member States. Finally, the single market initiative brought the need for changes in some policies, such as the harmonization of trade instruments (a competence of the Commission). Adaptation of other policies might become necessary, as with further corporate tax harmonization, which is a responsibility of Member countries.

Policies towards ensuring a level playing field

Competition policy

Under the Treaty of Rome, community competition rules apply to two broad areas, state intervention and enterprise conduct. These rules are to be applied when intervention or uncompetitive behaviour creates or threatens to create distortions to intra-EC trade, and they override individual country law.

Enterprise conduct

Restrictive agreements are generally prohibited (Art. 85 of the Treaty of Rome) insofar as they restrict trade between Member countries. The provisions cover horizontal agreements -- such as market sharing, quotas and price fixing --, vertical restraints -- such as exclusive marketing agreements and other discriminatory distribution systems -- and clauses related to intellectual and industrial property. However, some agreements may be declared compatible with the common market, insofar as they contribute "to improving the production of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit". In 1993, the Commission broadened the scope of certain "block exemption" regulations[35] relating to R&D promotion, the transfer of technology in Community industry and specialisation agreements and approved a notice concerning the assessment of cooperative joint

35. A well-known block exemption applies to exclusive car dealerships.

ventures in order to facilitate cooperation between companies. While steel and agriculture are exempted from the provisions related to restrictive agreements -- both are dealt with separately by specific legislation, the CECA and the CAP -- Art. 85 was extended recently, particularly to the sectors of transport, insurance and banking. The number of formal Commission decisions on restrictive agreements has gradually increased (Table 12). They have mainly concerned manufactured products. Most service-related decisions have been taken since 1985. Over the period 1988-92, when 77 substantive decisions were taken, the Commission rejected 11 complaints, imposed fines in 19 cases, granted exemptions in 29 and issued 5 negative clearances.

Under Article 86, abusive unilateral behaviour by dominant firms is prohibited. The main types of conduct leading to abuse of a dominant position include unfair trading conditions and restrictions to the prejudice of consumers. The existence of a dominant position is not prohibited, only its abuse. The assessment of a dominant position requires defining the relevant market and the notion of dominance. Very few formal decisions have been taken since 1971, most of them in the 1980s, with the first related to the service sector (British Telecom) made in 1982 (Table 12). These decisions related to Art. 85 and 86 represent a fraction of the Commission's work. In 1992, for instance, 27 decisions were made to be compared with 1 523 cases handled.

During the 1980s, the number of Community-wide mergers and acquisitions surged (see above). Concern about the danger of pan-European firms abusing dominant positions led to the adoption of the EC Merger Control regulation in 1989. The Commission controls mergers that have a Community dimension[36]. Mergers that lack a Community dimension are to remain within national jurisdiction. These jurisdiction provisions intend to achieve the "one-stop shop" -- a major policy objective in the Merger regulation -- meaning that a merger is considered either by the EC or national institutions and that enterprises know precisely where to address themselves. Should a merger fulfil the Community dimension provisions, the Commission must be automatically notified and is given one month to respond. The thresholds were reexamined in 1993 and the Member States decided to leave them unchanged. In 1990-93, the Commission published 65 decisions. Many decisions demanded notified mergers to be amended -- either to sell off part of the new group or to withdraw from particular markets where the new group would enjoy a dominant position, in order to maintain a competitive structure on the relevant markets. Only one decision led to a declaration of incompatibility, thus prohibiting the merger (Aérospatiale-Alenia/de Havilland).

The definition of the relevant geographical market is left to the Commission and has been evolving since 1990. Generally markets are larger in manufacturing than in services[37] (Sapir *et al*., 1993). As mergers in the service sectors are still largely between enterprises in the same Member country, they fall outside the scope of the EC merger regulation. As a result, the level of local competition varies widely in line with the different attitudes of Member countries (Neven *et al*., 1992). On the other hand, where national interest is recognised as being at stake (public security, plurality of the media and prudential rules), national authorities may review Community dimension mergers, but such a review must rest on grounds other than the potential impact of the merger on competition. Furthermore, the Commission can refer

36. The Commission only controls company mergers and acquisitions in the EC involving an aggregate world-wide turnover of no less than ECU 5 billion, and an aggregate EC-wide turnover of more than ECU 250 million for each of at least two companies concerned; in addition, less than two-thirds of the individual sales of each merging firm must be made within a single Member State.

37. In manufacturing, the relevant market is national or international as determining factors include cross-border trade, security of supplies and public purchases with national preferences. On the other hand, in the service sector, the relevant market is usually local, as regulatory, language and cultural and entry barriers are generally taken into account.

mergers of a Community dimension (Steetley/Tarmac) to the national authorities on the ground that the relevant markets and the implications of the transaction are confined to the territory of a Member State.

While a community-wide competition policy and internal trade liberalisation are likely to exert a significant disciplinary effect on price-cost margins, extra-EC competition could also help. Jacquemin and Sapir (1990), for instance, show the importance of extra-EC imports in constraining EC profit margins in a fashion that intra-EC imports apparently cannot. Their estimates suggest, that only extra-EC imports exert a significant disciplinary effect on price-cost margins, while intra-EC imports seem to exert no significant disciplinary effect. These results suggest that a combination of internal and external trade liberalisation is a superior strategy to internal liberalisation alone.

State aids

The internal market initiative requires *inter alia* free and undistorted competition. In the absence of a rationale for state aid, such as market failures, subsidies tend to prevent markets from working efficiently and to distort trade just as protectionist measures do. Indeed the founding fathers of the EC recognised that subsidies may distort trade and are in principle incompatible with the common market.

Subsidies which fall under Community policy are those that distort intra-EC competition. They are defined in detail by Community law and the decisions by the Commission and the Court of Justice. Member States have to notify the Commission of measures that could constitute a subsidy, with the Commission then deciding whether Community control applies, and whether a derogation should be granted. Notifications have risen considerably over the last decade, the Commission granting a derogation in about 80 per cent of all cases in recent years (Table 13). While some types of subsidy are easy to identify, others are not: these concern mainly the management of public enterprises and the drawing of dividing lines between subsidies and general measures (for instance, changes in corporate taxation). Derogations can be granted in the case of regional problems, for important projects of Community interest and the promotion of certain economic activities (for instance, favourable treatment of pollution control).

State aid has remained at an "alarming" level (EC, 1991) despite some decline in the ratio of subsidies to GDP (Diagram 12). Averaged over 1988-90, subsidies, as defined by the EC subsidy reports, amounted to 2 per cent of EC GDP, close to 4 per cent of government expenditure and nearly twice the Community budget[38]. Large differences in the degree of subsidisation have prevailed, the United Kingdom, Denmark and the Netherlands spending just 1 per cent of GDP, but Italy, Belgium and Greece close to 3 per cent. Subsidisation has remained considerably higher than in North America and Japan, though this may partly reflect improved transparency of state aids in the EC due to Community control procedures.

High levels of state aids have persisted in part because the basic principles have to some extent become blurred. However, recent measures have been taken to improve transparency and enforce discipline, such as the repayment of illegal subsidies. For many subsidy schemes to the agriculture, fishing, coal and the railway sectors, large amounts of state aids can be granted over which Community control is limited, and a higher degree of national subsidisation is allowed to the ever increasing part of the Community area

38. There are numerous problems in measuring state aids, which are described in more detail in Ford and Suyker (1990). The data for the EC include, for instance, housing subsidies. On the other hand, they do not include price support measures for agriculture or the effects of VERs. National Accounts data and the EC's state aids reports are likely to seriously underestimate the total amount of assistance. According to DIW (1992), for instance, the total amount of assistance to the business sector in Germany in 1988-90 on average is far above the Community figure.

defined as facing regional problems[39]. Certain sectors clearly benefit much more from national subsidies than others, partly reflecting the effect of other policy objectives, such as the strengthening of regional and social cohesion (Table 14).

Subsidies affect economic behaviour because of their impact on relative costs and prices. In the case of market failures such changes are welcome insofar as they improve welfare. In addition, subsidies may also be justified if they help ease the transition costs of structural adjustment. There is the suspicion, however, that many subsidies are either unjustified or in fact delay the necessary adjustment rather than speed it up. There are also pressures to provide subsidies to attract foreign investment. Only a few estimates exist for the macroeconomic costs of subsidisation, all showing that these costs may be of a considerable size. Weiss *et al.* (1988), for instance, estimate that dismantling all sorts of government aids to the business sector in Germany could raise welfare by 1 per cent of GDP.

Liberalising highly-regulated sectors

The internal market is still far from being a practical reality in sectors where national legislation grants monopolies or denies access to the market and, therefore, prevents competition. Liberalisation is to a large extent an obligation arising from the existing Treaties. The Treaties, however, also take account of the legitimate interest of Member States in guaranteeing the provision of certain public services. Entry restrictions are particularly severe in parts of the energy and telecommunication sector, rail transport and many postal services in a number of Member States. While the internal market programme had some effect on these sectors (for instance, standardization and public procurement rules), there are marked differences in Member countries' attitudes towards achieving a high degree of competition, as well as the desired level of public service obligations, and measures towards EC-wide liberalisation have been slow to advance. Liberalisation in the United Kingdom, for example, has advanced much faster than in most continental European countries.

Moves towards liberalisation in the field of electrical energy, gas and telecommunications are hampered by the fact that competition can apply only to the provision of services and/or goods, while electricity and telephone grids will have to remain regulated, as they are considered as "natural monopolies". However, both production and retail distribution of services have so far remained in the same monopolistic hands in most Member States. In the United Kingdom and a number of non-EC countries, liberalisation has been based on separating these two functions. While there is little impetus towards liberalisation in the energy field, the Council has endorsed the Commission's proposal to liberalise voice telephony by mid-1998. In addition, the Commission has advanced a new set of proposals to liberalise air transport further. Moves towards liberalising postal services have not gone beyond the stage of consultation.

Member countries view the further development of European-wide transport, energy and telecommunication networks as an important task that will complement the single market and the liberalisation of these sectors. Partly because of the existence of national monopolies, the networks have remained separate and compartmentalised and demand has suffered from the high prices of services. Intensifying European-wide co-operation is important so that current networks can be used more efficiently and co-ordination of future planning improved. The Commission will help to draw up master plans and provide guidelines to identify projects of common interest. Though the bulk of the financing of trans-European networks should be raised through private investors (especially in the telecommunications sector) or *via* public enterprises, the Commission will also provide financial support. ECU 5.3 billion per year are earmarked in the Communities' Budget between 1994-99, financed largely by the Structural Funds

39. Regional spending aims at promoting both an equitable and efficient competitive environment across the whole territory of the EC (see below).

and the Cohesion Fund. Subsidized credits and loan guarantees amounting to a possible total of ECU 20 billion (including the above-mentioned ECU 5.3 billion) might also be provided.

Tax distortions

Tax harmonization has proceeded with respect to VAT and excise taxes (see above). However, differences in the base or rate of other taxes could influence production, investment or employment decisions. The cross-country effects of tax distortions depend on the degree of market integration and factor mobility, both of which are likely to rise. In addition, tax competition could seriously erode the tax base of Member countries and lead to the under-provision of public goods. Market integration and mobility is clearly highest for financial capital, while harmonization of taxation of labour income or real assets should be the least urgent (Kopits, 1992 and Vanheukelen, 1993).

Apart from indirect taxes, harmonization has so far focused on the elimination of double taxation and other tax disadvantages on intra-EC investment income. Co-ordinated moves to harmonize corporate tax bases and rates have been limited. Proposals for harmonizing the corporate tax system at the EC level have been discussed since the mid-1970s, but were never adopted. In 1992, a committee of experts argued that total harmonization was not required at this stage, but a common system of corporate taxation was a beneficial long-term objective. Tax reforms during the 1980s have led nevertheless to lower rates and a broader tax base in many Member countries, and corporate tax systems have converged[40]. Given high capital mobility, problems with tax avoidance are particularly severe for the taxation of interest income. In 1989, the Commission proposed a common minimum withholding tax of 15 per cent. However, opposition by a few Member States and the fear of massive capital flights to tax heavens outside the EC have precluded any agreement so far.

Policies being affected by enhanced market integration

Regional aspects and policies

As noted above, income disparities across EC countries at the national level are fairly small among the richer Members but have remained considerable against the other countries, the rate of catch-up of poorer areas being slow. Per-capita GDP differences at the European State level are about double those in the nine United States census regions. Disaggregating further shows that income levels in the 10 and 25 weakest EC regions have remained close to 50 and 40 per cent, respectively, below the EC average over the 1980s, while the strongest regions showed some tendency to move further above the average[41].

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40. Outliers are Germany on the high side and Ireland on the low side. It is very difficult to judge the impact of remaining differences on locational decisions, as tax wedges depend on the type of investment, mode of financing, the rate of inflation, the depreciation regime, loss-carry forward provisions etc. In addition, differences in corporate tax wedges are just one among many factors influencing locational decisions. Simulations by De la Fuente and Gardner (1992) point to very small overall gains from complete corporate tax harmonization. Effects on capital stocks could still be sizeable for some countries.

41. At a much deeper level of disaggregation, differences in output per capita are seven times higher than among similarly-sized regions in the United States. Even if Greece, Portugal and Spain are excluded there is still a large discrepancy between regional inequality in the EC and in the United States (Eichengreen, 1990). This is partly due to high regional disparities in income levels in some Member countries, especially France and Italy. These have also changed little since the early 1970s. Cingolani (1993) shows that half the high rate of dispersion at the disaggregated regional level is attributable to inter-country income differentials and the other half to

Among the weakest regions, some have caught up quickly, while others have fallen further behind. Also disparities in regional unemployment rates remained stubbornly high during the 1980s.

Whether market integration promotes cohesion has become a hotly debated subject in recent years (Dehesa and Krugman, 1992). The traditional trade model suggests that free trade in goods and services and increased factor mobility should lead to a narrowing in income gaps: a rise in interregional equity and overall efficiency go hand in hand. However, per capita income differences may also be due to differences in total factor productivity (not just factor intensity). Such differences are historically very persistent and the reasons for their persistence are not well understood. In addition, scale and external economies may tend to create central and peripheral regions, so that regions that have below-average incomes may lose. However, in the United States, regional income differences have shrunk considerably since the 1920s, even though the redistributive effort is small. On the other hand, the Canadian union did not generate convergence between 1880 and 1939 (Strain, 1993). Even though redistributive efforts have risen sharply since then, income disparities have continued to remain large.

Concerns that the single market could exacerbate existing discrepancies between regions and therefore jeopardise the objective of convergence were raised in the 1985 White Paper. As a consequence, the Single Act not only set the objective of realising the internal market by the end of 1992, but also stressed the need to "strengthen economic and social cohesion" (a reduction in disparities in living standards). The cohesion objective is largely concerned with helping poorer regions catch up with the more wealthy ones. While equity considerations are clearly very important, efficiency considerations also favour interregional transfers: this is particularly the case if income levels are low because of a lack of infrastructure and education.

Structural funds were introduced in 1975[42] but considerably changed with the Single Act in order to strengthen the effectiveness of the Community's structural measures (EC, 1992b). More recently, greater emphasis has been placed on the capacity of Structural Funds to address directly the particular difficulties which may be created for certain regions by the ongoing implementation of the internal market programme. Regional policies for the period 1994-99 concentrate on five priority goals: development and structural adjustment of lagging regions, conversion of areas affected by industrial decline, combating long-term unemployment and occupational integration of young people, facilitating workers' adaptation to industrial change and to changes in production systems, and adjustment of agriculture and fisheries and the development of rural areas. The amount of money disbursed for regional aid doubled between 1987 and 1993 (Table 15). While regional aid has risen from about 15 to 25 per cent of total EC spending, it remains small as a percentage of EC GDP. However, for Portugal and Greece, the amounts spent reach 3 per cent of GDP (Table 16)[43]. With the introduction of the Cohesion Fund in 1993, spending by the regional funds will rise again significantly in future years.

Labour market policies

As with goods markets, the question arises whether market integration would need to be accompanied by more widespread standardization of labour standards and taxation, and how such a

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intra-country income differentials.

42. The European Social Fund was created in 1960.

43. The transfers represented about 5 per cent of government expenditure in these two countries. In the United States, federal transfers to the states represented around 21 per cent of state expenditure. However, the EC's regional aid comes on top of national regional policies. Regional policy schemes exist in all EC countries and generate a considerable amount of national interregional net transfers.

standardization would interact with the need for greater labour market flexibility. As argued above, greater labour market flexibility seems essential for reaping gains from restructuring. The single market initiative has indeed given new impetus to the idea of developing an EC-wide social policy. In 1989, for instance, 11 Member States agreed on a Social Charter which includes a number of non-binding declarations of intent, and the Commission has put forward some draft directives. The Maastricht Treaty also includes an Agreement on Social Policy signed by all Member States except the United Kingdom.

Only a few EC-wide labour market regulations which are legally binding[44]. These include, for example, issues concerning the co-ordination of social security systems for migrant workers, health and safety directives or a directive concerning weekly working time. The Maastricht Treaty Agreement on Social Policy aims at supporting and complementing the activities of Member States in such areas as health, safety and working conditions, and at harmonizing social policies in some areas. It increases the scope for qualified majority decision-making and strengthens the role of the social partners in the development of community policies. The Agreement stresses the need, however, for Community legislation to take account of the diverse forms of national practices and of maintaining competitiveness.

Independently of EC legislation or co-ordination, labour standards and the level of provision and the means of financing social security benefits differ widely among the Member States. Out of 18 ILO conventions pertaining to wages and working conditions -- including such important provisions as hours worked or minimum wage legislation -- 14 have been signed by Spain, 12 by Italy and 10 by France. At the other extreme the United Kingdom endorsed 2, Ireland 3 and Germany 5 (Diagram 13). They have been largely ignored by OECD Member States outside Europe (Torres, 1994). Concerning the provision of social protection, government expenditure is relatively high in the richer EC countries, but still below the OECD average in poorer ones. Public social protection expenditure is also high in the EFTA countries, but much lower in the non-European OECD countries. While spending on social protection is relatively high in most EC countries, financing methods differ significantly: social security contribution rates are very high in France and Italy, but low in the United Kingdom and virtually non-existent in Denmark, where spending is largely financed out of general tax revenues (Table 17).

Torres (1994) points to some harmonization of labour standards during the 1980s, even though the role of trade integration in such changes is difficult to assess[45]. From the viewpoint of efficiency changes went in the right direction: working hours and employment contracts have become more flexible in the EC countries (except the Southern ones)[46], relative minimum wages have declined and relative labour costs for young workers have been reduced in many Member States. After advancing very rapidly between the 1960s and 1980s, social security outlays have come under closer scrutiny and have stabilised as a percentage of GDP or shown some trend decline. The Southern EC countries are again an exception.

With the freeing up of trade, differences in labour standards and the financing and provision of welfare benefits could have some impact on location decisions. As such decisions may influence wage, employment and tax revenue developments across regions, labour standards and welfare regulations could

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44. Petersen (1991) provides a brief overview of the ebbs and flows of the Commission’s proposals towards harmonization of social legislation.

45. As argued below, there would seem little need to harmonize labour standards in the case of low labour mobility. Member countries appear to be more worried about adverse effects of rigidities and disincentive effects of labour standards on structural unemployment.

46. The Spanish and Portuguese authorities launched wide-ranging labour market reforms recently, however (OECD, 1994a and OECD, 1994b).

be pushed to low levels as a consequence of "social dumping"[47]. The question arises as to whether there will be pressure towards "social dumping" and if so, whether legislation should be harmonized *ex-ante* or during the integration process. The United States experience may be instructive in this respect: where labour standards do exist, they are generally legislated at the federal level (Tarullo, 1992). However, while federal laws set minimum standards, states are usually permitted to enact higher standards. Federal standards are often truly minimal and, given competition among jurisdictions, state standards do not differ much from the federal one[48].

Lower labour standards and welfare benefits in the United States than in most EC countries could reflect the political preferences of the population at large and may not be the outcome of strong market integration. Theory would suggest, that -- in the absence of strong factor mobility -- even large differences in such standards are no reason for harmonization. From the point of view of a producer, costs due to labour standards or social security contributions are no different from wage costs. In the case of trade liberalisation, different levels of such non-wage costs do not matter, if wages are sufficiently flexible. Even if they do not adjust quickly, temporarily higher unemployment or exchange rate changes will restore a new equilibrium. As competitiveness considerations increase in importance with trade integration, individual countries may still be inclined to think harder than before about taking measures which raise labour costs[49]. However, if standards do not allow adjustment at all -- minimum wages, for instance, rising above market clearing rates -- trade integration will lead to inefficient outcomes; and even if there was an explicit choice between equity and efficiency considerations before liberalisation, trade integration and fiercer fiscal competition could make it more costly to achieve a given equity objective.

Should a homogeneous European labour market develop at a later stage, including large-scale mobility and a single currency, policy choices would become more difficult as people with a high need for social protection (often the ones with low productivity) would tend to choose jurisdictions with high benefit levels and vice versa. The tax base of high benefit countries would be eroded and factor mobility would not follow an efficient pattern. A higher degree of centralisation of social protection decision making could become necessary.

External trade policies

Regional trade agreements raise the fear that trade diversion outweighs trade creation for non-EC countries. It has been argued above, that this has not been the case and non-members have also benefited from intra-EC trade liberalisation. Whether trade diversion occurs will partly depend on external trade policy changes[50]. Since its creation, EC integration has indeed gone hand in hand with a lowering of

47. There are many good reasons for state intervention in setting labour standards and providing social assistance, for instance, asymmetric information, externalities and time inconsistency. There is an optimum amount of regulation and provision, which could differ across jurisdictions. "Social dumping" may lead to an under-provision of such "goods" as health and safety or social assistance (CEPR, 1993).

48. Despite the sharp fall in relative minimum wages in the United States over the 1980s, only 10 states increased their minimum wage. In 1992, the French minimum wage was 46 per cent higher than the federal U.S. standard; total compensation (including employers' social security contributions) was 87 per cent higher.

49. Under a system of fixed exchange rates there may also be the temptation to resort to 'internal' devaluations in order to boost employment.

50. Winters (1993) and Shigehara (1990) provide excellent overviews of the various issues relating to trade policies and the EC's integration process.

external barriers, largely in connection with the successive GATT rounds. Weighted average tariff levels have fallen considerably, from 13 per cent in 1958 to 10½ per cent in 1968 and 6 per cent in 1988. There was little progress in reducing tariffs between 1988 and 1993, but they will start to decline again due to the successful conclusion of the Uruguay Round (Table 18). It should be noted, that tariff levels in table 18 only refer to imports from countries with Most Favoured Nation Status. Products from other countries may be subject to lower preferential rates or be exempt from tariffs altogether. This is the case, for instance, if imports come from countries which are party to a customs union or a free trade area. In sensitive areas tariffs can be less relevant as trade instruments than non-tariff barriers (NTBs), such as anti-dumping actions or bilateral restraint agreements. Preliminary work by the OECD Secretariat suggests that such hard-core NTBs covered somewhat more than 10 per cent of EC imports in 1993, with a declining tendency since 1988. Welfare consequences of trade regimes are difficult to evaluate. Glancing over the summary statistics presented in Table 18 suggests, that the EC's foreign trade regime does not differ much from that in the United States, Japan or Canada.

While the foreign trade regime has changed little overall since the mid-1980s, harmonization of technical rules and health and safety standards brings benefits to foreign suppliers, if they fulfil the common standards. They also benefit from lower intra-EC trade costs as imported goods and services may circulate freely. In addition, some of the principles guiding intra-EC trade integration have been used in foreign trade agreements (for instance, mutual recognition of certification and testing procedures with a number of OECD countries) or even built into the latest GATT agreement.

The completion of the internal market has led to the harmonization in the use of trade instruments[51]. Although the legal provisions of Article 115 of the EEC Treaty (allowing Member States to erect national barriers, if approved by the Commission) remain in force, the infrastructure to enforce them no longer exists. At the start of 1993 there still existed 6417 country-specific restrictions, even though the number of new restrictions has fallen sharply from 119 in 1990 to just 8 in 1992 in the run-up to the dismantling of border checks. Most of these have been abolished in the meantime, benefitting extra-EC imports. Exceptions are the quotas in the MFA agreement, which have been unified at the EC level, and a limited number of quantitative restrictions with state-trading countries. Also in other sensitive areas, EC-wide arrangements replace the previous national restrictions. For instance, access of Japanese cars will increase gradually with the aim of full liberalisation by the year 2000; quantitative restrictions on CIS countries' steel imports are now EC-wide; and new import regimes apply to imports of bananas, canned tuna and sardines. There also remain a few additional unresolved contentious issues: a limited Community preference in public procurement, a reciprocity clause in banking and a cultural specificity clause for television. Even though the Community preference in the public procurement directive restricts foreign access, it should provide better access of foreign firms to the EC market than the previous national preference schemes; and the protectionist measures in the audio-visual industry merely prolong already-existing policy.

The latest Trade Policy Review of the EC by the GATT (1993) notes that fears that the EC would become more protectionist do not seem to be justified. On the contrary, the internal market programme has improved access, transparency and legal certainty in many sectors. It also notes, however, that not all measures have been fully implemented yet, and many of the new rules are still awaiting their first test. EC integration has clearly been a success, if judged by its attractiveness to recent entrants and potential members, such as Hungary, Poland and the Czech and Slovak Republics. For the latter, European Agreements should establish a free trade area with the EC within 10 years. The process of "deepening" has also given an impetus to "widening" the Community.

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51. Harmonization of export-related policies, such as preferential financing and insurance has not gone very far yet and areas such as countertrade remain a national responsibility. The current foreign trade regime is described in detail in GATT (1993) and EC (1993b).

V. Summary

In 1958, the Treaty of Rome already spelt out the goal of establishing a common market -- interpreted as being a customs union with free mobility of workers, companies, services and capital. However, progress in achieving the so-called four freedoms was patchy until the mid-1980s. In order to boost flagging European growth by promoting further integration, the EC proposed in 1985 a large legislative programme in a White Paper, set a precise deadline for its achievement, and lightened the decision-making process. This programme aimed at abolishing existing barriers to trade, and removing impediments to mobility of capital and labour. Barriers to trade were especially important in some service sectors. A large majority of the directives had been adopted by early 1993, and some speeding-up of decision-making might allow the whole agenda to be finalised by the end of 1994. Most legal acts need transposition into national law, and while nearly 90 per cent of the directives have been incorporated into the national laws, so far only half of them apply in all Member States.

Despite the delays in transposing directives into national law, frontier controls on goods moving between Member States were abolished as of January 1993. The introduction of minimum VAT rates and excise duty levels and the installation of a transitory regime for indirect taxes were crucial to this move. The destination principle still applies to the business sector, but the origin principle to individuals. A definitive system, aiming at the full application of the origin principle, could be established in 1997, but may require considerable further harmonization of indirect tax rates. Progress made in the harmonization or mutual recognition of phytosanitary, veterinary and technical standards has been equally important. Some directives, particularly those concerning health and safety requirements, set precise EC-wide rules, but most other pieces of legislation lay down only minimum requirements, and technical implementation remains flexible.

Progress has also been achieved in opening up tendering procedures for public procurement contracts, an area which has remained largely sheltered from competition. Competition in the banking sector is also likely to increase, with the introduction of a single EC-wide banking licence and mutual recognition of banking products. The freeing-up of the insurance market has also advanced but to a lesser degree. Finally, liberalisation of the transport sector, which was among the most regulated in the mid-1980s, has made considerable progress, but an integrated transport market will only be achieved in several years' time.

Complete liberalisation of capital movements was quickly attained and the last restrictions concerning short-term capital movements have been lifted. On the other hand, the right to cross borders freely has been delayed by disputes concerning the rights of asylum seekers and problems in setting up an EC-wide information system. On the other hand, and economically more significant, mutual recognition of professions has advanced, allowing EC citizens to work in other Member States, and measures have been taken providing the right to live in other Member countries.

Despite the virtual finalisation of the legal work on the internal market and rapid progress towards integration in some areas, an integrated market is far from being a reality in some sectors, as a number of reforms have not been brought to their conclusion yet and some measures are very recent and await their first test in the market place. In addition, changes in the legal framework need to be followed by changes in attitudes and behaviour by national administrations and market participants. In order to make the internal market a practical reality, the EC has set itself a medium-term agenda to: check the conformity and transparency of the transposition of Community directives into national law; enforce EC legislation in an effective and even-handed way; prevent the emergence of new barriers; step up the economic evaluation of single market legislation; and raise substantially co-operation and information exchanges between national administrations.

A large amount of research has gone into the evaluation of the effects of a fully-integrated internal market. The Commission’s studies focused on gains from dismantling technical trade barriers and customs formalities, exploiting economies of scale and reductions in profit margins due to stronger competition. These studies pointed to sizeable economic gains (3 to 7 per cent of GDP), spread over a number of years. Such a range was confirmed by later independent research. All the studies indicate that considerable industrial restructuring will be necessary for Member States to realise significant gains. For non-member countries, various studies suggest that trade diversion and creation effects would roughly balance.

Transitional issues were seldom addressed in the studies, but given the need for restructuring, gains will be reaped quickly only if factors of production adjust smoothly. However, labour markets in many Member countries appear to be relatively inflexible. In addition, while trade integration is likely to lead to gains for all Member countries in the long run, currently lagging regions could lose over the medium term. Concerns about this have led to a considerable increase in EC spending on regional transfers, largely designed to help lagging regions to catch up by providing subsidies for infrastructure projects and grants for investment in human capital.

It is difficult to find strong evidence that the single market programme has yet had sizeable effects on aggregate output. A wide variety of macro- and microeconomic indicators show, however, that integration has proceeded since the mid-1980s, even though it is impossible to isolate the integration effects of the internal market programme from other forces acting. Signs of enhanced integration are clearest in capital markets and foreign direct investment, while labour mobility has remained very low. Some progress in aggregate convergence, convergence in price dispersion and in further trade integration is apparent, particularly in countries which acceded during the 1980s. A simple macroeconomic evaluation points to an EC-wide cumulative gain of 1½ per cent of GDP so far.

It is important that policies conducive to harvesting further gains be put in place at the EC and Member State level. Foremost, competition policy needs to ensure a level playing field. The Community has the legal capacity to investigate restrictive business practices and the trade distorting effects of state intervention. The internal market programme itself should increase the contestability of EC markets, which -- in connection with a liberal trade regime -- will raise competitive pressure. In addition, the EC has moved towards liberalising telephone services, the airline industry, the remaining parts of the energy sector and postal services. So far, progress is very uneven across sectors, even though some countries have liberalised on their own. The Commission is also controlling subsidies of Member countries, which could distort intra-Community trade. Overall, the level of subsidisation has shown some trend decline, but remains high. Fiscal measures which can also influence locational decisions have been under less scrutiny. However, fiscal competition has led to some harmonization in corporate tax regimes, but proposals to implement a minimum withholding tax on interest income have not been adopted yet.

The single market initiative has given new impetus to the idea of developing an EC-wide social policy. Harmonization of labour standards and social security systems may, on the other hand, run counter to the perceived need to make European labour markets more flexible. While Community-wide standardization in this area has not gone far yet, the inflexibility of labour markets largely emanates from national legislation. However, rules have become more flexible over the 1980s (except in the Southern Member countries), even though it is difficult to evaluate the role of trade integration in such changes.

While there are fears about "social dumping", there appears to be little need for harmonization, as long as labour mobility remains low and wages show a certain degree of flexibility. Labour costs also include those due to labour standards or social security contributions, and changes in trade and factor flows will have little effect on overall employment, if wages are sufficiently flexible to adjust to new circumstances. However, slow wage adjustment could imply temporarily higher unemployment and, if standards do not allow adjustment at all, trade integration could lead to inefficient outcomes. Should a more homogeneous European labour market develop, harmonization could become much more important, as differences in benefit and contribution packages will influence migration patterns. Competition among jurisdictions could also lead to a watering down of labour standards that also have the characteristics of public goods, such as health and safety regulations. So far, these have been the major concern of the Commission, even though a truly minimum central standardization, which allows regional differences, could suffice to ensure that there is no underprovision of public goods.

The completion of the internal market has led to the harmonization and centralisation of the use of trade instruments at the EC level. Quantitative restrictions against non-EC countries have largely been abolished, but in some areas EC-wide arrangements have replaced previous national restrictions. In addition, the single market legislation has given rise to some trade issues, which remain largely unresolved: a limited Community preference in public procurement; a reciprocity clause in banking; and a cultural specificity clause protecting European audio-visual programming from outside competition.

Over the longer run, EC integration has gone hand-in-hand with a lowering of external barriers, largely in connection with the successive GATT rounds, and this process will continue with the conclusion of the Uruguay Round. The lowering of external barriers is important, as it will limit the risk of trade diversion. In addition, the single market programme has improved access, transparency and legal certainty in many sectors, and lower intra-EC costs have also brought benefits to foreign suppliers. If judged by its forthcoming expanding membership, EC integration has been a clear success and the "deepening" of the Community has so far not impeded its "widening".

Table 1. **VAT rate harmonization in EC countries**

Per cent

	Reduced rate		Standard rate		Increased rate	
	April 1987	January 1993	April 1987	January 1993	April 1987	January 1993
Belgium	1;6	1;6;12	19	17;20.5	25;33	
Denmark	-	-	22	25	-	-
France	2.1;4;5;7	2.1;5.5	18.6	18.6	33	-
Germany	7	7	14	15	-	-
Greece	6	4;8	18	18	36	-
Ireland	0;2.3;10	2.5;12.5	25	21	-	-
Italy	2;9	4;9;13	18	19	38	-
Luxembourg	3;6	3;6	12	12;15	-	-
Netherlands	6	6	20	17.5	-	-
Portugal	8	5	17	16	30	30[1]
Spain	6	3;6	12	15	33	-
United Kingdom	0	0	15	17.5	-	-

1. Application of the 30 per cent rate is contrary to Community law since 01.01.1993. This question is currently the subject of infringement procedures taken by the Commission against Portugal.

Source: EC.

Table 2. **The Commission's assessment of welfare gains: a summary**[1]

As a per cent of GDP

	Estimates	
	A	B
Direct gains from elimination of barriers		
Stage 1: barriers affecting trade only	0.2	0.3
Stage 2: other barriers affecting production	2.0	2.4
Total	2.2	2.7
Indirect gains from market integration		
Stage 3: economies of scale from restructuring and increased production	2.0	2.1
Stage 4: competition effects	1.6	1.6
Variant I (sum of stages 3 and 4 above)	3.6	3.7
Variant II (stages 3 and 4 computed jointly)	2.1	2.1
Total gains		
Variant I	5.8	6.4
Variant II	4.3	4.8

1. Estimates based on 1985 data at 1985 prices.
2. The A and B estimates reflect differing data sources or assumptions introduced in stages 1 and 2.

Source: Emerson *et al.* (1988).

Table 3. **Trade integration effects: macroeconomic model results**

	Total Community[1]		
	1 year	2 years	Medium Term[2] Simulation
Relative to baseline (per cent)			
GDP	1.1	2.3	4.5
GDP price deflator	-1.6	-2.8	-6.3
Absolute change from baseline			
Employment (thousands)	-525	-35	1 840
Budgetary balance[3]	0.2	0.7	2.2[4]
External balance[3]	0.3	0.4	1.0

1. Extrapolation to EUR-12 of the (weighted) average of the countries analyzed.
2. Six years.
3. Per cent of GDP.
4. If deficits were held constant, GDP could rise by 7.5 per cent above baseline and the price level could fall by 4.5 per cent below baseline.

Source: Emerson *et al.* (1988).

Table 4. **Industrial sectors most affected by the internal market**

<table>
<tr><th rowspan="2">Trade intensity ↓</th><th colspan="2">Price differences between members States</th></tr>
<tr><th>Weak</th><th>Strong</th></tr>
<tr><td rowspan="2">Weak</td><td colspan="2">Traditional or regulated public-procurement markets</td></tr>
<tr><td>Characteristics:
- sectors subject to competition form NICs
- restructuring in progress

Example: electrical and electronic equipment, shipbuilding</td><td>Characteristics:
- sectors in which competition in intra- and extra-EC imports is weak
- high concentration and economies of scale

Example: energy-producing equipment, railway equipment, pharmaceutical products</td></tr>
<tr><td>Strong</td><td>High-technology public-procurement sectors

Characteristics:
- sectors already partly open to competition
- degree of openness to extra-EC countries
- high concentration and economies of scale
- low productivity of European companies compared with American and Japanese competitors
Example: telecommunications, data processing</td><td>Products with moderate non-tariff barriers

Characteristics:
- sectors with fragmented distribution and/or marketing networks
- high levels of differentiation

Example: motor vehicles, textiles, clothing, footwear, domestic electrical appliances, television, video, toys</td></tr>
</table>

Source: EC (1990a).

Table 5. **Price level dispersion**[1]

Unweighted coefficients of variation

	EC - 12		EC - 9	
	1985	1990	1985	1990
Private final consumption expenditure	0.20	0.18	0.11	0.13
Food, beverages and tobacco	0.18	0.16	0.15	0.14
Clothing and footwear	0.12	0.17	0.12	0.16
Household equipment and operation	0.14	0.15	0.06	0.09
Transport and communication	0.23	0.18	0.16	0.16
Government final consumption expenditure	0.29	0.25	0.14	0.15
Gross fixed capital formation	0.12	0.11	0.08	0.06
Construction	0.19	0.18	0.11	0.11
Machinery and equipment	0.08	0.05	0.09	0.06
Gross domestic product	0.20	0.17	0.09	0.10

1. Comparative dollar price levels of final expenditure on GDP; includes indirect taxes.

Source: OECD.

Table 6. **Price similarity indices for tradeables**[1]

	BEL	DEN	FRA	GER	GRE	IRE	ITA	LUX	NET	POR	SPA	UKM	AUT	FIN	NOR	SWE	CAN	USA
Belgium		942	986	979	911	958	969	987	974	948	966	964	973	922	918	911	925	915
Denmark	14		943	958	894	968	936	941	966	917	925	964	954	944	934	910	922	917
France	-4	8		978	919	964	976	982	973	954	972	964	975	921	912	901	915	900
Germany	6	5	-3		906	967	965	979	984	934	951	972	982	935	928	915	940	930
Greece	16	23	15	13		903	923	917	915	956	950	922	914	892	896	827	882	865
Ireland	-2	9	-6	-8	22		957	953	969	938	939	985	967	940	936	906	932	913
Italy	-3	4	5	-3	7	-10		972	968	959	963	959	973	932	917	895	918	894
Luxembourg	2	13	1	5	17	0	-2		972	947	962	958	972	935	919	909	923	911
Netherlands	-3	5	-4	-6	11	-4	-10	0		941	955	974	978	943	935	904	935	921
Portugal	6	31	1	13	9	8	-3	4	12		964	947	948	898	894	855	891	866
Spain	7	23	1	5	2	9	7	10	-4	7		947	957	911	901	878	914	897
United Kingdom	6	3	5	0	9	-7	3	9	0	11	8		968	944	947	906	941	920
Austria	5	14	-2	1	19	-4	-6	7	-5	3	3	5		940	934	912	942	915
Finland	17	13	14	1	21	13	-5	8	0	16	13	-2	16		965	924	931	919
Norway	-6	-1	-2	-17	6	-8	-15	-1	-16	-2	-9	-27	-3	9		929	932	915
Sweden	31	40	36	25	55	37	35	30	39	47	36	38	48	53	31		931	925
Canada	6	21	11	-2	16	21	3	15	8	12	-5	1	2	21	13	8		968
United States	-8	3	-6	-11	7	1	-13	7	2	18	-18	-8	9	0	-7	-17	-20	

1. The similarity of the structure of prices between any pair of countries is measured by the correlation coefficient which is obtained by regressing the relative price level indices for each basic heading of the first country against the corresponding relative price level indices of the second country. The level of correlation coefficients for 1985 is shown in the upper panel and the change between 1985 and 1990 in the lower panel.

Source: OECD.

Table 7. **Foreign direct investment flows**

As a per cent of GDP

	Inward investment		Outward investment	
	1980-86	1987-92	1980-86	1987-92
Belgium	1.15	3.85	0.36	3.30
Denmark	0.16	0.73	0.35	1.23
France	0.39	0.86	0.53	1.60
Germany	0.12	0.25	0.64	1.16
Greece	1.35	1.52	0	0
Ireland	0.85	0.24	0	0
Italy	0.20	0.45	0.38	0.51
Netherlands	0.79	2.04	2.02	3.82
Portugal	0.84	2.92	0.05	0.35
Spain	1.07	2.00	0.17	0.41
United Kingdom	1.14	2.51	2.13	3.03
EC countries	0.53	1.16	0.85	1.55
United States	0.59	0.84	0.30	0.53
Japan	0.03	0.03	0.44	1.09
OECD countries	0.46	0.82	0.56	1.11

Source: OECD.

Table 8. **Mergers in the Community by sector**[1]

	National	Community	International	Total
Industry				
1984-1985	146	44	18	208
1985-1986	145	52	30	227
1986-1987	211	75	17	303
1987-1988	214	111	58	383
1988-1989	233	197	66	496
1989-1990	241	257	124	622
1990-1991	186	170	99	455
1991-1992	175	119	49	343
Services				
1984-1985	47	16	4	67
1985-1986	44	13	13	70
1986-1987	79	15	18	112
1987-1988	107	34	34	175
1988-1989	119	28	27	174
1989-1990	112	58	41	211
1990-1991	94	28	19	141
1991-1992	113	40	11	164

1. National mergers of firms from the same Member States, Community mergers of firms from different Member States and International mergers of firms from Member States and third countries with effect on the Community market. Figures are based on operations involving at least one of the 1 000 largest firms in the Community.

Source: Commission of the European Communities, *Report on Competition Policy*, various issues.

Table 9. **The regional structure of EC trade**

As a per cent of total EC trade

Year	Western Europe		Eastern and southern neighbours			Rest of the world	
	EC-12	EFTA	Eastern Europe	Mediterranean countries	ACP[1]	Developing countries	Industrial countries
				Exports			
1958	37.2	12.2	2.7	7.8	6.6	15.3	18.2
1970	53.4	11.7	3.4	4.8	3.6	7.1	16.0
1980	56.1	11.2	3.5	5.9	3.5	9.2	10.6
1985	55.2	10.0	2.8	5.2	2.3	8.7	15.8
1990	61.2	10.4	2.3	4.2	1.6	7.3	13.0
				Imports			
1958	35.2	9.3	2.9	4.5	6.8	19.2	22.1
1970	50.3	8.7	3.2	4.7	4.4	10.3	18.4
1980	49.3	8.6	3.7	4.2	3.8	15.6	14.8
1985	53.4	9.4	3.9	5.1	3.5	9.8	14.9
1990	59.0	9.6	2.7	3.8	1.8	8.2	14.9

1. African, Caribbean and Pacific countries having signed the Lomé convention.

Source: Eurostat.

Table 10. **Intra-EC trade developments**

Intra-EC imports and exports as a per cent of the respective totals

	1980		1985		1992	
	Imports	Exports	Imports	Exports	Imports	Exports
Original six Member States						
Belgium-Luxembourg	61.6	73.2	68.6	70.2	71.2	74.8
France	52.0	55.4	59.4	53.7	65.7	63.1
Germany	49.4	51.1	53.1	49.7	54.7	54.1
Italy	46.2	51.6	47.1	48.2	58.8	57.7
Netherlands	54.7	73.5	55.8	74.7	58.8	75.4
First enlargement						
Denmark	50.3	51.6	50.7	44.8	55.4	54.5
Ireland	75.3	76.0	71.7	68.9	71.9	74.2
United Kingdom	40.9	45.0	47.3	48.8	50.7	55.5
Second and third enlargements						
Greece	40.9	48.2	48.1	54.2	62.8	64.2
Portugal	45.3	58.6	45.9	62.5	73.6	74.8
Spain	31.3	52.2	37.9	53.3	60.3	66.3
Trade among regional groupings						
EC 6	41.2	46.1	41.5	42.2	44.8	44.9
EC 9	47.6	52.4	50.2	51.4	53.2	53.7
EC 12	49.2	55.7	53.4	54.9	59.3	61.3

Source: Eurostat.

Table 11. **Intensity of intra-industry trade**[1]

(Manufactured goods)

	1970	1980	1985	1990	1992
Belgium	65	70	67	75	76
Denmark	57	64	60	66	65
France	75	78	78	82	82
Germany[2]	59	65	65	71	74
Greece	16	23	28	28	27
Ireland	43	61	63	61	63
Italy	58	59	57	61	60
Netherlands	70	74	77	80	80
Portugal	36	36	40	43	43
Spain	41	56	54	65	67
United Kingdom	61	76	76	80	82

1. Intra-industry trade is the value of total trade $(X_i + M_i)$ remaining after subtraction of the absolute value of net exports or imports, $|X_i - M_i|$, of the industry *i*. For comparison between countries and industries, the measures are expressed as a percentage of each industry's combined exports and imports. Trade flows are measured at the three-digit level:

   The aggregated measure of intra-industry trade is $\frac{\sum (X_i + M_i) - \sum |X_i - M_i|}{\sum (X_i + M_i)} \cdot 100$

2. German data have been strongly influenced by the sharp swing in its overall balance since 1989.

Source: OECD.

Table 12. **Commission activity relating to the application of restrictive agreements (Art. 85) and abuse of a dominant position (Art. 86)**

	1988	1989	1990	1991	1992
Cases settled	480	443	880	835	767
Procedures closed by administrative letter	36	46	158	146	176
Cases settled without formal decision[1]	419	382	710	676	553
Decisions on substantive matters	25	15	12	13	27
Article 85					
Substantive decisions	19	13	9	12	24
With fines	5	2	1	3	8
Without fines	2	1	1	4	5
Negative clearance	1	1	3	..	..
Rejected complaint	1	3	..	..	7
Exemptions	10	6	4	5	4
Article 86					
Substantive decisions	6	2	3	1	3
With fines	3	..	..	1	3
Without fines	3	..	..	..	..
Rejected complaint	..	2	3	..	..

Substantive decisions by sector

	Manufacturing			Services		
	1964-1969	1970-1979	1980-1990	1964-1969	1970-1979	1980-1990
Article 85	25	108	120	2	1	28
Article 86	0	6	10	0	0	5

1. As the agreements were no longer in force, their impact was too slight to warrant further consideration, the complaints had become moot or investigation had not revealed any anti-competitive practices.

Source: Commission of the European Communities, *Report on Competition Policy*, various issues, and Sapir *et al.* (1993).

Table 13. **Activity in the control of State aids**

Excluding aids to agriculture, fisheries and transport

Year	Number of proposals notified	Action taken by the Commission				Proposals notified and later withdrawn by Member States
		No objection raised	Procedure opened	Procedure closed[1]	Final decision	
1981	92	79	30	19	14	
1982	200	104	86	30	13	
1983	174	101	55	18	21	9
1984	162	201	58	34	21	6
1985	133	102	38	31	7	11
1986	124	98	47	26	10	5
1987	326	205	27	32	10	1
1988	375	311	31	32	13	
1989	296	254	37	27	16	7
1990	429	352	33	24	12	2
1991	472	383	53	25	9	21
1992	459	393	26	33	8	25

1. In most cases after amendments negotiated during the procedure to remove those aspects which made the proposal incompatible with the common market.

NB: The figures in the first column do not total with those of the next four columns on account of carry-overs from one year to the next and because if the procedure is initiated the Commission has to take two decisions, firstly to open the procedure and then a final decision terminating it.

Source: Commission of the European Communities, *Report on Competition Policy*, various issues.

Table 14. **State aids by country and sector**[1]

As percent of total subsidisation, 1988-90 averages

	Bel	Den	Fra	Ger	Gre	Ire	Ita	Lux	Neth	Por	Spa	UK
Agriculture/Fisheries	**6**	**27**	**14**	**11**	**14**	**20**	**15**	**7**	**21**	**20**	**4**	**10**
Industry/Services												
Horizontal objectives	**24**	**18**	**25**	**9**	**58**	**30**	**15**	**7**	**37**	**12**	**12**	**17**
Innovation	4	11	6	4	1	2	2	1	17	1	4	3
Trade/export	4	3	14	1	16	23	3	0	0	0	0	6
Small & medium-sized firms	8	0	4	2	7	5	5	4	15	0	2	4
Others	8	4	1	2	25	0	5	2	5	11	6	4
Particular sectors	**64**	**54**	**57**	**62**	**17**	**25**	**43**	**74**	**36**	**65**	**82**	**60**
Coal	28	0	17	32	0	0	0	0	0	0	19	42
Steel	0	0	0	0	0	0	3	0	0	16	12	0
Shipbuilding	0	10	3	1	2	0	2	0	1	19	4	3
Transport	35	42	30	26	13	20	36	74	31	11	35	10
Others	1	2	8	2	1	5	2	0	2	19	12	5
Regional aid	**6**	**1**	**4**	**18**	**11**	**25**	**27**	**12**	**6**	**3**	**2**	**13**
Memorandum item: **Total subsidies (per cent of GDP)**	**2.8**	**1.1**	**1.8**	**2.4**	**3.1**	**2.0**	**2.9**	**4.0**	**1.3**	**2.2**	**1.8**	**1.1**

1. Including direct grants, tax reductions, equity participation, and aid elements contained in soft loans, tax deferrals and State guarantees, but excluding EC subsidies.

Source: EC (1992), *Third Survey on State Aids.*

Table 15. **The EC budget**

	By sector and institution					
	1988		1990		1992	
	Million ECU	Per cent	Million ECU	Per cent	Million ECU	Per cent
I. Payments						
Administration	1900	4.6	2298	5.3	2848	4.9
EAGGF[1]	26390	63.9	24980	57.7	31234	53.3
Structural actions and fisheries	7102	17.2	10368	23.9	18466	31.5
R&D	963	2.3	1429	3.3	2028	3.5
Cooperation	1041	2.5	1225	2.8	2027	3.5
Miscellaneous[2]	436	1.1	644	1.5	934	1.5
Refunding, guarantees, and reserves	3447	8.4	2381	5.5	1036	1.8
Total	41279	100.0	43324	100.0	58573	100.0
II. Revenues						
Own resources[3]	11915	29.1	12161	29.4	13281	23.6
of which:						
Customs duties	10344	25.3	11428	27.6	12548	22.3
VAT-based revenue	24522	60.0	28968	69.9	34659	61.6
GDP-based revenue	4446	10.9	284	0.7	8322	14.8
Total	40883	100.0	41413	100.0	56262	100.0

By country, 1992

Per cent

	EC	Bel.	Den.	Ger.	Gre.	Spa.	Fra.	Irl.	Ita.	Lux.	Net.	Por.	UK	Misc.
I. Payments	100.0	4.1	2.2	12.5	7.4	12.9	15.5	4.4	13.3	0.5	4.6	5.1	7.4	10.1
II. Revenues	100.0	4.0	1.8	30.2	1.3	8.6	18.7	0.8	14.7	0.2	6.3	1.5	11.9	..

1. European Agriculture Guidance and Guarantee Fund.
2. Social action, energy, Euratom, environment and internal market.
3. Customs duties, farm levies, sugar contributions and administrative costs.

Source: Official Journal, C309, *Annual Report of the Court of Auditors*, 16 November 1993.

Table 16. **Structural fund spending**

1. Basic data on the five priority objectives

Objective	Countries or regions concerned	Territory covered	Population concerned	Structural fund spending (1989-93) at 1989 prices ECU billion[1]
OBJECTIVE 1 Regions where development is lagging behind	7 States[2]	41%	21.5%	38.3
OBJECTIVE 2 Conversion of areas affected by industrial decline	60 regions	-	16.5%	7.2
OBJECTIVE 3 & 4 Reducing long-term unemployment and occupational measures	9 States	100%	-	7.5
OBJECTIVE 5a Adjustment of agricultural structures	9 States	100%	-	3.4
OBJECTIVE 5b Development of rural areas	50 regions	17%	5%	2.8

2. Member States' receipts from the Structural Funds (1989-93)

	Percentage distribution of financial allocations	Percentage share in EC population	GDP per capita expressed in PPS[3] 1990 data
Belgium	1.4	3.0	102.8
Denmark	0.6	1.6	105.1
Germany	5.4	19.4	112.4
Greece	11.7	3.1	53.4
Spain	22.5	11.9	76.7
France	10.6	17.2	108.5
Ireland	6.4	1.1	68.8
Italy	17.5	17.6	104.0
Luxembourg	0.1	0.1	124.2
Netherlands	1.3	4.6	103.8
Portugal	12.3	1.4	56.2
United Kingdom	10.3	17.5	105.4

1. Plus ECU 1 150 million for transitional measures.
2. Spain: 10 regions, Greece, Ireland, and Portugal: whole country; France: overseas departments and Corsica; United Kingdom: Northern Ireland, and Italy: 8 regions.
3. EC average = 100.

Source: EC (1992b), and *Annual Report on the Implementation of the Reform of the Structural Funds.*

Table 17. **Financing the welfare state**

	Social security contribution rate[1]		Income tax rate[2]	Total tax rate[3]
	Employers	Employees		
Belgium	41.9	12.1	11.6	46.2
Denmark	0.0	2.5	36.0	38.5
France	43.8	17.1	1.0	43.1
Germany	18.2	18.2	8.7	38.1
Ireland	12.2	7.8	16.4	32.4
Italy	50.1	9.0	14.2	48.9
Netherlands	10.8	10.7	32.5	48.8
Portugal	24.5	11.0	0.9	29.2
Spain	30.2	6.0	6.4	32.7
United Kingdom	10.4	7.6	15.5	30.3
United States	7.7	7.7	11.3	24.8
Japan	7.6	7.0	2.4	15.8
Total of 20 OECD countries[3]	17.4	8.0	14.3	32.9

1. Per cent of average earnings.
2 Per cent of average earnings plus employers' social security contributions.
3. Simple average.

Source: OECD (1992), *The tax and benefit position of production workers.*

Table 18. **The use of trade instruments in the "Quad"**

A. Tariffs	EC		United States		Japan		Canada	
	1988	1993	1988	1993	1988	1993	1988	1993
	Per cent							
Overall simple average MFN tariff rate	7.5	7.6	6.6	6.8	7.2	6.5	9.1	8.8
Overall weighted average MFN tariff rate	6.0	6.1	4.2	4.2	4.3	3.4	6.9	6.7
Overall coefficient of variation	82	82	140	136	170	147	97	95

B. Non tariff barriers[1]	EC				United States				Japan				Canada			
	Frequency index		Trade coverage index		Frequency index		Trade coverage index		Frequency index		Trade coverage index		Frequency index		Trade coverage index	
	1988	1993	1988	1993	1988	1993	1988	1993	1988	1993	1988	1993	1988	1993	1988	1993
All NTBs	13.0	12.7	14.1	11.5	10.0	6.0	16.8	17.4	14.5	14.0	17.7	14.0	9.7	8.8	5.9	4.4
Quantitative Restrictions	8.8	8.2	8.1	7.4	9.0	4.5	13.8	10.5	13.8	13.4	16.9	13.2	6.6	5.7	3.2	1.6
Price Control Measures	4.3	4.1	6.1	5.2	1.4	1.6	3.6	7.4	0.1	0.1	0.3	0.3	0.9	0.5	1.1	0.9

1. The frequency index for a particular importing country typically indicates the proportion (or percentage) of national tariff lines that are affected by a particular NTB or by a specified group of NTBs, and the trade coverage index is computed by attaching actual values to bilateral trade flows between exporters and the importing country.

Source: OECD Secretariat.

Diagram 1. IMPLEMENTATION OF THE WHITE PAPER MEASURES
February 1994

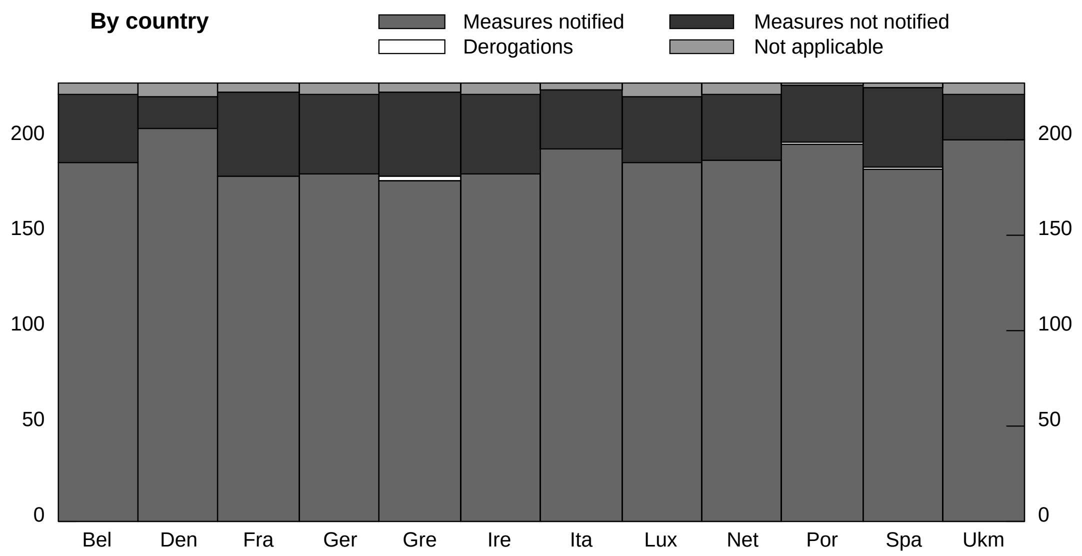
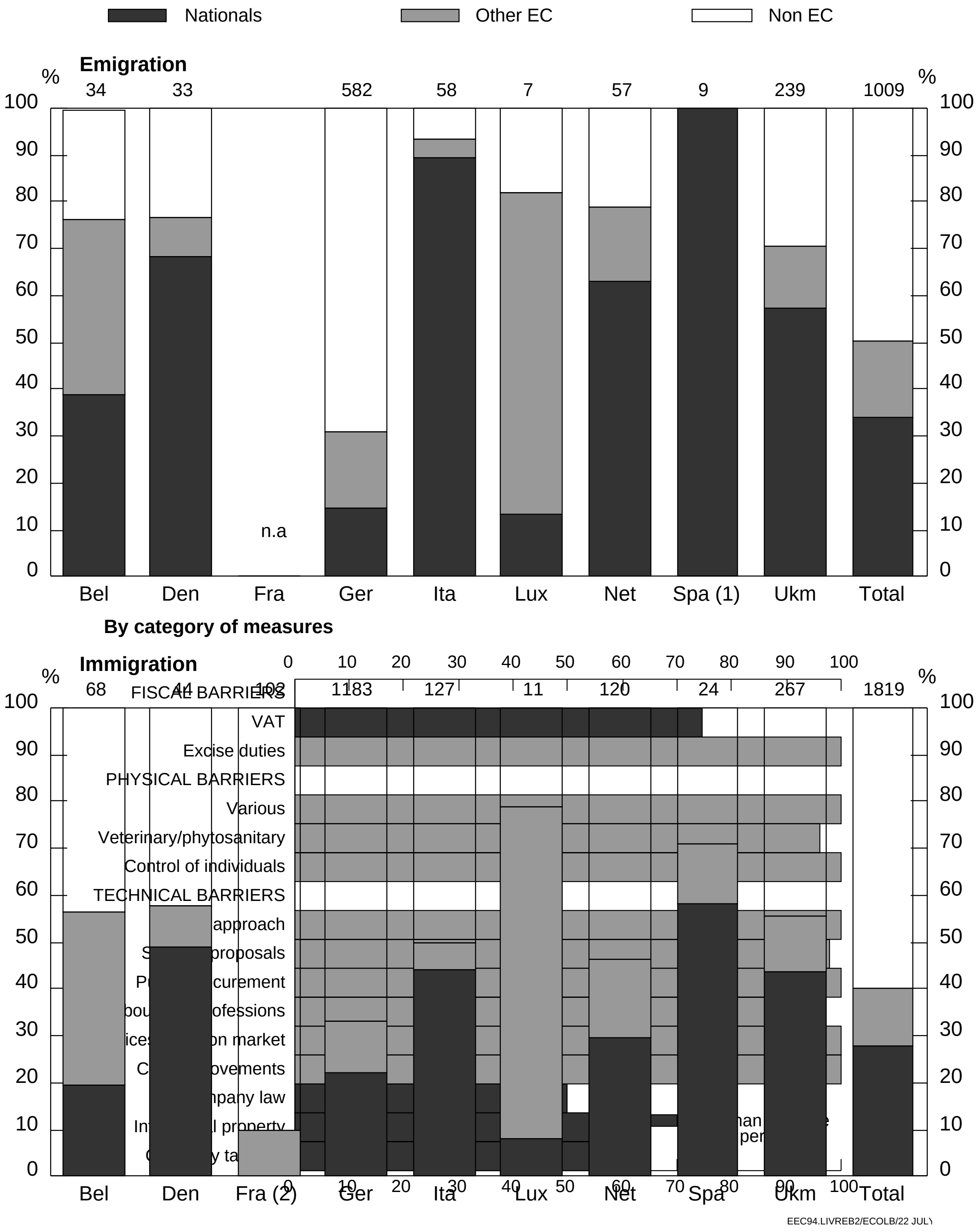


Diagram 2. MIGRATION FLOWS IN SELECTED EC COUNTRIES

1991, in thousands and percentages of the total



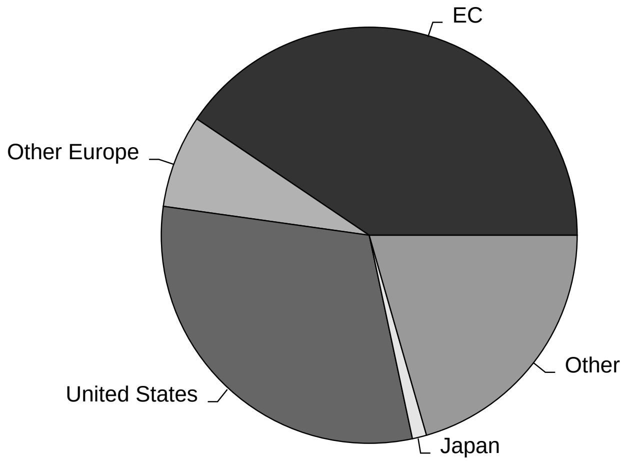
1. Data refer to emigration of Spanish nationals only.
2. Data do not include returning French nationals.
Source: Eurostat, Rapid Reports, Population and social conditions, 1993−12.

Diagram 3. STOCKS OF FOREIGN DIRECT INVESTMENT BY END−1990

US $ billion

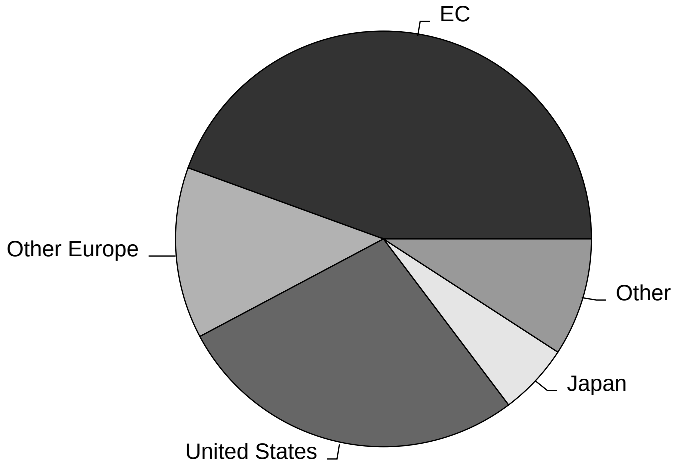
A. EC outward foreign direct investment

(Total equals 789 billion US$)



B. Inward foreign direct investment to EC

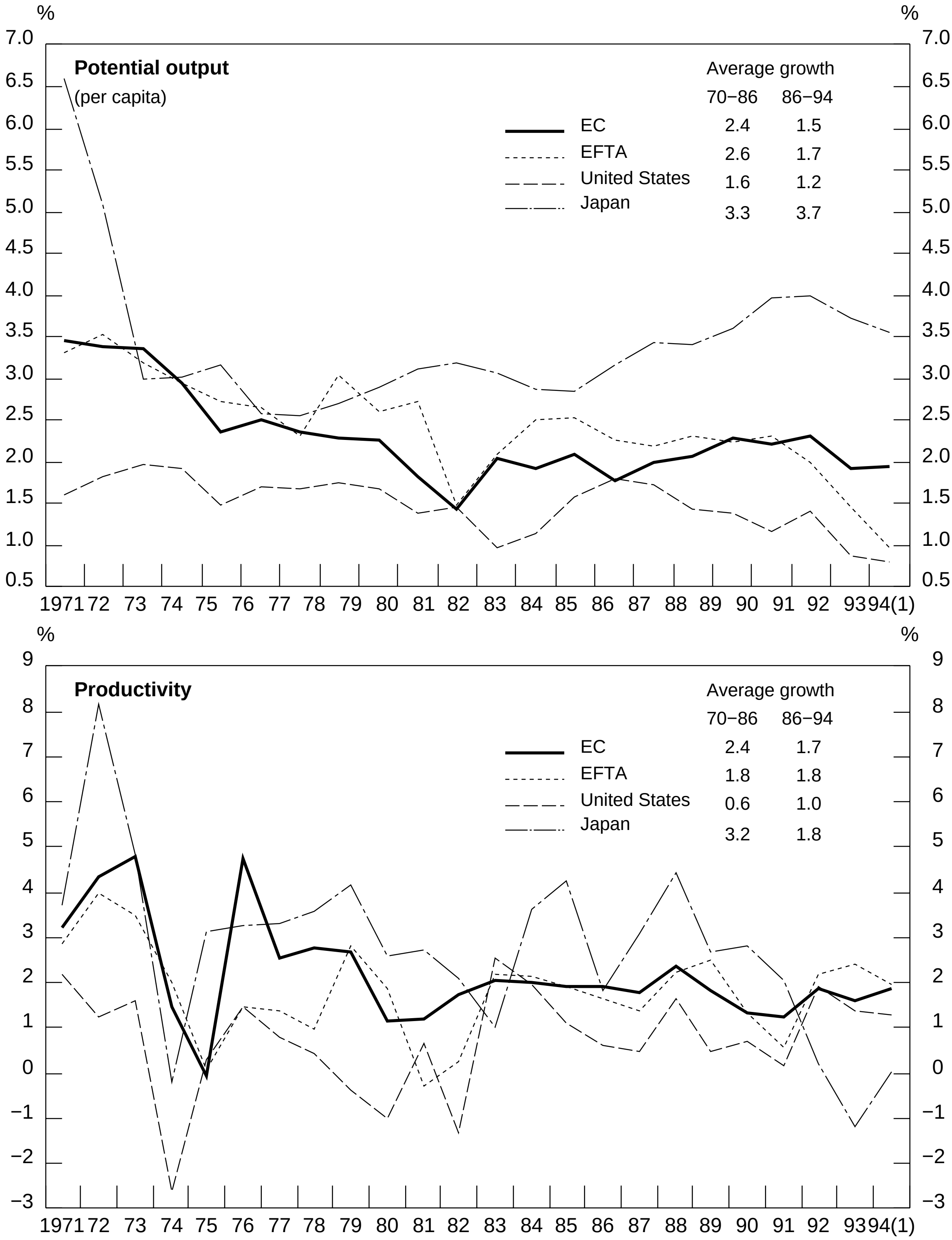
(Total equals 722 billion US$)



Source: De Laubier (1993)

EEC94.FDI/ECOLB/07 JUNE 94

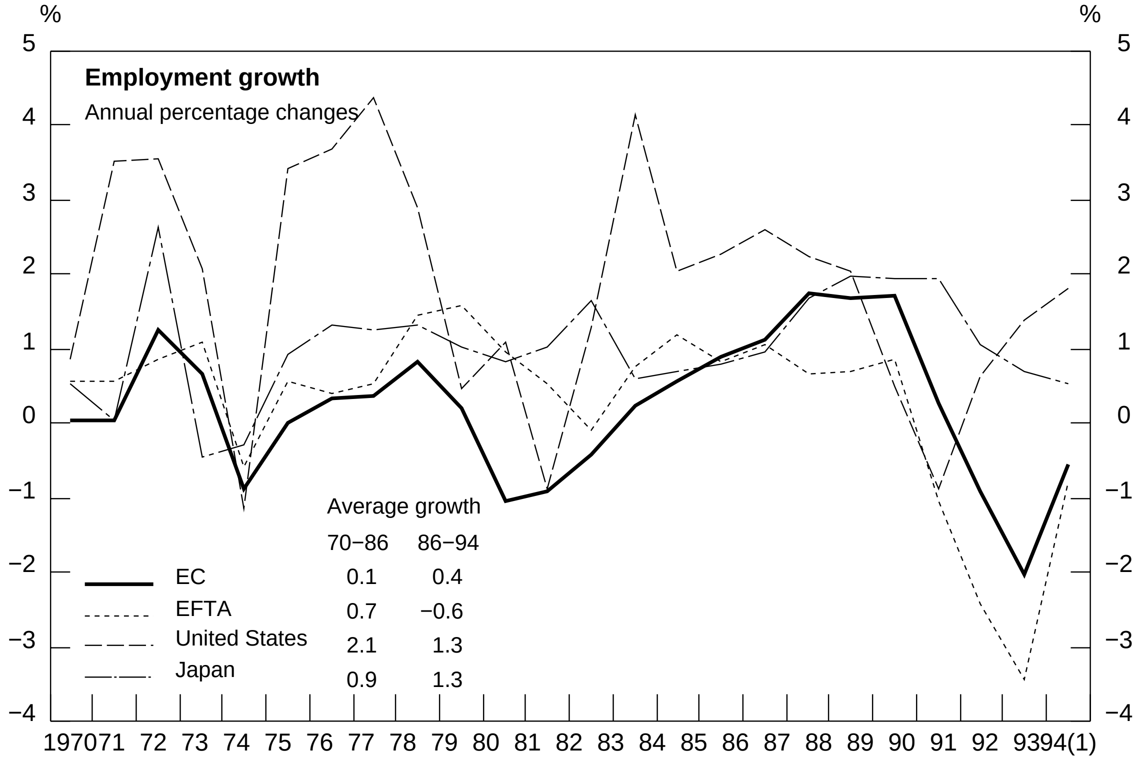
Diagram 4. GROWTH PERFORMANCE: AN INTERNATIONAL COMPARISON
Annual percentage changes

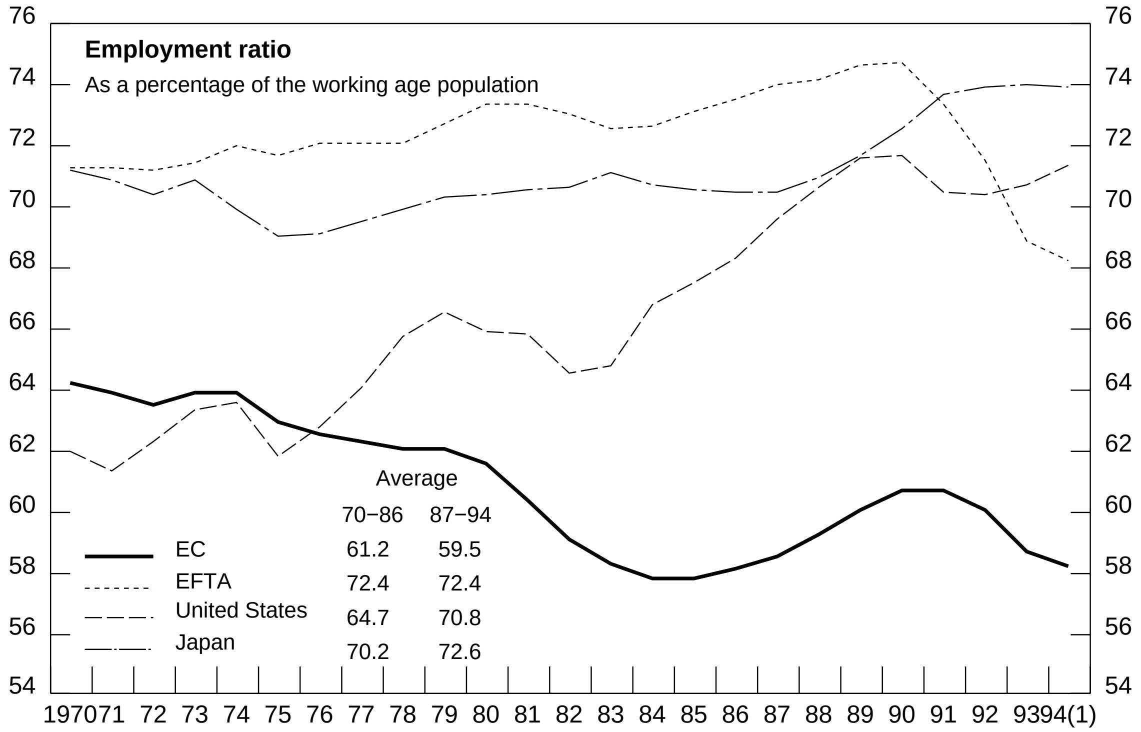


1. OECD estimates.
Source: OECD.

EEC94.POT.OUT/ECOLB/22 JULY 94

Diagram 5. LABOUR MARKET PERFORMANCE

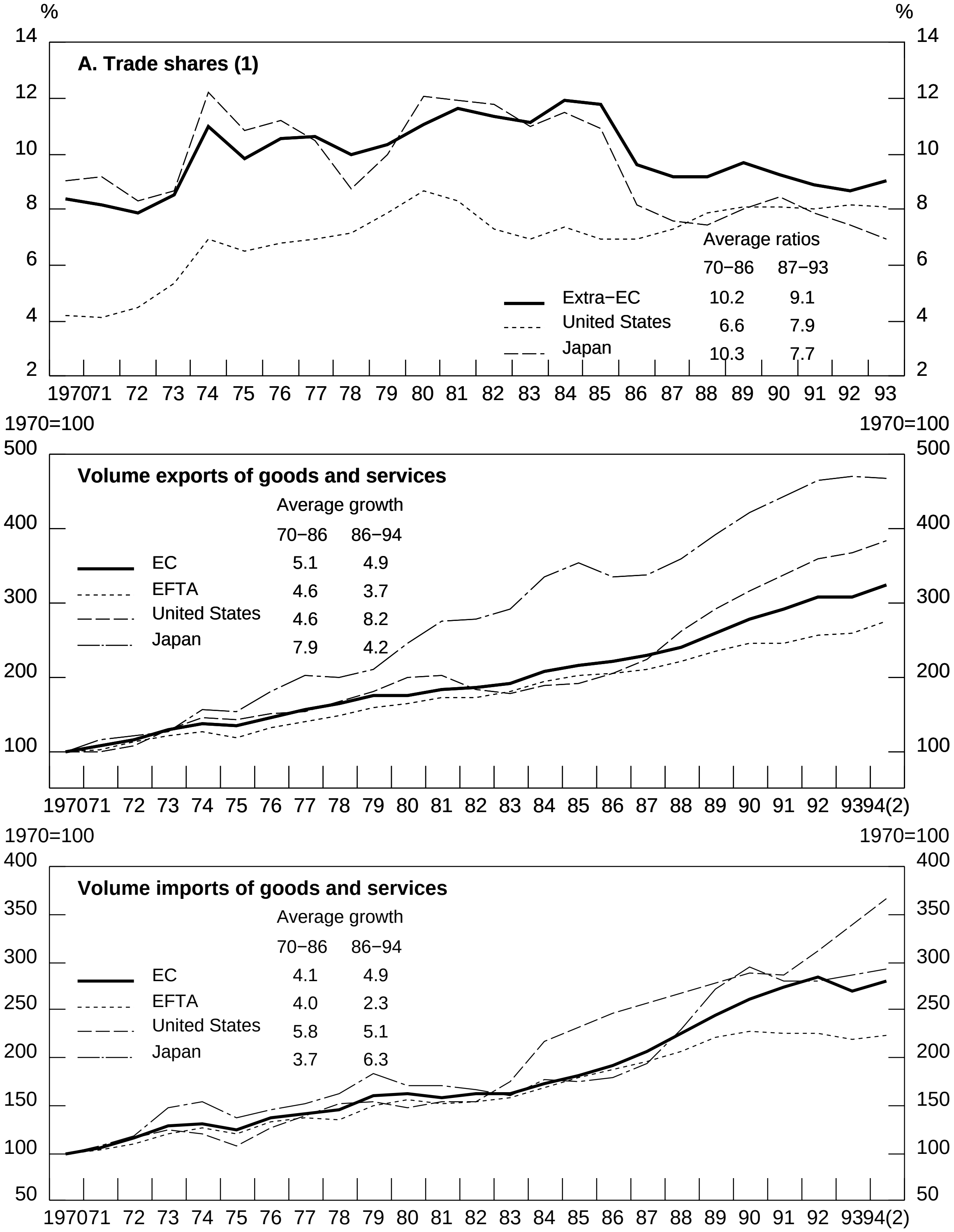




1. OECD estimates.
Source: OECD.

EEC94.EMP/ECOLB/07 JUNE 94

Diagram 6. AGGREGATE TRADE DEVELOPMENTS



1. Average of goods export and import shares in GDP, current prices, per cent.

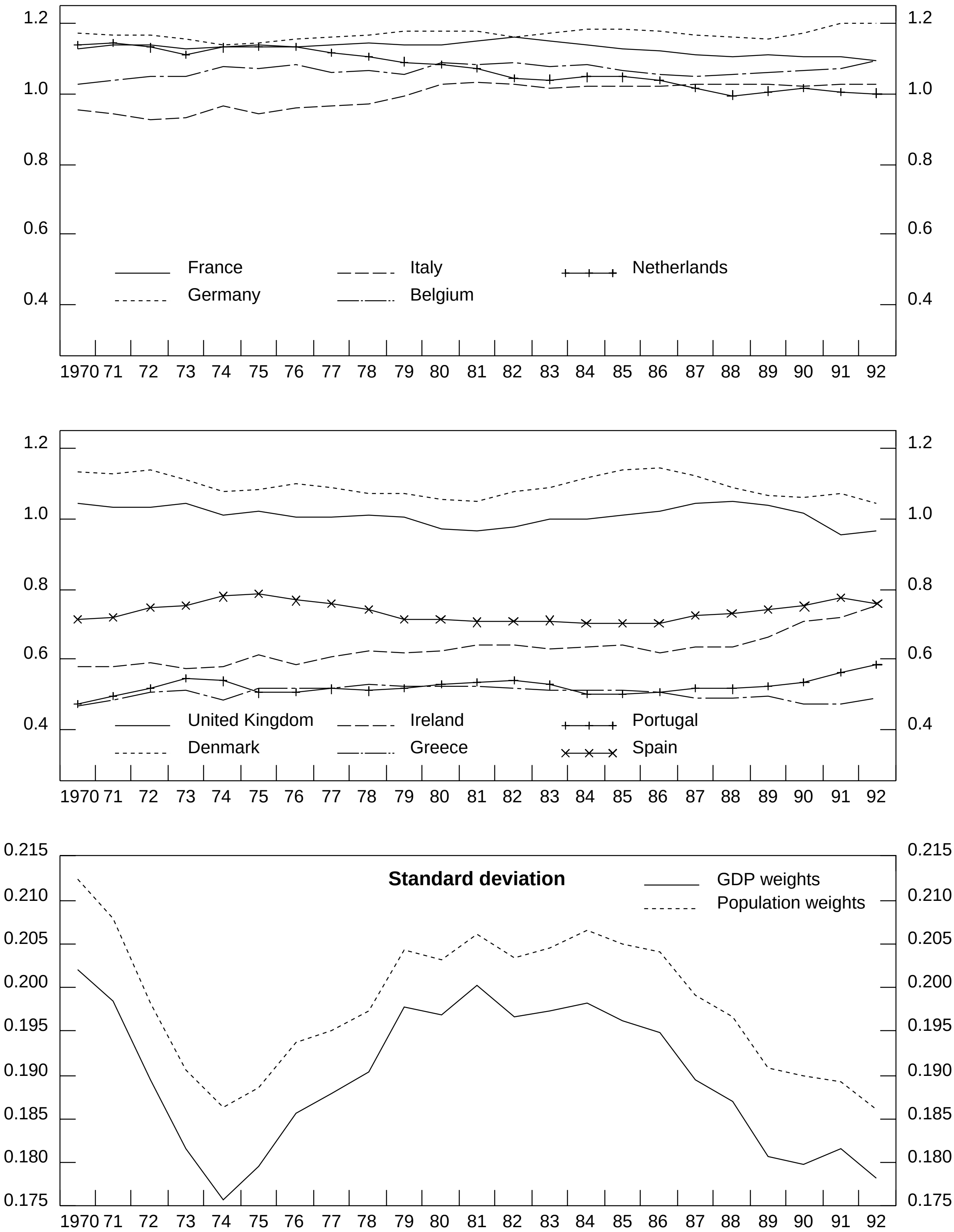
EEC94.TRADE1/ECOLB/22 JULY 94

2. OECD estimates.

Sources: EUROSTAT and OECD.

Diagram 7. CONVERGENCE OF PER CAPITA INCOME LEVELS (1)

(Deviation from the EC average)

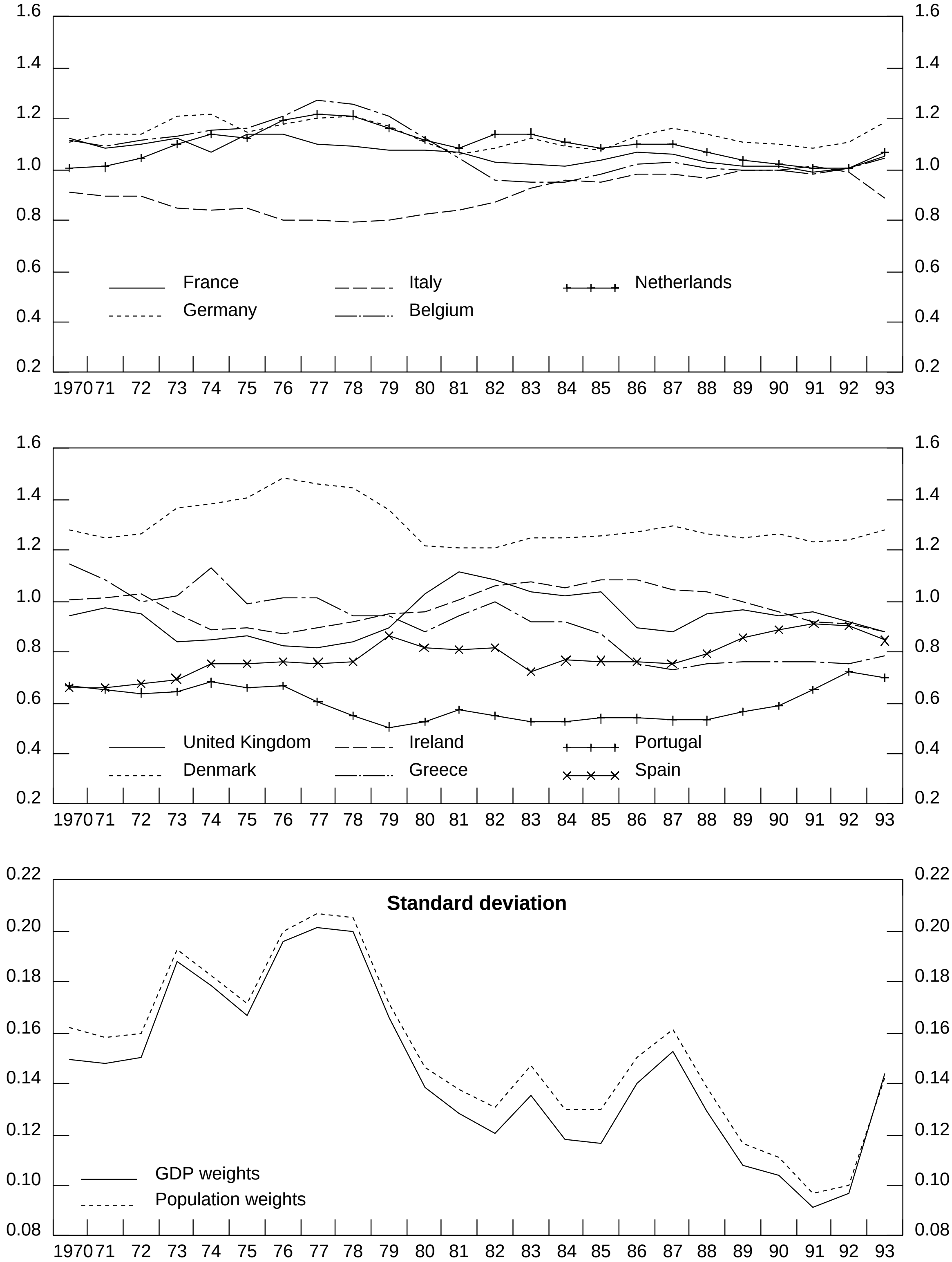


1. At international prices.

Source: OECD.

EEC94.GDPCAP/ECOLB/07 JUNE 94

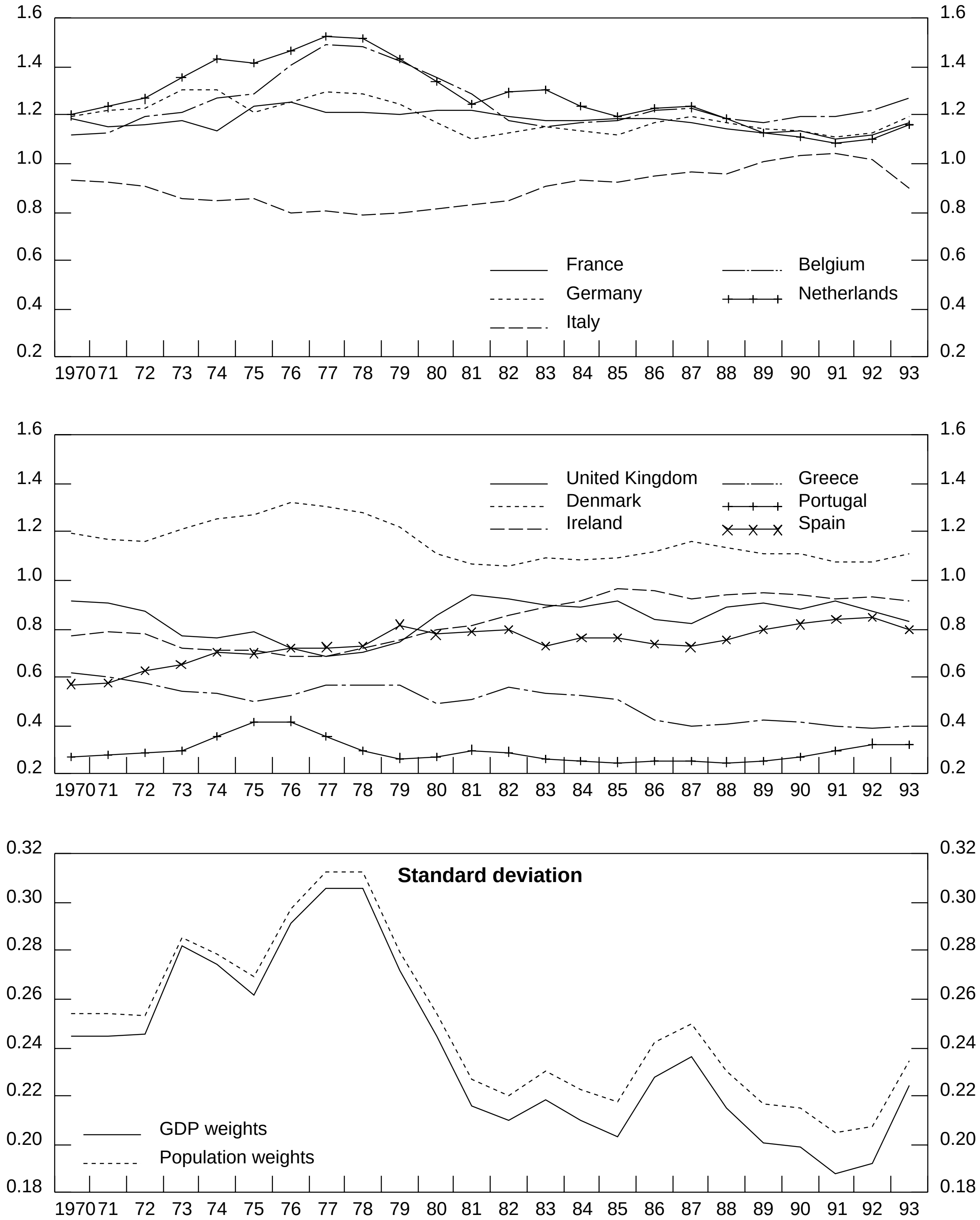
Diagram 8. CONVERGENCE OF PRICE LEVELS (1)
(Deviation from the EC average)



1. Comparative GDP price levels at international prices.
Source: OECD.

EEC94.PRICE/ECOLB/07 JUNE 94

Diagram 9. CONVERGENCE OF WAGE RATES (1)
(Deviation from the EC average)

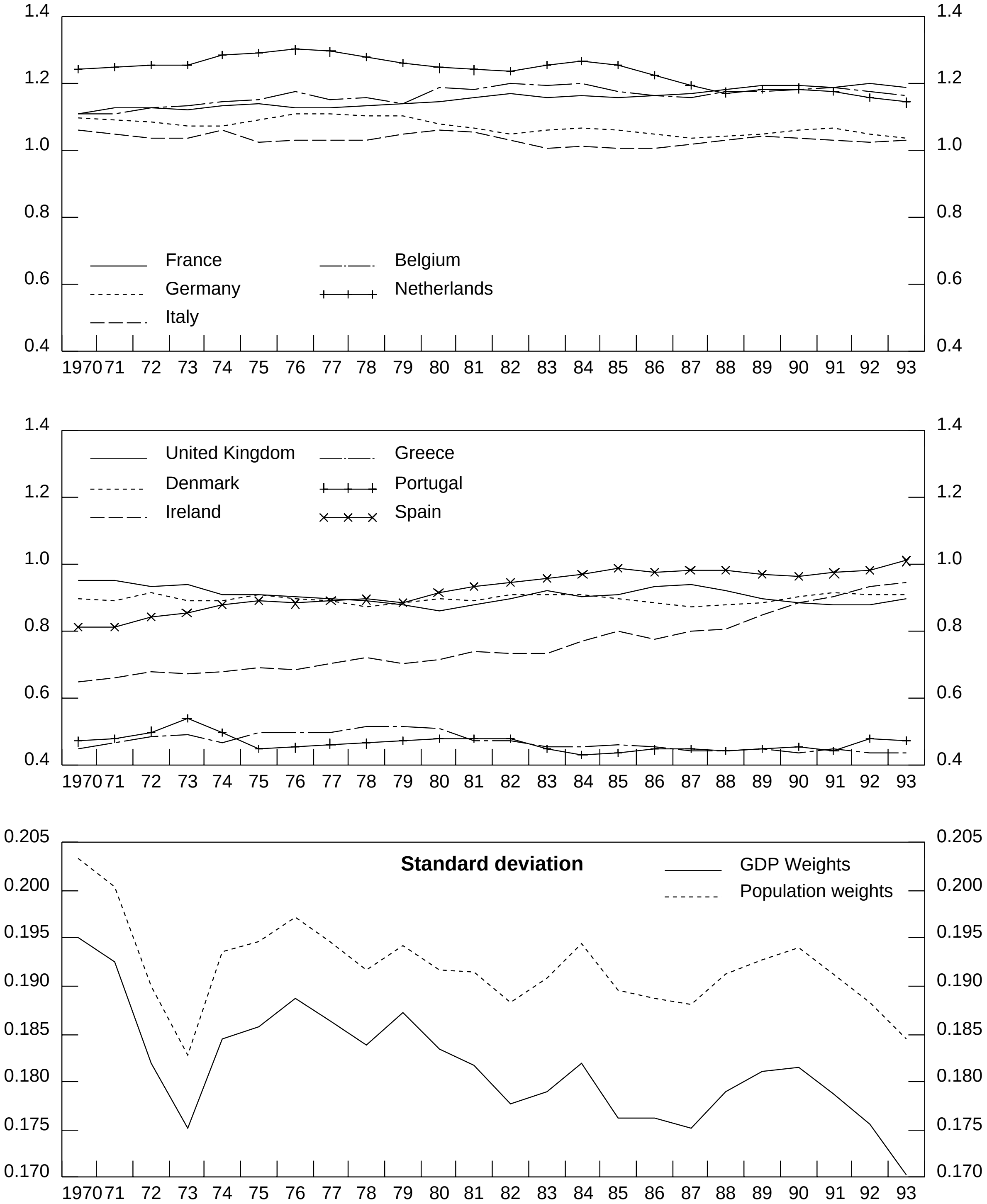


1. Compensation per employee in the business sector.
Source: OECD.

EEC94.COMP/ECOLB/07 JUNE 94

Diagram 10. CONVERGENCE OF PRODUCTIVITY LEVELS (1)

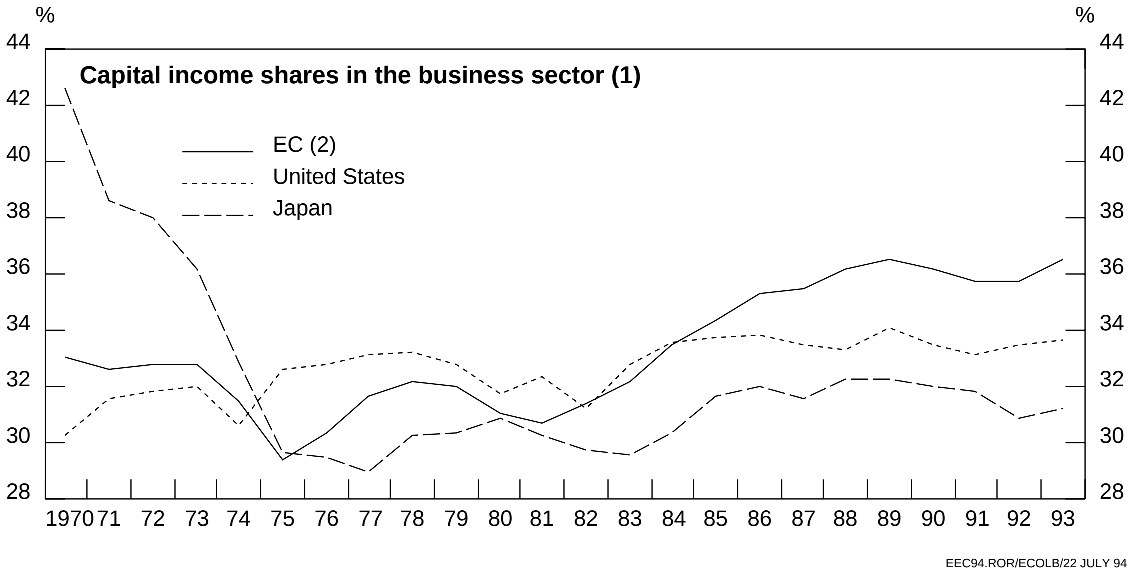
(Deviation from the EC average)



1. Business sector.
Source: OECD.

EEC94.PROD/ECOLB/07 JUNE 94

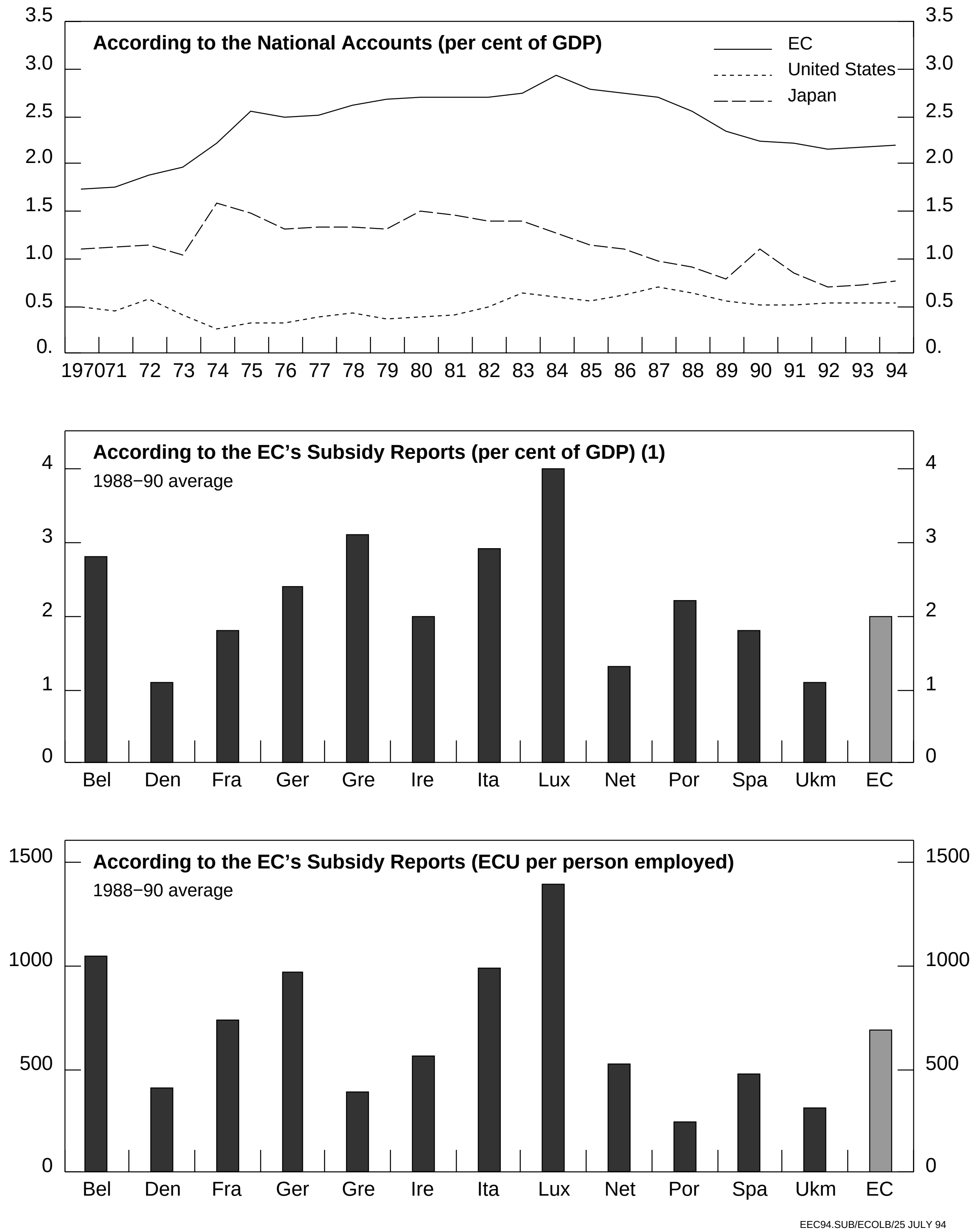
Diagram 11. PROFIT MARGINS



1. Gross operating surplus is adjusted for imputed income to self−employed persons excluding unpaid family workers.
2. EC data include western Germany until 1991 and total Germany as from 1992; they exclude Portugal and Luxembourg.

Source: OECD.

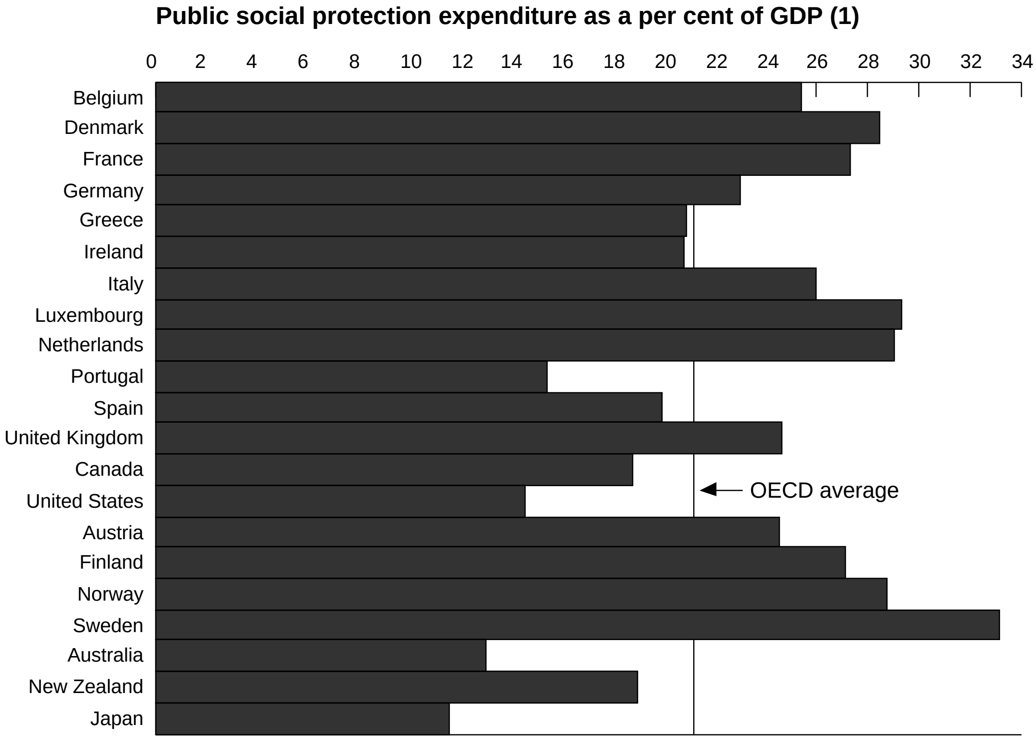
Diagram 12. SUBSIDISATION

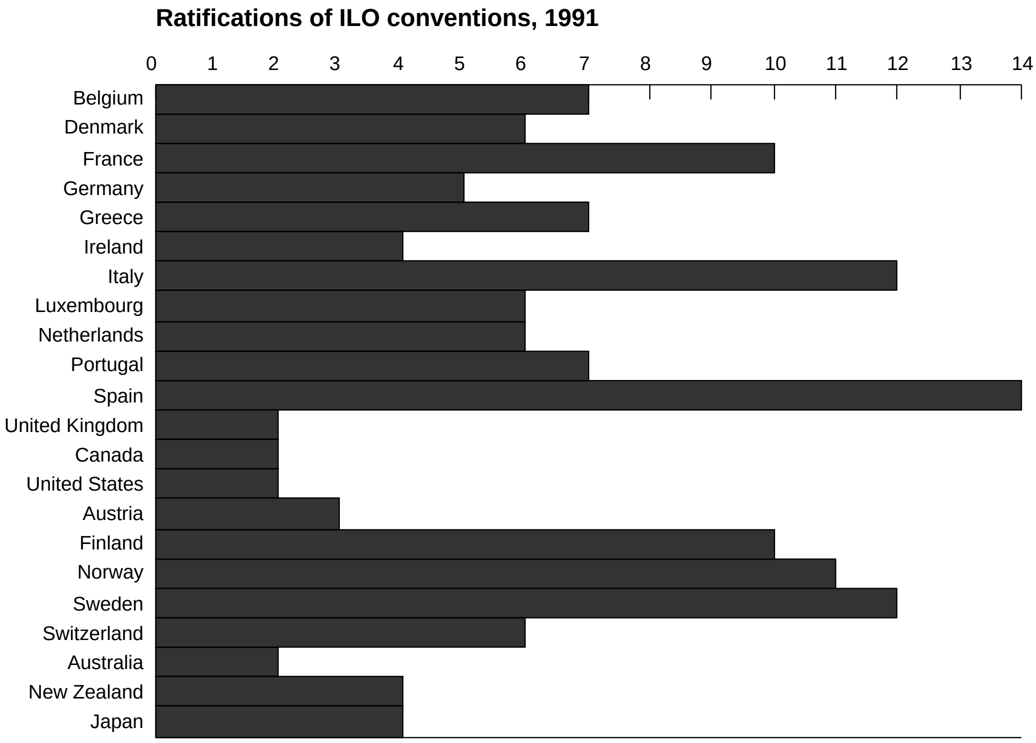


1. Including direct grants, tax reductions, equity participations, and aids elements contained in soft loans, tax deferrals and State guarantees, but excluding EC subsidies.

Sources: OECD; EC (1992), Third survey on State aids.

Diagram 13. LABOUR STANDARDS AND PUBLIC SOCIAL PROTECTION EXPENDITURE





EEC94.LAB.ST/ECOLB/07 JUNE 94

1. EC countries : 1991 (except Greece : 1989), non EC countries : 1990.
Sources: Torres (1994) and ILO.

Annex I

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Annex II

Harmonization of standards

In the case of standard industrial products, the "new approach" is characterised by directives defining the essential requirements a product has to meet. Standards intended to become harmonized standards are developed by the European standards bodies. Some 240 technical committees work within CEN (Comité européen de normalisation), CENELEC (Comité européen de normalisation électrotechnique) and ETSI (European Telecommunications Standardization Institute) on the preparation of such standards. Every product which meets these standards is presumed to comply with essential requirements laid down in Community law, such as those on health and safety, and enjoys freedom of movement.

The "new approach" directives appeared first in 1987. They relate, for example, to pressure vessels, toys, construction materials, electromagnetic compatibility, machine safety, personal protective devices and gas appliances. In 1991, the Commission published a Green Paper on the future of Community standards making (technical harmonization), and a June 1992 Council Resolution stressed that the aim was to achieve high-quality standards as well as efficiency and transparency in the standard-making process. The Community has set about strengthening the procedures and expanding the role of standardization in Community legislation. In July 1993, a Council directive laid down a single mark of conformity with the essential requirements of the "new approach" directives.

In those areas where the "old approach" applies, complete harmonization of standards has been achieved in the case of fertilisers, chemicals, cosmetics, tractors and pharmaceuticals[52] (including the adoption in July 1993 of a regulation to create a European Medicines Agency -- which should be operative in 1995). Harmonization of standards is virtually complete for some foodstuffs falling under framework directives (materials in contact with certain foodstuffs), while others have merely been the subject of a joint decision (food hygiene, for example) or are under discussion in the Council (additives, labels or irradiated food). Where motor vehicles are concerned, all the required technical specifications (44 directives) have been effectively harmonized and administrative formalities have been adapted to a standard EC approval[53].

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52. Given the diversity of national health regulations and appreciable differences in social security reimbursement systems, harmonization was especially difficult for pharmaceuticals, and the Council has adopted a set of directives aiming at establishing a single market for pharmaceuticals.

53. This approval has been operational on a voluntary basis since 1993 and will be compulsory in 1996.

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