EUROPEAN FILE

The big European market: a trump card for the economy and employment

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The completion of the European internal market[1] planned for the end of 1992, will help to regenerate industry and services; it will give a lasting boost to the prosperity of all Europeans, with savings of some 200 000 million ECU for firms[2] and – in the medium term – 2 to 5 million new jobs as well as 5 to 7 % extra non-inflationary economic growth.

These are the main conclusions of a scientific study commissioned by the European Commission to evaluate the benefits of the single market.[3] The study also confirms what everyone working to build Europe suspected: the failure to achieve the single market has been costing European industry thousands of millions in superfluous expenditure and missed opportunities.

The study not only quantifies the heavy costs that we now bear because of border controls which partition the Community's economy into 12 separate markets. It also calculates the value of the immense opportunities which the completion of the internal market will open up: opportunities for growth, job creation, economies of scale, improved productivity and profitability, healthier competition, mobility for workers and firms, price stability and wider consumer choice.

The economic advantages are estimated to be of the order of 170 000 to 250 000 million ECU in 1988 prices. This will increase the Community's gross domestic product by up to 5 % of the 1988 level. The medium-term gain, within five to six years, might even be close to 7 %, if the right effort is made in economic policy. This calculation includes the savings made by removing barriers directly affecting intra-Community trade (essentially internal frontier formalities and related delays), but also – and most importantly – the effects of removing barriers to production which hinder new market entrants and thus obstruct free competition. To this must be added the cost savings which businesses can achieve by exploiting more fully the potential economies of scale offered by a large, single market, for which larger production runs are possible. These benefits will start to materialize in the short term, as increases in production allow fixed investment costs to be covered by an increased volume of sales. However, they will be particularly evident in the long term as companies and production units restructure themselves and come closer to the optimum level of production.

Finally, further gains in efficiency will be achieved through intensified competition, which will affect such factors as overhead costs and the gearing of manning levels and management in general to production requirements; the large market will demand a re-evaluation of commercial strategies and increased efforts for technical innovation.

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1 See *European File*, No 17/87: 'Europe without frontiers: towards a large internal market'

2 1 ECU (European currency unit) = about £ 0.66; Ir£ 0.78 or US$ 1.2 (at exchange rates current on 1 June 1988).

3 English language edition published under the title 'The European challenge - 1992: the benefits of a single market' by Gower Publishing Company Ltd.

In addition, the study shows that the anticipated effects of the integration of the Community market through the removal of border controls, the opening-up of public procurement, the liberalization of financial services etc. and other supply-side factors will, in the medium term:

- ☐ Avoid overheating the economy. This is because, as economic activity receives a strong boost and employment and living standards improve, consumer prices will be deflated by an average of 6 %.

- ☐ Relax budgetary and external constraints, by improving the balance of the public accounts of the Member States by an average equivalent to 2.2 % of GDP and by consolidating the external position of the European Community – its balance of trade and payments with the rest of the world – by approximately 1 % of GDP.

The consequences for employment would be tangible: in five or six years, close to 2 million new jobs would be created in the Community, and that figure could be increased to 5 million or so, with appropriate accompanying economic policies.

Origin of the study

In 1986, on behalf of the European Commission, Lord Cockfield, Commission Vice-President responsible for the internal market, invited Mr Cecchini, special advisor to the Commission, to organize a comprehensive enquiry into the likely economic impact of completing the action programme set out in the 1985 White Paper on the internal market.

A large number of independent economic experts, consultants and research institutes contributed to this project, which was fully supported by the service of the Commission.

The project included:

- ☐ Studies of individual categories of trade barriers (for example, frontier delays).

- ☐ Studies on the disadvantages which affect manufacturing industries (e.g. the food industry, the pharmaceutical industry, the automobile sector, the telecommunications equipment industry).

- ☐ Studies on the disadvantages for various branches of the services sector (such as commercial and financial services and telecommunications).

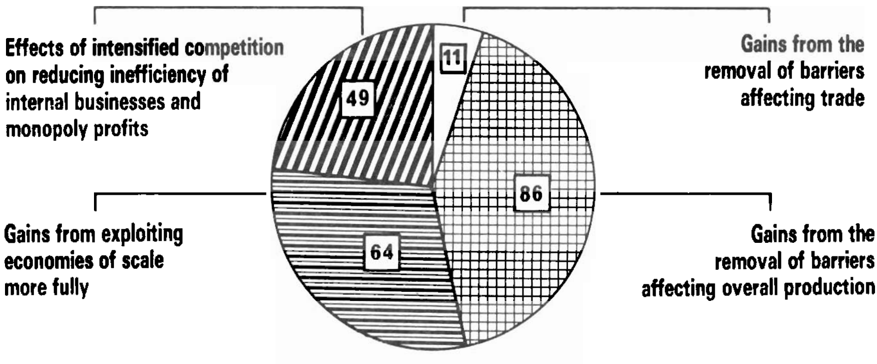
- ☐ Studies of the principal relevant economic phenomena (economies of scale, structure of industries, the effect of competition on corporate behaviour, etc.).

- ☐ An opinion survey among 11 000 industrialists, covering all member countries and all branches of industry.

- ☐ An econometric model for integrating the results of the micro-economic data into overall macro-economic results.

Potential gains from the completion of the European internal market: micro-economic estimates

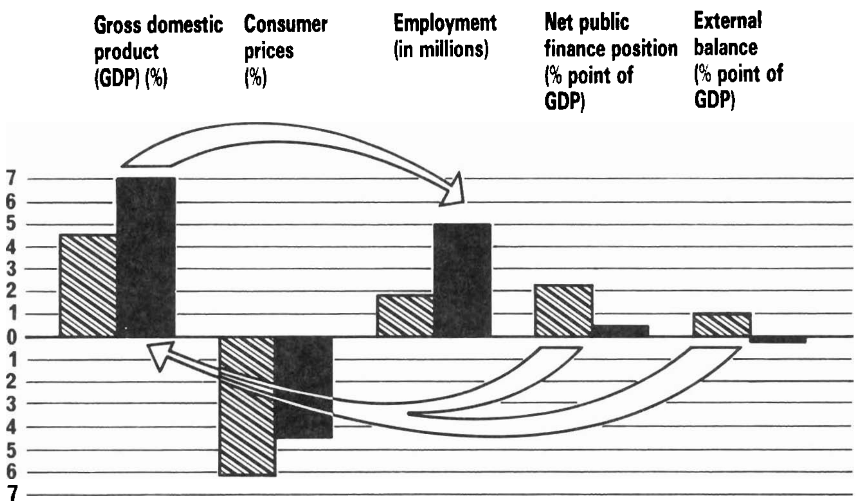
in billions of ECU, at 1988 value, for the 12 Community Member States *



Total: 210 billion ECU

* Average values estimated for a total within a range from 170 to 250 billion ECU (4.25 to 6.50 % of Community GDP).

Medium-term macro-economic consequences of market integration *



Without accompanying economic policy.

With accompanying economic policy, conducted in such a manner that the margins of manœuvre for the budget and external balances are used to support growth and employment (e.g. increased public investment, reduction in direct taxation).

* Simulations conducted on the Hermes and Interlink models. Margin of error: ±30 %.

Source: Commission of the European Communities.

Mr Paolo Cecchini and his colleagues have assembled the results of the study in a book which is to be published in all Community languages and distributed by private publishers in the Member States. In addition, the Commission's Directorate-General for Economic and Financial Affairs has provided details of the underlying economic analysis in a special edition (March 1988) of the review *European Economy.*

The Commission is also to publish three volumes of working papers summarizing the results of the numerous sectoral studies and business surveys. Finally it will publish, as documents, the complete reports on the consultants' studies.

Very significant results

Our two diagrams summarize respectively the estimated micro-economic and macro-economic consequences of the completion of the internal market.

Two types of assessment were carried out. The first approach was to measure the effects with the aid of micro-economic concepts and in close sectoral detail. The second approach gave results expressed by means of the usual macro-economic aggregates: GDP, inflation, employment, etc. The two types of approach were based on the same sources of information and are therefore coherent from this point of view. However, results may differ slightly as they are sometimes based on different hypotheses (in regard to methodology or economic policy).

☐ *Micro-economic assessment*

- The direct costs of border formalities and their associated administrative costs for the public and private sectors are estimated to be of the order of 1.8 % of the value of goods traded within the Community.

- To these must be added the costs for industry of other identifiable barriers within the European market, such as technical regulations. According to the industrialists questioned for the opinion surveys, these represent on average just below 2 % of their overall costs.

These figures, which in total represent approximately 3.5 % of industrial value-added, reflect the direct cost of identifiable market barriers. The total benefits which are to be expected from complete competitive integration of markets are much greater.

- In particular, certain industries and branches of the services sector which are currently subject to market entry restrictions, could have their costs and prices reduced by a much greater percentage. Examples include branches of industry for which public procurement markets are important (energy production, transport, office or defence equipment), financial services (banking, insurance and securities), and road and air transport. For these sectors, cost and price reductions would frequently be of the order of 10 to 20 %, and in certain cases would be even greater.

- The study shows that the potential economies of scale not exploited by European industry are substantial. In more than half of all branches of industry, 20 firms of efficient size can co-exist in the Community market while the largest individual nation markets could support only four each. As a result, only a real European internal market can combine the advantages of technical and economic efficiency — 20 firms being more capable of ensuring effective competition than four. If the current industrial structure is compared with a more rationalized (but still less than optimal) one, it is estimated that approximately a third of European industry could benefit from cost reductions of 1 to 7 %, depending on the branch concerned. The aggregate saving from economies of scale would be equivalent to approximately 2 % of GDP.

- There will be further gains in efficiency as a result of increased pressure of competition. These gains will be achieved in such areas as overhead costs, the deployment of labour and efficient stock management. Evidence from a range of sources suggests that these factors may be of considerable importance. In addition, in situations where there are now monopolies as a result of national market protection, the elimination or reduction of monopolies will bring benefits for consumers through price reductions. While much of the variation in consumer prices between different Community member countries is due to indirect taxation, the remainder is indicative of inefficiency and non-competitive partitioning of the market.

The study concludes that, in total — that is for all sectors and for all types of cost savings and potential price reductions — there would be economic gains of the order of 4.25 % to 6.50 % of GDP for the Community as a whole. This is how a range of 170 000 to 250 000 million ECU in 1988 prices is arrived at for the 12 Member States.

The study did not systematically evaluate the distribution of such benefits between the Member States. However, it is clear that all would gain. Because the potential benefits of market integration often arise from more efficient production methods and lower unit costs, the new Member States could register gains above the average, especially if account is taken of the support which the recently decided doubling of Community structural Funds should give to their development.

☐ *Macro-economic simulation*

The study also included a certain number of exercises in macro-economic simulation, the object of which was to determine the possible destribution over time of the impact of the 1992 programme and the results for certain economic variables such as employment and inflation. For this purpose, the effects of the internal market programme, as obtained from the micro-economic evaluation, were re-organized under four major headings, each with a different type of macro-economic impact:

- The elimination of delays and costs resulting from internal border formalities.
- The opening of public markets to competition.
- The liberalization and integration of financial markets.
- More general supply-side effects, reflecting changes in company strategy in a new competitive environment.

The results depend in part on the macro-economic policy accompanying the 1992 programme.

The global impact would first show itself in terms of downward pressure on prices and costs. An increase in production would follow with a modest time-lag. After approximately five to six years, a cumulative impact of + 4.5 % in terms of GDP and of - 6 % in terms of price levels could be expected. Taking account of the overall effects of increased economic integration with regard to productivity and the inevitable restructuring, the impact on employment should in the medium term be positive, with a net gain of about two million jobs.

If there is a more active macro-economic policy, to accompany the completion of the large market and draw maximum benefit from the new potential for growth and from the non-inflationary room for manoeuvre in regard to budgetary and external balances, the medium-term gains could be as high as 7 % of GDP. On this basis, the number of additional jobs could reach 5 million, which corresponds to close to one third of Europeans currently seeking work.

☐ *Overall results*

The micro-economic estimates and macro-economic simulations are mutually supporting. Moreover, the results might well be underestimated in that they exclude certain types of continuing dynamic benefit which market integration is likely to bring. Such benefits should be significant, but they are very difficult to quantify.

Three examples can be given:

- It is becoming more and more clear that the trend rate of technological innovation in the economy depends on whether or not there is competition; only an integrated market can simultaneously offer benefits of scale and competition.
- Dynamic effects of economies of scale and of increased know-how will be felt particularly by fast-growing, high technology industries, with costs diminishing as the total accumulated production of certain goods and services

increase. At present, market fragmentation seriously limits such benefits and is damaging to the performance of key, high-growth industries vital for the future.

- European enterprises are being called on to change their commercial strategies; there is evidence that this has already started. The full integration of the internal market will encourage the emergence of truly European companies, whose structures and strategies will be more suitable and ensure them a strong market position. The study further argues that the benefits of the single market will develop gradually and that they will multiply as they grow. During the first phase, the elimination of barriers will produce modest, technical and short-term benefits, but as market integration begins to influence economic structures, the benefits will become much greater.

A potential which must be fully exploited

The study confirms that if the Community means to draw maximum benefit from its large internal market, its internal frontiers and associated administrative formalities must truly and completely disappear.

All barriers must be eliminated, otherwise the last remaining barriers could suffice to maintain partitioning of the market and to stifle competition.

Europe is facing political and social challenges as much as economic ones. The 1992 objective will not be achieved without risks for a range of positions and interests which benefit from protection, on the regional or national level as well as on the level of industries, firms and their workforces. Whatever the potential benefits, the path to economic integration is not an easy one, but is strewn with obstacles. The decisions to be made will often be hard. They will be facilitated if the following conditions are fulfilled.

☐ Community entrepreneurs and industrialists must be ready to face the challenges of 1992 and seize the new opportunities offered to them. Corporate management must encourage the involvement of workers in their enterprise and ensure for them their share of the profits from productivity gains resulting from economic integration.

☐ An effective competition policy must be implemented by both the Community and national administrations in order to guarantee that particular barriers which have just been dismantled will not be replaced by other anti-competitive devices. Those who want competition must be certain that they can compete. Firms should be capable of competing on fair terms with known commercial rivals, but they should not be expected to compete with governments operating behind their competitors. Moreover, enterprises must clearly understand that commercial practices intended to protect markets or to abuse dominant positions must be vigorously opposed. At present, price discrimination between national markets is widespread and substantial, to the considerable detriment of consumers. In order to arrive at a fully integrated market, competition policy must ensure, for example, that parallel imports — purchases made abroad, without going through national distributors — are warmly welcomed wherever unjustified price differences exist.

- ☐ The distribution of the benefits of the large market must be fair; so must the distribution of costs. The assumption must not be that such a distribution will be problematic. The removal of customs tariffs between the original member countries of the Community had only modest redistributive effects; the enlargement of the Community subsequently stimulated investment and economic growth in the new Member States. However, there can be no doubt but that it will be necessary to provide support for disadvantaged or declining regions; this the Community has undertaken to do. Similar measures are also justifiable for workers affected by restructuring. The success of the 1992 programme will be guaranteed only insofar as the benefits of economic integration are used to strengthen the consensus around it.

- ☐ Economic policy must help integration. Surveys undertaken as part of the study have shown that business opinion is optimistic about the positive results of the 1992 programme in relation to turnover and output. A well coordinated and growth oriented macro-economic policy must support these expectations and hopes.

- ☐ The prime objective of monetary policy must continue to be the maintenance of a zone of monetary stability within Europe. However, one cannot hide the fact that the elimination of barriers between financial markets and the full liberalization of capital movements will increase the risk of exchange-rate instability. Such a risk must be countered by strengthening the European Monetary System and by increasing cooperation on monetary policy.

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The current fragmentation of the European economy and its weak competitiveness in numerous markets implies that there is plenty of room to rationalize production and distribution structures, which will lead to improvements in productivity and many cost and price reductions. The completion of the internal market, if judiciously reinforced by the economic and competition policies of the Community and its Member States, will have a wide and positive impact on the structures and performance of the European economy.

The size of this impact can be calculated in terms of the potential for additional non-inflationary growth: there would be an economic gain of approximately 200 000 million ECU in 1988 prices and 5 million new jobs would be created.

It is up to the people and the governments of the 12 Community countries to ensure that full advantage is taken of this potential. The implementation of the 1992 programme is still going ahead too slowly. By the end of 1988, the Commission will have submitted almost all the proposals and measures, some of them very complex, necessary for the total elimination of physical, technical and fiscal barriers to trade between Community countries. Some of these proposals have already been approved, but the number still awaiting decision is still a cause for concern.

The study briefly presented here should help every European to become more aware of the stakes involved ■

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