



HM Government

Review of the Balance of Competences between the United Kingdom and the European Union The Single Market

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The Single Market

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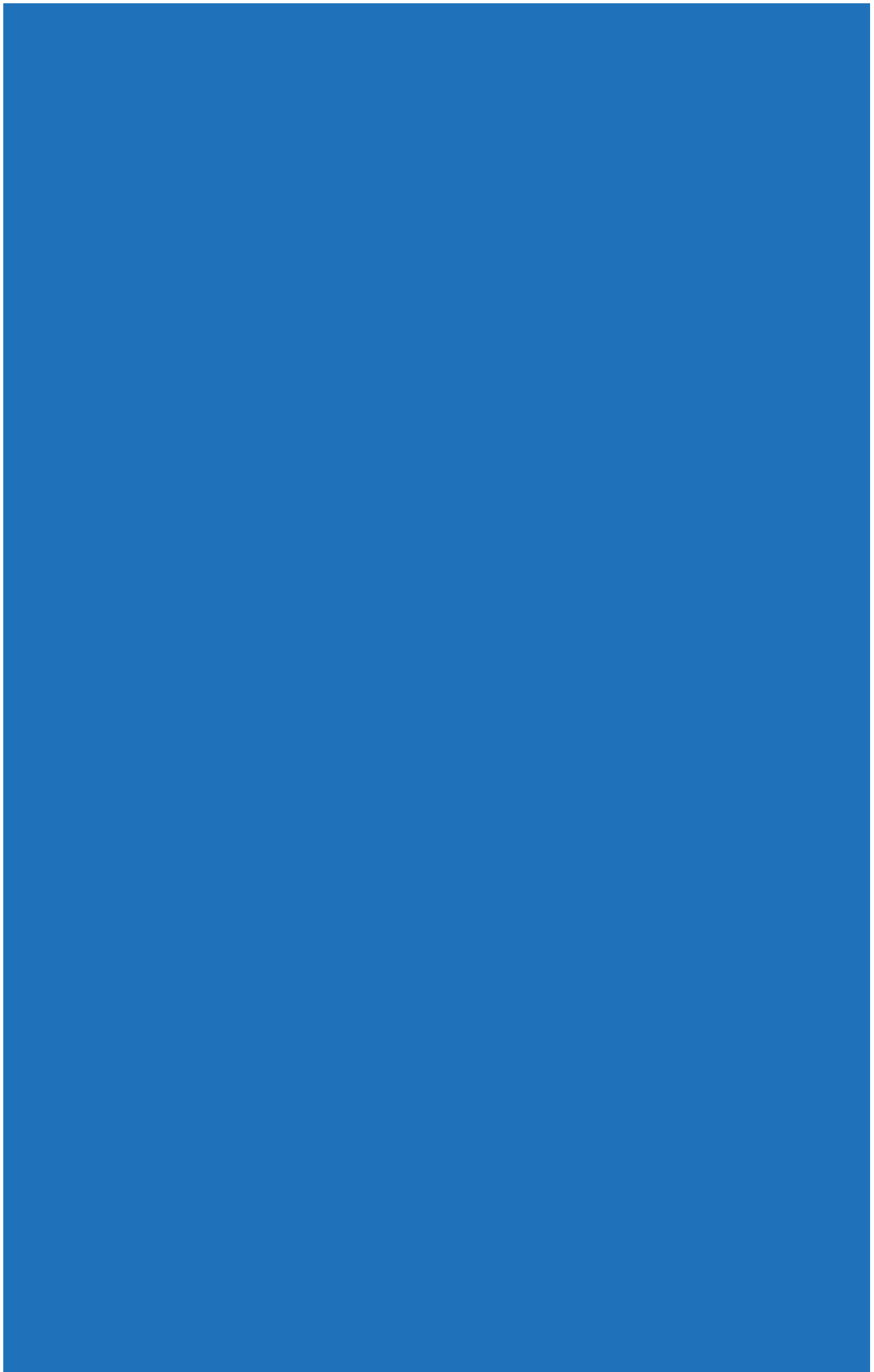
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Contents

Executive summary	5
Introduction	9
Chapter 1 The historical development of the Single Market	13
Chapter 2 The current state of competence	19
Chapter 3 The Single Market and the UK's national interest	35
Chapter 4 Future options and challenges	51
Appendix 1 Comparative analysis of economic studies on the impact of the Single Market	61
Annex A Certain third-country relationships with the Single Market	75
Annex B Submissions to the Call for Evidence	77
Annex C Engagement events	80
Annex D Other sources used for the review	82



Executive summary

This report examines the balance of competences between the European Union and the United Kingdom in the area of the Single Market. It is a reflection and analysis of the evidence submitted by experts, non-governmental organisations, businesspeople, Members of Parliament and other interested parties, either in writing or orally, as well as a literature review of relevant material. Where appropriate, the report sets out the current position agreed within the Coalition Government for handling this policy area in the EU. It does not predetermine or prejudge proposals that either Coalition party may make in the future for changes to the EU or about the appropriate balance of competences.

Chapter One sets out the **historical development of the Single Market** since its inception in 1958 with the Treaty of Rome. The Single European Act, which came into force in 1987, committed the EU to creating a functioning single market allowing for the free movement of goods, persons, services and capital (the so-called Four Freedoms). Subsequent Treaties have seen the addition of other areas, such as environmental, social and employment policy, to the original core. The jurisprudence relating to the Single Market has also developed in parallel through a number of important European Court of Justice (CJEU) judgments. Although the completion of the Single Market was celebrated in 1992, in reality it was far from complete at that point. Subsequent liberalisation over the past twenty years has created a deeply integrated, but not perfect, Single Market. Much further liberalisation remains possible and many barriers, both formal and informal, still remain.

Chapter Two sets out the **legal framework which makes the Single Market work**. It explains the Treaty structure, the Four Freedoms (goods, services, people, and capital), and how the EU legislates. It sets out the scope of competence within each of the Four Freedoms and the debates that surround each of them. It considers the pros and cons of harmonisation and mutual recognition as ways of encouraging market integration. It explores the debate surrounding the powers given to the EU by Article 114 in the Treaty on the Functioning of the European Union (TFEU). It concludes that it is not possible to establish a clear division between Member State and EU competence in the Single Market area, but that any situation where there is a restriction of movement on people, goods, services, or financial flows is potentially unlawful, susceptible to legal challenge, and must be shown to be objectively justified in the public interest.

Chapter Three explores **the impact of the Single Market on the UK's national interest**. It looks successively at:

- The **economic** benefits of the Single Market. It notes that most studies suggest that the GDP of both the EU and the UK are appreciably greater than they otherwise would be, thanks to economic integration through the Single Market. There is a fuller discussion of the studies in Appendix 1 of this report, including a summary table on page 72;
- The effect of the **legal regime** on economic actors, noting that businesses value the additional access to EU markets that the Single Market brings and recognise this will bring a regulatory burden. Views vary about the nature of that burden, the direction of it, and whether the UK “gold plates” it. The evidence also indicates that the standard of implementation and enforcement of legislation varies greatly across the EU and that this forms a significant barrier to UK firms’ ability to take advantage of the Single Market’s opportunities in practice;
- The impact of the Single Market on **policy development**. It highlights the strong influence the UK has had on the development of the Single Market, driving it in a broadly liberalising direction. It looks at whether the Single Market necessarily generates the need for EU-level policy-making in other areas, for either economic or political reasons, and concludes that it inevitably does in areas such as state aids, competition and network industries; potentially does in areas such as environment or regional policy; and that views vary about whether it necessarily requires EU-level employment and social policy-making, with large corporations and business trade associations being broadly sceptical.
- The Chapter concludes that:

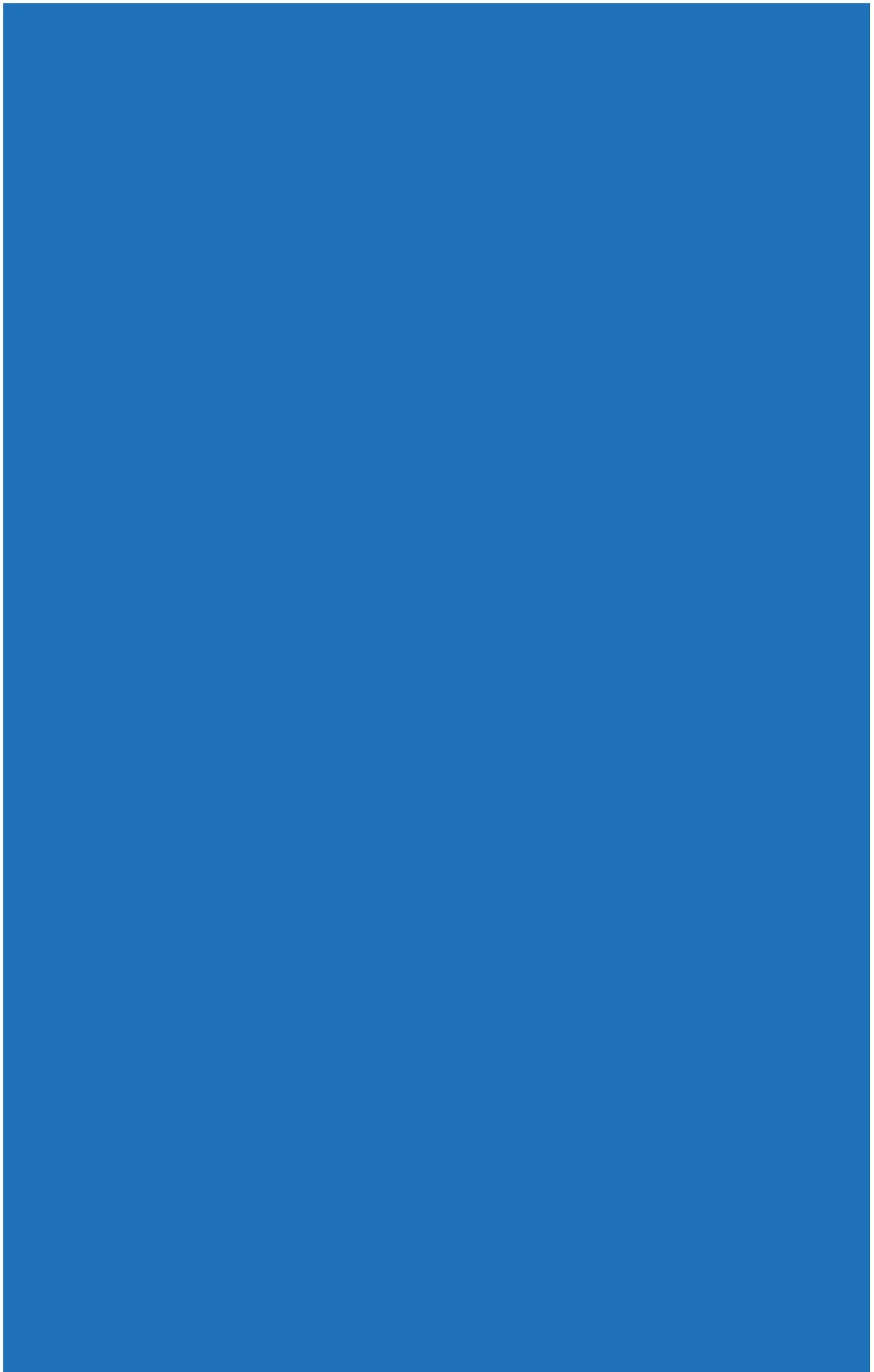
... integration has brought to the EU, and hence to the UK, in most if not all observers’ opinions, appreciable economic benefits. It has also spread the UK’s liberal model of policy-making more widely across the EU. But it has brought with it constraints on policy-making of varying kinds, and a regulatory framework which some find difficult to operate within or find burdensome, even if the obligations are not necessarily any greater than would have been imposed nationally. Is that trade-off, between cost and benefit, between economics and politics, of overall benefit to the UK? ... Most observers, and indeed most of the evidence received for this report, answer positively. They do so, not without qualifications or reservations, but with a focus on the economic benefits already achieved... and on those potentially available in the future.

Chapter Four considers the **future direction of the Single Market**.

- It explores how the economic crisis has caused many to look for ways to deepen the Single Market further to generate new growth across Europe. It highlights that the evidence submitted to the Review shows very strongly how important it is that the Single Market remains open to the wider world economy. It considers the impact upon the Single Market of possible further euro area integration.
- It looks at areas where the EU doing more might be in the UK’s interest, and suggests that the EU could strengthen its own enforcement efforts, focus on network and services liberalisation, and maybe make some small institutional changes.
- It also considers where the EU doing less would be in the UK’s interest. It suggests less and better legislation, with more reliance on the mutual recognition principle.

- It concludes that there is:

a broad consensus that [the Single Market] is at the core of the EU's development, that it has driven growth and prosperity in the Member States, and that it should continue to do so. At the same time the political will to drive its development into more politically sensitive areas is under challenge. The "free good" of significant enlargement of the market may not be on offer in the near future. Institutional developments in the euro area could also influence it significantly, for good or ill. All this means that the Single Market could once again be more at the centre of European political debate, which could open up opportunities for Britain.



Introduction

This report is one of 32 reports being produced as part of the Balance of Competences Review. The Foreign Secretary launched the Review in Parliament on 12 July 2012, taking forward the Coalition commitment to examine the balance of competences between the United Kingdom and the European Union. It will provide an analysis of what the UK's membership of the EU means for the UK national interest. It aims to deepen public and Parliamentary understanding of the nature of our EU membership and provide a constructive and serious contribution to the national and wider European debate about modernising, reforming and improving the EU in the face of collective challenges. It has not been tasked with producing specific recommendations or looking at alternative models for Britain's overall relationship with the EU.

The Review is broken down into a series of reports on specific areas of EU competence, spread over four semesters between 2012 and 2014. More information about the Review, including a timetable of reports to be published over the next two years, can be found at <https://www.gov.uk/review-of-the-balance-of-competences>.

The objectives of this report

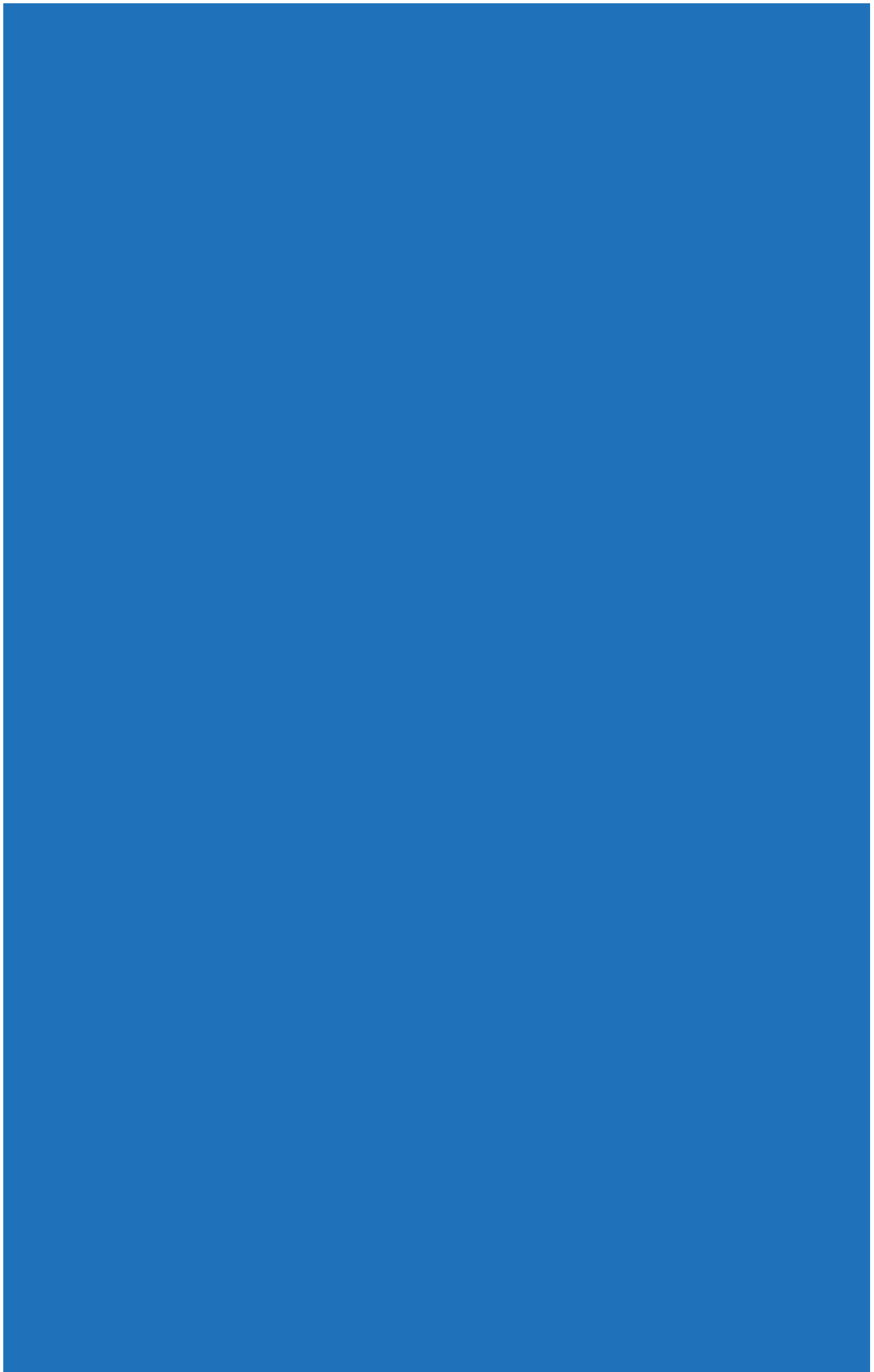
The objectives of this report are:

- To consider the broad issues and main debates underlying the Single Market as a whole, in particular exploring the level of market integration thought to be necessary for an effective Single Market, and the mechanisms (such as harmonisation or mutual recognition) for achieving it;
- To explore the interrelationships between the Single Market and other areas of competence, and to assess the strength of the arguments that certain other areas of competence are needed to enable the Single Market to operate effectively;
- As a result, to assess the implications for the UK national interest of the current state of integration and EU competence in the Single Market field.

Chapters 1 and 2 of this report set out the essential background: the history of the development of the Single Market and the current nature of the EU's powers in the Single Market area. Chapter 3 considers the three areas set out above. Chapter 4 looks to the future, identifying trends and possible policy options.

The nature of this report

The analysis in this report is based on evidence gathered following a call for evidence. It draws on written evidence submitted, notes of seminars and discussions held during the call for evidence period and existing material which has been brought to our attention by interested parties, such as past Select Committee reports or reports of the European Commission. These are set out in the Annexes.



Chapter 1:

The historical development of the Single Market

- 1.1 What is now known as the Single Market was a concept at the heart of the original Treaty of Rome, which came into force in 1958. That Treaty aimed at creating a “common market”, later “internal market”, covering the whole territory of the then six members of the then EEC. That common market involved a Customs Union and the free movement of goods – that is, a single external customs tariff plus the abolition of all duties and similar mechanisms between the Member States – as well as provisions on the free movement of workers, of services, and (in guarded form) capital, known as the Four Freedoms. There were provisions on competition policy and government aid to business (state aids). All these mechanisms continue to form the core of the Single Market (the more usual term nowadays for the common or internal market), today.
- 1.2 There was limited formal evolution in the system until the mid-1980s. The Customs Union was completed, and duties between Member States abolished, in 1968. But there was little EU legislation, partly because at that time it had to be agreed unanimously by all the Member States.
- 1.3 In parallel, though, there was significant evolution of the jurisprudence affecting the system, through a series of important judgments of the Court of Justice of the European Union (CJEU), judgments that promoted the Single Market, and invalidated trade barriers.

The Single European Act and the Single Market programme

- 1.4 This all changed in 1985. For some years Europeans had been preoccupied by “Eurosclerosis”, the perceived stagnation of European economies. A possible solution was quickly identified: to make a reality of the plans in the Treaty for a genuine single market for Europe. The UK was a major driving force in generating political impetus behind this, and pressed for the Single Market portfolio for the UK’s Commissioner, Lord Cockfield, in 1984. In 1985 the Commission submitted to the Milan European Council a White Paper¹, *Completing the Internal Market*, which argued for a new more dynamic strategy based on mutual recognition *and* on more legislative harmonisation. It listed 279 specific legislative measures to be brought into force by 1992, and proposed a series of Treaty changes to enable that to happen more swiftly. This essentially set the agenda for the Single Market as we know it today.

¹ European Commission, *Completing the Internal Market*, COM(85)310 final

- 1.5 Some, but not all, of these changes were incorporated into the Treaty through the Single European Act (SEA) which came into force in 1987: notably, a new Article which committed the EU to creating a functioning single market by 31 December 1992 and defined it as “an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured”, and an Article which allowed legislation with this aim to be agreed by qualified majority voting in Council (albeit with some exceptions such as tax policy). The SEA also added specific provisions on research and technological development, environmental policy, social policy, and economic and social cohesion.
- 1.6 At the same time the Commission proposed a new approach to Single Market legislation. Hitherto the approach had been to spell out the content of harmonisation in great detail in the legislation. This was slow, hard to agree, and often outdated by technical progress. There was also no link to the wider process of setting standards for products. The new approach, now incorporated into Directive 98/34, was based more clearly on the mutual recognition² of Member States’ standards where possible; on more transparency between Member States in standard-setting; and, where mutual recognition was not sufficient, on limiting legislative harmonisation to the health and safety area, with the private standardisation bodies setting out the technical standards. The advantage was that legislation could be less detailed and hence drafted more easily, and that technical progress could be incorporated through the standards process rather than redrafting legislation. The New Approach has been refreshed on several occasions and the principles are currently set out in Decision 768/2008/EC.
- 1.7 Attention between 1987 and 1992 focused on agreeing and implementing the legislation identified in the 1985 White Paper, and on maintaining political momentum. An important element was the so-called Cecchini Report from 1988, which attempted to quantify the benefits of the Single Market to the European economy. It claimed they would be in the region of 4¼% to 6½% of GDP.³ The Single Market programme also drove the separate push towards Economic and Monetary Union (EMU), with the intellectual underpinnings in the Commission’s paper *One Market One Money* of 1990.⁴

Deepening the Single Market

- 1.8 The “completion” of the Single Market was formally marked on 31 December 1992, by which time almost all of the original 279 measures had become law. In reality, of course, the Single Market was far from complete at this point. Integration was much deeper in the areas of goods and free movement of workers than in other areas. Services liberalisation was limited and rested almost entirely on jurisprudence rather than legislation. And some restrictions on capital movements between Member States remained in place.
- 1.9 The twenty years since 1992 have been years of progressive deepening of integration in respect of the Four Freedoms. Although there have been major adjustments to the original Treaty framework, the Single Market principles, as first conceived in 1958, have remained largely intact.

² See Chapter 2 for further detail

³ Cecchini, P., M. Catinat & A. Jacquemin (1988), *The European Challenge 1992: The benefits of a Single Market*, for the Commission of the European Communities

⁴ European Economy, *One Market, One Money – An evaluation of the potential benefits and costs of forming an economic and monetary union*, No 44, October 1990

Treaty changes

- 1.10 There were a number of major Treaty staging posts. The Maastricht Treaty (1993) added new EU competences in areas relevant to the Single Market such as consumer protection and trans-European networks; modified other areas such as the environment; gave Treaty standing to the 1988 legislation that largely abolished controls on capital and payments transfers between Member States; and created the concept of European citizenship, which would turn out to have major implications for freedom of movement within the EU. The Amsterdam Treaty (1999) brought social and employment policy fully into the EU Treaty framework, ending the UK-specific opt out, and brought many of the Third Pillar free movement provisions into the normal EU framework, though with special opt-out arrangements for the UK. Energy became a specific EU competence only with the Lisbon Treaty (2009) though there had already been much legislation liberalising the energy market on the basis of general Single Market provisions.

New legislation

- 1.11 In parallel there has been a major effort to deepen integration within the existing framework. In 1996 the Commission carried out the first of many studies into the impact and effectiveness of the Single Market, the conclusions of which were developed into the first of many Internal Market Action Plans, first endorsed at the Amsterdam European Council in 1997. Much subsequent attention focused on services. The Financial Services Action Plan in 1999 set out a range of proposed legislation aiming to make it easier to market financial services across the EU; in 2005 legislation was agreed, consolidating the system for mutual recognition of a range of professional qualifications across the EU; and in 2006 the Services Directive was agreed, consolidating jurisprudence and making it easier for unjustified barriers to services provision to be abolished.

The political context

- 1.12 Political impetus for continued economic reform, including deepening the Single Market, came from the 2000 Lisbon Agenda, which aimed to make the EU the “most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”.⁵ Similar single market principles underlie the current “Europe 2020” programme.

Enforcement

- 1.13 There has also been increased focus on the enforcement of legislation. In 2002 SOLVIT was established. This is a network between Member States that allows businesses and citizens to solve, without formal legal proceedings, problems caused by Member States not implementing, implementing incorrectly, or not enforcing EU legislation. Subsequently other networks have been established, such as the Points of Single Contact, which allows service providers to complete procedures online and in one place so they can deliver services in other Member States, and the Internal Market Information System, which allows Member States to share information quickly on services and recognition of qualifications.

⁵ European Council, *Lisbon Agenda*, March 2000

The Single Market as a package

1.14 Over this whole period there has been an increasing identification of the Single Market with the EU's broader micro-economic policy-making effort – that is, an acceptance that the Single Market represents more than just the Four Freedoms. That was arguably inherent even in the original Treaty of Rome, but it has become more explicit since then, as the quotation from the Lisbon strategy above makes clear. For many Member States, the current Treaty represents a “bargain” in which every Member State has to accept some decisions they find unpalatable in order to gain in other areas. Given Member States' different national traditions and their different “varieties of capitalism”, that is probably inevitable. Mario Monti, in his 2010 report, set out the issue most clearly, and controversially for some:

The new comprehensive strategy ... should be seen as a “package deal”, in which Member States with different cultural traditions, concerns and political preferences could each find elements of appeal important enough to justify some concessions, relative to their past positions.

In particular, Member States with a tradition as social market economies could be more prepared to [make] a new commitment on fully embracing competition and the single market, including a plan with deadlines on putting in place the single market in areas where it is still lacking, if Member States in the Anglo-Saxon tradition show readiness to address some social concerns through targeted measures ...⁶

The current state of play

- 1.15 Twenty years of liberalisation have produced a deeply integrated, but not perfect, Single Market. The high hopes of 1992 have not been wholly delivered upon. Much liberalisation remains to be done and many barriers, formal and informal, still remain.
- 1.16 The EU is currently in the middle of another phase of deepening the Single Market, kicked off by the Monti Report in 2010, and with legislative proposals subsequently enshrined in two Single Market Acts in 2011 and 2012. This work in progress is wide-ranging, but particular areas of emphasis have been developing the legislative framework to create a genuine digital single market, improving consumer protection to enhance confidence in cross-border purchases, improving financing for small and medium-sized enterprises, and deepening and enforcing liberalisation in the major network industries such as transport and energy.

Other European States' participation in the Single Market

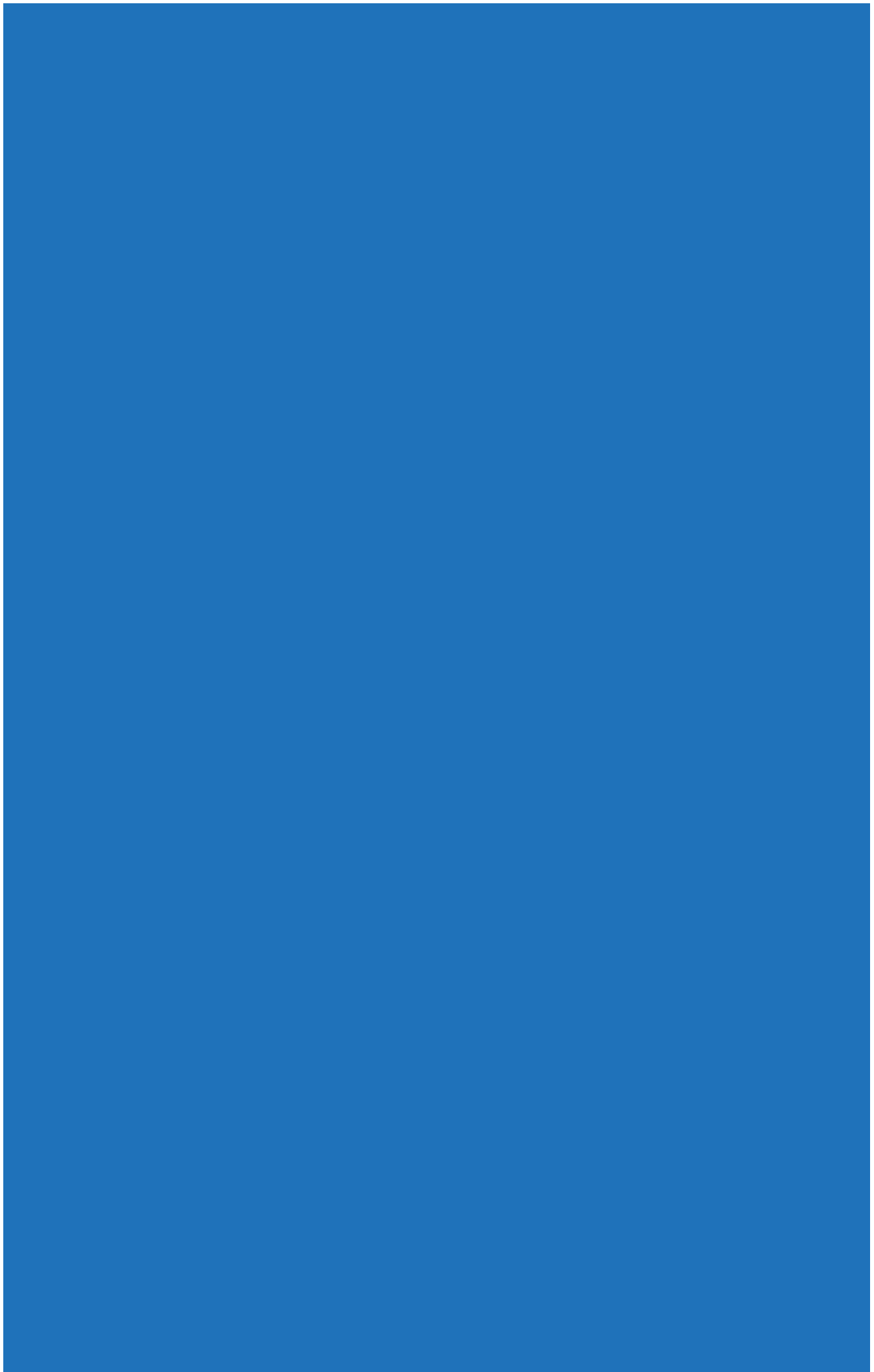
1.17 The Single Market is created by and made up of the Member States of the European Union. Other European states have various relationships with it. Relevant arrangements for European Economic Area members (Norway, Iceland, Liechtenstein), for Switzerland, and for Turkey, are set out in Annex A. Gibraltar is part of the EU under the arrangements in Article 355 of the Treaty on the Functioning of the European Union (TFEU). It is accordingly part of the Single Market, but outside the EU Customs Union, is exempt from the Common Agricultural Policy and the requirement to impose VAT. The Crown Dependencies' arrangements are discussed in the box below.

⁶ Mario Monti, *A Strategy for the Single Market – At the Service of Europe's Economy and Society*, 9 May 2010

The Crown Dependencies and the Single Market

The Crown Dependencies (the Bailiwicks of Jersey and Guernsey and the Isle of Man) are not members of the EU Single Market. Under Protocol 3 of the UK's Treaty of Accession to the European Union, the Islands are part of the Customs Union and cannot therefore impose restrictions on the free movement of goods. The other Single Market freedoms do not automatically apply.

However, in many areas the Islands have voluntarily adopted European legislation or implemented domestic legislation with the same effect, in order to facilitate the relationship between the Crown Dependencies and other EU Member States. For example, the Channel Islands airspace is sovereign but the Islands have voluntarily adopted EU airspace legislation to enable a Single European Sky. Some EU Directives allow third countries to be awarded equivalent treatment, for example on money laundering or audit requirements. Under such Third Country Treatment, the Islands agree a memorandum of understanding with the relevant EU agencies to oversee and validate implementation and enforcement of the directives by the Islands' governments.



Chapter 2:

The current state of competence

2.1 The Single Market as it now stands is highly complex. This chapter sets out a high-level sketch of the way it works. It is necessarily simplified, and should not therefore be relied upon as a precise statement of the legal position in all areas¹.

Treaty provisions covering the Single Market

2.2 Article 3(3) of the Treaty on European Union (TEU) requires the EU to
“establish an internal market”.

2.3 Article 26(1) of the Treaty on the Functioning of the European Union (TFEU) requires the EU to:

“adopt measures with the aim of establishing or ensuring the functioning of the internal market, in accordance with the relevant provisions of the Treaties”.

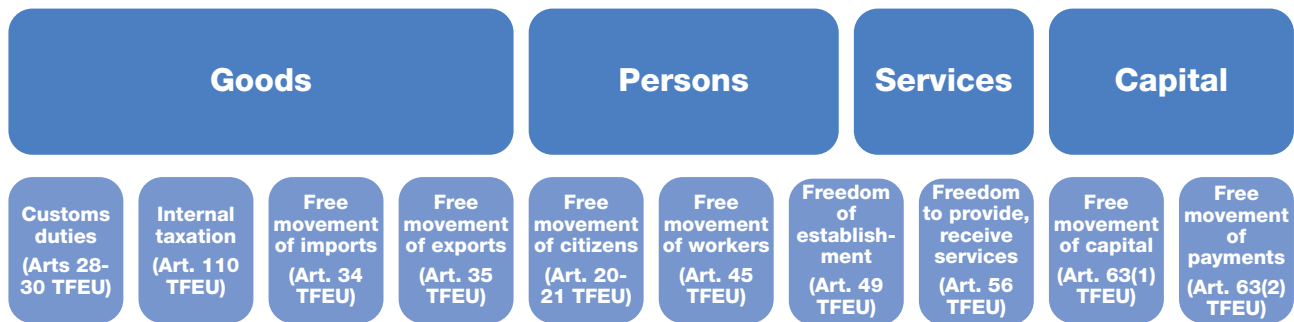
2.4 Article 26(2) of the TFEU then defines the Single Market as:

“an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties”.

2.5 The detailed provisions covering these Four Freedoms are then laid out in Articles 28 – 66 of the TFEU. They are summarised in the picture below. Some other relevant provisions are to be found elsewhere in the Treaty, notably Articles 110 -118 TFEU. The basic legal power allowing the EU to legislate in this area is found in Article 114 TFEU.

¹ That said, this section is drawn from many of the legal writers in this area, notably Craig and De Burca (*EU Law*), Barnard (*EU Law: the Four Freedoms*) and evidence submitted by them and others, notably Dougan

The Four Freedoms



How the system works

- 2.6 The EU Treaties provide for two kinds of activity aimed at building the Single Market.
- 2.7 First, the Treaty articles themselves, interpreted over the years by the CJEU, establish a basic legal framework covering both general principles of the EU's action, for example, the principle of non-discrimination between Member States' citizens and the specific application of the Four Freedoms, for example, the circumstances in which Member States must allow goods produced in another Member State to be sold on their own market. This is usually known as **negative integration** because it is designed to prevent Member States from having in place unjustified or disproportionate barriers to the free movement of goods, persons, services and capital.
- 2.8 Second, the Treaty gives the EU the power to make laws to remove barriers to the Four Freedoms, or distortions of competition, created by diverging national laws. These laws can set minimum standards on which the Member States can improve; "approximate" or harmonise a particular area; or codify the Court's existing jurisprudence into legislative form. They can be directly applicable (Regulations), which means they are automatically part of Member States' national law, or alternatively they may require implementation into Member States' national law (Directives). This process is known as **positive integration**.
- 2.9 The EU is given the powers to act in this area by means of a "shared competence" between the EU and the Member States (Article 4(2)(a) TFEU). Articles 114 and 115 TFEU give the EU a specific legislative power to legislate in the Single Market area, by qualified majority in one, by unanimity in the other. Article 118 gives a specific power to legislate in the specialised field of intellectual property.
- 2.10 In fields of shared competence, in principle powers can be exercised at EU level or by Member States nationally. The principle of subsidiarity guides the choice as to whether the aims of the measure can be better achieved at Member State or EU level. However, once the EU *has* acted, Member States can no longer act in ways which contradict that EU legislation.

- 2.11 The effect is that:
- (i) Where there is EU legislation, Member States must act in accordance with it and enforce it;
 - (ii) Where there is no EU legislation, a Member State can exercise its own powers. But when it does so, it must do so in a way which is compatible with the Treaty provisions and the CJEU's jurisprudence.
- 2.12 In other words, Member States are bound not just by the legislation but by the Treaty and the general principles of the CJEU's jurisprudence. Indeed, even if all EU legislation relevant to the Single Market were repealed overnight, the Single Market would continue to exist because Member States would still be bound by the Treaty provisions.
- 2.13 So why legislate at all? Legislation is needed because it clarifies the detail of broad Treaty provisions and jurisprudence in a way that is useful to economic operators, allows policy choices that would otherwise have to be left to the courts², and ensures, in theory at least, similarity of application across Member States. Without legislation, it would be much more difficult in practice for people and companies to enforce their rights, because their scope would be less clear and because any breaches by a Member State would need to be settled ultimately in court, which is more expensive, time-consuming, and uncertain. In practice Member States would be able to get away with more discrimination and protectionism.
- 2.14 But, in legislating, choices have to be made: administrative systems have to be established that may be more familiar to some Member States than others; the level of administrative and compliance burden has to be defined and some Member States may be more comfortable with it than others; and decisions may in practice impose economic costs more on some Member States than others. These trade-offs underlie much of the political debate around EU legislation and explain why measures designed to improve the collective European good can sometimes become bogged down in arguments about the detail between Member States. Added to this there can also be pressure to ensure that no Member State loses out, which means that the most expensive or burdensome existing national provisions can become the baseline for legislation, and costs ratchet up.
- 2.15 Where there is no EU legislation, Member States can continue themselves to legislate, but they must do so in a way which is consistent with the Treaty and the jurisprudence. Member States need to reflect before legislating to ensure what they are doing is in fact consistent. If it seems not to be, Member States can be challenged, ultimately in court, by individuals, other Member States, or the Commission, to prove that their action can be justified.
- 2.16 The Treaty principles can also apply to a broad range of situations involving cross-border economic relationships, going well beyond the Four Freedoms narrowly defined³, such as cross-border higher education or health care, areas where there is very limited or no formal EU competence. For example, it is these Treaty rules that require the UK to charge EU citizens the same university fees as UK citizens, and not the higher rates applying to non-EU citizens.

² The British Chambers of Commerce argues, however, that Directives can often be so vague that significant elements still have to be interpreted in the courts (BCC, p3)

³ Dougan, p1

2.17 Overall the effect is to constrain Member States' actions and to limit the range of economic and regulatory policy choices to those which are consistent with the goals of building the Single Market and of economic integration.

The Four Freedoms

2.18 The following sections set out the nature of the EU's competence in each of the Four Freedoms.

Goods

2.19 The Treaty provisions are at Articles 28 – 44 and 110 of the TFEU.

2.20 Articles 28 – 33 establish the EU as a Customs Union, i.e. an economic area with an external tariff and no customs barriers internally, and deal with some of its consequences, notably that all Member States must have the same external tariff, that this must be set collectively, and therefore that the EU must have a single trade policy with regard to other countries.

2.21 Article 30 stops Member States imposing on each other customs duties or any charges which are equivalent in practice, for example, charges for storage of imported goods unless this reflects real underlying costs. Article 110 prevents any Member State taxing other Member States' products more heavily than their own.

2.22 Articles 34 – 36, and the jurisprudence based on them, have been fundamental to establishing the Single Market. They forbid any quantitative restrictions on imports or exports, i.e. quotas or similar, or any "measures having equivalent effect". Article 34 in particular has been used by the CJEU over the years to rule illegal a wide range of Member States' measures that potentially have an impact on trade between Member States. In a series of noteworthy cases⁴, the CJEU has established that the Treaty provisions apply to all national rules that might hinder trade and that any product legally produced in one Member State can be sold in all (the famous "Cassis de Dijon" case), subject to certain limited exceptions, and that national legislation having the effect of preventing this was unlawful.

2.23 The effect of these rules is that:

- With certain limited exceptions, any national rules which hinder the access of goods from one Member State to another's market are unlawful unless they can be justified. This is true whether another Member State's goods are directly discriminated against ("distinctly"); discriminated against because rules in practice make it harder for that Member State's goods to comply ("indistinctly"); or because a Member State's national measures simply in practice hinder others' access to the home market.
- Direct discrimination can be justified only by using one of the exemptions in Article 36, ie "public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures; ...or the protection of industrial and commercial property." This is a closed list and its exemptions have been vigorously policed by the Court;

⁴ "Dassonville" [Case 8-74, Procureur du Roi v Benoît and Gustave Dassonville], "Cassis de Dijon" [Case 120/78, Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein], "Keck" [Case C-267/91 and C-268/91 [1993] ECR I-6097 Keck and Mithouard], "Towing Trailers" [Case C-110/05, Commission of the European Communities v Italian Republic]

- Other forms of discrimination or barriers can be justified on grounds known as “mandatory requirements” set out by the CJEU (notably fiscal supervision, public health, fairness in commercial transactions, and consumer protection, though the CJEU has not closed the list).

2.24 This jurisprudence has driven far-reaching integration in free movement of goods. Member States can ultimately be expected to demonstrate that national rules are in accordance with the Treaty or in compliance with any specific provisions in EU legislation in this area.

2.25 Articles 38 – 44 set out the special rules governing trade in agricultural (and fisheries) goods, which are very different from those in the rest of the Single Market. Broadly, the Treaty requires the EU to establish a common agricultural policy with aims that include stabilising prices and increasing farmers’ earnings as well as increasing productivity in agriculture. It does so through a series of “common market organisations”, set out in secondary legislation, and also allows for legislation to create specific exemptions from the ordinary competition rules.

Persons

2.26 This is possibly the most complex area of the Single Market. Although free movement of persons was in the Treaty of Rome right from the start, the most recent substantive developments stem from the creation of the concept of EU citizenship in the Maastricht Treaty. This eventually created a far-reaching set of rights for EU citizens (i.e. all nationals of Member States), and for third-country nationals who are also family members of EU citizens, which went beyond earlier provisions that focused on giving rights mainly to economically active EU nationals, i.e. to workers, companies, and service providers.

2.27 The fundamental underlying principles in this whole are the following:

- There can be no direct discrimination against nationals of other EU Member States on grounds of nationality. Exceptions are only justified if they are for one of the reasons set out in the Treaties, ie public policy, security, or health, which the CJEU interpret strictly;
- There can be no indirect discrimination (i.e. rules which seem to treat everyone equally but in fact have a particular effect on other countries’ nationals) and no broader restrictions which make it unattractive to use free movement rights in practice, unless they can be objectively justified.

EU Citizenship

2.28 **EU Citizenship** is a catch-all set of rights, ie they apply even to people who do not have rights as workers, service providers, etc. The Treaty provisions are at Articles 20 – 25 TFEU, though only Articles 20 – 21 are relevant in the Single Market context. Article 20, inserted by the Treaty of Maastricht, creates the concept of EU citizenship and provides that anyone who is a national of a Member State is also a citizen of the Union. Article 21 provides that

“Every citizen of the Union shall have the right to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in the Treaties and by the measures adopted to give them effect.”

2.29 Also significant is Article 18 TFEU, which prohibits any discrimination on grounds of nationality within the field of application of the Treaties. EU citizens can rely on these rights and they are directly applicable, ie individuals can rely on them even if there is no legislation implementing them.

2.30 The most significant secondary legislation in this area is the Citizenship Directive, 2004/38, which sets out the main free movement rights of EU citizens, as well as the limitations on those rights.

2.31 EU citizens have the following main rights:

- **The right of residence anywhere in the EU.** Broadly, EU citizens and their family members, including third-country nationals, may reside anywhere for up to three months. They may remain for over three months if they are working, if (in most circumstances) they have become unemployed or are in training; if they can support themselves otherwise; or if studying. They gain the permanent right of residence if legally resident in a Member State for five years;
- **The right of free movement anywhere in the EU**, including not to be deterred from moving to another Member State, and including the coordination of social security entitlements in accordance with the regime in Regulation 883/2004. The jurisprudence suggests that this provision even covers areas where the EU does not otherwise have extensive legislative powers;⁵
- **The right not to be discriminated against in another Member State.** Again, this provision even covers areas where the EU does not otherwise have extensive legislative powers.

2.32 In all cases, except direct discrimination, these rights can be restricted if there is “objective justification”, for example to restrict them to those with a sufficient link with the Member State concerned. But controlling costs *alone* is not sufficient grounds to restrict the rights, and national provisions are examined carefully to ensure they do actually achieve their declared objective and do not go beyond what is necessary to achieve that objective.

Free Movement of Workers

2.33 The Treaty provisions are set out in Articles 45 – 48 TFEU. They cover virtually all permanent employees.

2.34 Article 45 TFEU confers on workers and their families the right to work in any EU Member State; to travel to any EU Member State to seek employment; to live in any Member State; and to claim some benefits after having been employed. The detail has been laid down in legislation, most recently codified in Regulation 492/2011.

2.35 Article 48 allows the EU to ensure the coordination of national social security systems in ways that are necessary to provide freedom of movement for workers. Legislation is agreed by qualified majority, but, unusually, there is a so-called “emergency brake” allowing the European Council to consider and if necessary halt legislation. The latest provisions in this area are set out in Regulation 883/2004.

The Freedom of Establishment and the Freedom to Provide Services

2.36 The freedom to provide services is different economically from the free movement of goods. Goods, once produced, can circulate in the EU without the producer and consumer being present at the same time. This is not normally true for services: either the recipient moves to receive the service, for example, tourism, or the producer moves to provide it, either temporarily or permanently. The latter case is usually described as the freedom of **establishment**.

⁵ Case C-192/05 Tas-Hagen

- 2.37 The Treaty provisions on **establishment** are in Articles 49 – 55. Article 49 is a parallel right to that of free movement of workers and gives the right to persons to establish themselves **permanently** in another Member State as self-employed and to companies to establish themselves as a branch or subsidiary. Article 50 allows for EU legislation to facilitate this right: in practice this has been used principally for legislation providing an EU-level framework for company law. Article 53, which also covers services, requires Member States to recognise equivalent qualifications from other Member States, and is the legal basis for the important **Mutual Recognition of Professional Qualifications Directive**.
- 2.38 The Treaty provisions on **services** are set out in Articles 56 – 62. They give nationals or firms of one Member State the right to deliver services in another, on a **temporary** cross-border basis. (Transport services fall outside these provisions and are dealt with in Article 90 TFEU).
- 2.39 There is some overlap between the provisions of the two sets of articles.
- 2.40 The most prominent and controversial piece of legislation in this area is the **Services Directive**, Directive 2006/123. It deserves special comment. Despite its name, it covers both services and establishment. It was proposed by the Commission in 2004. The original proposal was controversial because it was aimed at enshrining the country of origin principle (see box below) into the EU services market, i.e. that Member States should, in principle, allow any person or company duly registered in one Member State to provide services or establish itself in another. In this, it reflected earlier legislation that did just that, for example the Television without Frontiers Directive (now updated into Directive 2010/13) or the E-commerce Directive (2000/31). However, the breadth of the Services Directive's scope, and its lack of positive regulation to balance out the deregulation implied by the country of origin principle, led some Member States to fear, however unrealistically, that it could produce unfair competition or a race to the bottom.

The country of origin principle

The distinction between **home country regulation** (often known as the “country of origin principle”) and **host country regulation** was important in the Services Directive negotiation and in many other areas too. Under the former, the regulatory rules of the home state (i.e. the sending or originating state) apply to a product or service. Under the latter, the host country's rules apply, and products or services on the host's market must comply with the host's rules.

In some areas, for example much of the market in goods, the country of origin principle applies and is generally uncontroversial, partly because in practice Member States all apply much the same or similar standards. In services and related areas it is more problematic, because of fears that poorly regulated and hence cheaper service providers from one Member State could legally operate on another's territory and undercut competition from the local producers.

- 2.41 The country of origin provisions were watered down in the final version of the Directive. It still requires Member States to allow access for others' service providers, but allows the imposition of a range of conditions which qualify the country of origin rule in practice. Beyond this, it codifies some case law, lays down rules on the rights of recipients and quality of service, and requires the establishment of a network of contact points between Member States enabling exchange of information about service providers' bona fides and enabling providers to register in each Member State to provide services. Some major areas of service provision are excluded, and the Directive does not apply to areas covered in separate legislation. The effect is to exclude major areas from the Directive, such as

financial services, telecoms, energy, healthcare, audiovisual, and taxation. Finally, the Directive specifically provides that it cannot affect labour law and social security provisions in the Member States. All this together means that the services landscape in the EU is fragmented and it is still difficult for service providers to enforce their rights. Major efforts are being led by the Commission and some Member States to deepen and integrate the market further, but it remains much less integrated than the Single Market for goods⁶.

- 2.42 **Financial services** are handled in a significantly different way. There is a large quantity of subject-specific legislation covering both the wholesale and retail areas. The wholesale financial services sector in particular is one of the most integrated parts of the Single Market. There is a very high degree of integration of money markets, considerable integration of bond markets and increasing integration of equity markets, under the supervision of the recently constituted European Supervisory Authorities⁷.
- 2.43 Finally, it is worth also noting that the EU's rules on **public procurement** are part of this freedom. With public procurement making up 19% of EU GDP (€420bn in 2009)⁸, a common set of rules is important to the operation of the Single Market. The key Directives are 2004/17 and 2004/18, though they are currently being revised by the Council and EP.

Capital

- 2.44 The Treaty provisions are set out in Articles 63 – 66 TFEU. Article 63 provides for the right to move capital freely, not just between EU Member States, but also between EU Member States and third countries, for purposes of investment or of payment, without restrictions and without discrimination. In their current form these provisions date from the Maastricht Treaty (1993).
- 2.45 This general provision is subject to a series of broad exemptions.
- First, Article 64 allows certain restrictions in place on 31 December 1993 to remain in force in the Member States. It also gives a legislative power to put in place **certain restrictions on movements of capital involving direct investment** vis-a-vis third countries, or to adopt measures which “constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries”.
 - Second, Article 65 provides a series of specific exemptions: to protect the integrity of national tax systems; to prevent capital transfers that break national law in taxation, prudential supervision of financial institutions, and, according to the Court, activities such as money laundering, drug trafficking, and terrorism; and to allow national rules for reasons of public policy and public security (which the CJEU has ruled may not be justified for purely economic ends, e.g. to weaken competition or prevent the closure of companies). This final exemption is the one on which Cyprus has relied for its recent introduction of temporary capital controls.
 - Third, Article 66 allows safeguard measures for up to six months where in exceptional circumstances movements of capital vis a vis third countries might cause operating difficulties for the Euro.

⁶ See examples in evidence submitted by the British Retail Consortium

⁷ See evidence submitted by the British Bankers' Association, the Building Societies Association, and TheCityUK for a fuller discussion of the detail and implications

⁸ European Commission, MEMO/11/931 (2011)

How legislation happens in practice: Article 114

- 2.46 Until the Single European Act (1987) all legislation covering the Four Freedoms had to be agreed unanimously by all Member States, with a very limited role for the European Parliament. The Single European Act introduced what is now Article 114 TFEU. This provides a power for “approximation” of Member States’ rules for the purposes of creating the Single Market. Decisions under it are generally taken by qualified majority. The role of the European Parliament has grown steadily over the years in this area to the extent that it is now a co-legislator with the Member States in the Council, i.e. the Parliament and the Council must both agree on a law if it is to come into force.
- 2.47 For example, Single Market legislation may be needed to avoid the risk of different national rules which would require, say, lawnmower manufacturers to adapt their product to each national market before it can be sold there. In these cases the EU can and does legislate under Article 114 to adopt a single standard. Indeed it has done just that with Directive 2000/14/EC.⁹
- 2.48 Article 114 cannot be used to adopt fiscal (tax) measures or decisions relating to the freedom of movement of persons or workers.
- 2.49 There has been a vigorous debate about what Article 114 can be used to do. It is drafted very broadly. Some have argued that it is close to being a general legislative power for the EU. Perhaps sensitive to this debate, the CJEU drew a formal limit in 2000, in the Tobacco Advertising case¹⁰. This was a challenge to the EU’s power to adopt the Tobacco Advertising Directive (98/43/EC) under Article 114. Germany argued that the Directive was really a public health measure, and that the Treaty article on public health, Article 168, did not give the EU the power to harmonise rules. The Court annulled the Directive on the grounds that not all of its provisions concerned inter-state trade or distortions of competition, and made clear that Article 114 could only be used for measures that genuinely improve the functioning of the Single Market, not just to eliminate differences between Member States.
- 2.50 This case was a symbolic and important recognition that there were limits to the use of Article 114 and hence to positive integration. That said, the CJEU has not, since 2000, struck down any other use of Article 114 TFEU, although this may be because the Commission has become more adept at drafting proposals which fit within the guidance provided by the Court. Indeed, some would say that in some ways the Court has broadened the scope of the Article. It has ruled, for example, that Article 114 can in some circumstances cover situations which concern only one Member State, i.e. where there is no cross border element¹¹; that it can be used to establish EU agencies^{12 13}, provided the Agency’s tasks are “closely linked” to existing Single Market legislation (the Meroni case¹⁴ sets the limits of discretion in this area); and that “approximation” can mean a wide range of measures, including in certain circumstances even banning a product¹⁵.

⁹ Evidence submitted by Barnard

¹⁰ Case C-376/98 Germany v. European Parliament and Council [2000] ECR I-8419 and Case C-74/99 R v. Secretary of State for Health and others, ex p. Imperial Tobacco [2000] ECR I-8599.

¹¹ Case C-465/00 [2003] ECR I-4989, para. 41.

¹² Case C-66/04

¹³ Case C-217/04

¹⁴ Case C-9/56 and 10/56, Meroni v High Authority (1957/1958) ECR 133

¹⁵ Case C-380/03 Tobacco Advertising II [2006] ECR I-11573, para. 42.

- 2.51 The current position is therefore as follows. There are in principle limits to the use of Articles 114 and 115: they can only be used for Single Market measures, those measures must genuinely improve the Single Market, and there must be no more specific legal base anywhere else in the Treaty. However, what actually constitutes a Single Market measure has been interpreted expansively by the Court.
- 2.52 The use of Qualified Majority Voting (QMV) in Single Market legislation has also aroused comment at times, though more so in the UK than elsewhere. All Single Market legislation is decided by QMV except on taxation, which is decided by unanimity, and social security, which is decided by QMV with an emergency brake, although a vote is only explicitly taken on a small proportion, and consensus is usually found in practice. It is argued by many observers that the extension of the Single Market would not have been possible without the use of QMV¹⁶.

Mutual recognition v harmonisation

- 2.53 An important distinction is that between **mutual recognition** and **harmonisation**.
- 2.54 Under **mutual recognition**, Member States agree to recognise each others' regulations and goods or services authorised under them. For example, if a particular good meets the requirements of one Member State, it has in principle to be accepted onto the market in all other Member States. Mutual recognition can be provided for directly by the Treaty or by the CJEU's jurisprudence, or it can be set out in legislation.
- 2.55 Under **harmonisation**, Member States' rules are explicitly brought into line through legislation. Despite the name, it does not necessarily, or even usually, mean making rules exactly the same in all Member States (known as exhaustive harmonisation): examples of exhaustive harmonisation include the Cosmetics Directive (76/768) and much of the legislation covering motor vehicle safety. Its typical form is the "approximation" provided for in Article 114, which normally means significant though not exhaustive harmonisation. Another form is minimum harmonisation, rules which all Member States must observe but which do not prevent some having tougher rules, for example, in the environment area.
- 2.56 Mutual recognition is generally simpler and can more readily reflect local conditions and preferences¹⁷. It could be said to be more in consonance with the principles of subsidiarity and proportionality set out in the Treaties. It enables regulatory competition and acts as a brake on over-regulation¹⁸: for example, many of the large digital service companies have located in Member States with less onerous national privacy and consumer protection regimes¹⁹. It does not *require* legislation²⁰ and can therefore be more adaptable to changes in technology or business models, and be less vulnerable to lobbying by vested interests. But it can be difficult to assert a mutual recognition right in court if a Member State does not easily enable it; and it can put onus on the consumer to deal with the consequences of divergent national requirements.

¹⁶ Evidence submitted by TheCityUK, Senior European Experts Group

¹⁷ Evidence submitted by Consumers for Health Choice

¹⁸ Evidence submitted by Open Europe

¹⁹ Evidence submitted by Vodafone

²⁰ Evidence submitted by Open Europe

Much of the legislation that governs this internal market is unnecessary and leads to the perverse outcome of consumers finding that products that they have long and safely used have been banned, or that there is less information available about them....In such areas where there are important dietary and cultural differences, mutual recognition should be preferred to harmonisation at all cost.

Evidence from Consumers for Health Choice

- 2.57 Harmonisation has the corresponding advantages and disadvantages. It can avoid, as some see it, a race to the bottom, by requiring a specific level of regulation across the whole of the EU.

On balance, there is an argument for favouring maximum harmonisation as the overarching model, as... simplification of the rules reduces fragmentation, clarifies both scope of application and interpretation and enhances social inclusion. All of which ultimately strengthens the single market.

Evidence from UK European Consumer Centre

- 2.58 It gives greater certainty across the whole market and can therefore be cheaper and simpler for businesses to comply with²¹. This may be why some studies have found that harmonised standards have raised trade in manufactures²². But it can involve significant adjustment costs, with potentially a disproportionate impact on SMEs.²³ Harmonised standards can constrain innovation²⁴ and competition²⁵ if new products are unable to comply with overly definitive harmonised requirements. It can also be very slow to negotiate because of the complexity of national regimes that are being harmonised²⁶. (In their evidence, Lloyd's point out that the Solvency II proposals have been discussed for over a decade and are unlikely to be agreed before 2016²⁷.)
- 2.59 Neither approach is self-evidently best and much depends on the sector concerned. BAE Systems maintain that harmonisation is preferable for new technologies if it can be achieved speedily, and that mutual recognition is more appropriate for existing, evolving technologies where standards already exist.²⁸ In contrast, Smiths Group argue that, in the medical device sector, mutual recognition is an appropriate method for ensuring the timely introduction of innovative products. Harmonisation may work better where there is a strong need for a single standard, goods are tangible and standards are easily assessed, and the need to maintain consumer confidence is strong. Mutual recognition may be better where there are significant differences between Member States in consumer preference or regulatory regimes²⁹.

²¹ Evidence submitted by Kingfisher

²² Evidence submitted by Centre for European Reform, Wine and Spirit Trade Association. For further case studies of the advantages of harmonisation for cross-border trade, see submissions from the Scotch Whisky Association and Safelincs

²³ Evidence submitted by Federation of Small Businesses

²⁴ Evidence submitted by CBI

²⁵ Evidence submitted by Institute of Directors

²⁶ Evidence submitted by Standard Life

²⁷ Evidence submitted by Lloyd's

²⁸ Evidence submitted by BAE Systems

²⁹ Evidence submitted by Senior European Experts Group

- 2.60 In practice, both processes are used together. There can be a process of regulatory development as economic actors become more comfortable with each others' approaches, with initial EU regulation handled through mutual recognition, before progressing to minimum harmonisation and finally exhaustive harmonisation³⁰. Or the two approaches can be used together, with mutual recognition combined with elements of common, positive rules, for example in Directive 2005/36 on the Mutual Recognition of Professional Qualifications. Another alternative is the so-called "28th regime", for example in some EU consumer law, whereby an EU framework exists in parallel, for voluntary use, as well as the national frameworks³¹. In all these processes there is in practice much scope for consultation with stakeholders and for getting the detail of the arrangements right.
- 2.61 Whatever the objective merits of the two systems, harmonisation has been used more in practice. One estimate is that only around one-fifth of goods are traded under mutual recognition without the need for a Directive.

...it has turned out to be difficult to get mutual recognition accepted with all its consequences, despite the almost universal acclaim of its great merits. The widespread recognition on its own has neither led to a sweeping liberalisation of the Internal Market, whether in goods or services, nor to much of a deeper analytical economic understanding.

Jacques Pelkmans, 'Mutual Recognition in Goods and Services,' Centre for European Policy Studies 2003

Implementation

- 2.62 Effective market integration depends not only on the regulatory mechanisms themselves, but on how effectively they are used.
- 2.63 First, Member States must **transpose** EU Directives into national legislation on time and correctly (EU Regulations are directly applicable and generally do not require such transposition). Member State performance has improved significantly over the past fifteen years, but there is still significant variation between Member States on the speed and accuracy of transposition. Performance can depend on political factors such as government stability and the controversy of the measures, or practical ones such as whether sub-national administrations also need to legislate.
- 2.64 Second, Member States must **enforce** the agreed legislation in practice. Government authorities and regulators need to be properly aware of the legislation, understand what it means, and allow individuals and companies to use their rights under it. Standards here can vary too, reflecting sometimes limited capacity in smaller or poorer Member States, sometimes a lack of political will.

³⁰ As, for example, the BSA argues in its submission is the case for financial services.

³¹ The FSB notes that such regimes can generate significant extra complexity.

- 2.65 Ultimately, if Member States transpose incorrectly or do not enforce legislation, the Commission, Member States, or individuals can take legal action against them. This is usually a last resort. To avoid it, Member States are supported by a range of Commission-run practical problem-solving mechanisms, such as SOLVIT (see paragraph 1.13). However, these mechanisms handle few cases, which suggests that there is low awareness or confidence in them to resolve problems^{32 33}. This may give rise to a perception that trading in the EU is more difficult than it actually is³⁴, having a ‘chilling effect’ on intra-EU trade.
- 2.66 There are also other mechanisms, such as prior notification, which can be more effective than problem-solving after problems arise³⁵. For example, under the Telecoms Regulatory Framework, the Commission can review and publicly comment on national telecoms regulatory measures; this process has delivered greater convergence of regulation without the need for extensive European legislation³⁶. Similarly, under the “98/34” process, Member States must notify national technical regulations to the Commission and other Member States in good time before implementing them. This is backed up by the sanction that an un-notified national measure cannot be enforced against a private party. This process is generally seen as an effective way of preventing technical barriers to trade.^{37 38}

Conclusion: what powers remain with Member States?

In this centrally important field of EU law, the boundary between national and Union competence has the character, not of a clear dividing line, but of a potentially infinite series of actual and potential interactions.³⁹

- 2.67 It should be clear from this discussion that it is not possible to establish a clear division between Member State and EU competence in the Single Market area. It is clear, of course, that where the EU has legislated, Member States no longer have the right to act or to behave in a way that is contrary to that legislation. Given the range of legislation, that is a significant constraint on Member States’ action. But Member States’ freedom of action is also limited more broadly because of the application of Treaty principles. Anything Member States do in almost any area of public policy is in principle subject to the general principles of the Treaty and of the specific Single Market jurisprudence, and almost any action can be struck down by the Court if a Member State infringes them.

³² For further analysis on the SOLVIT process, see Pelkmans, *Enforcement in the EU Single Market*, October 2012

³³ Evidence submitted by BRC

³⁴ BCC, UK European Consumer Centre, United Utilities

³⁵ The Industry Council for Packaging and the Environment

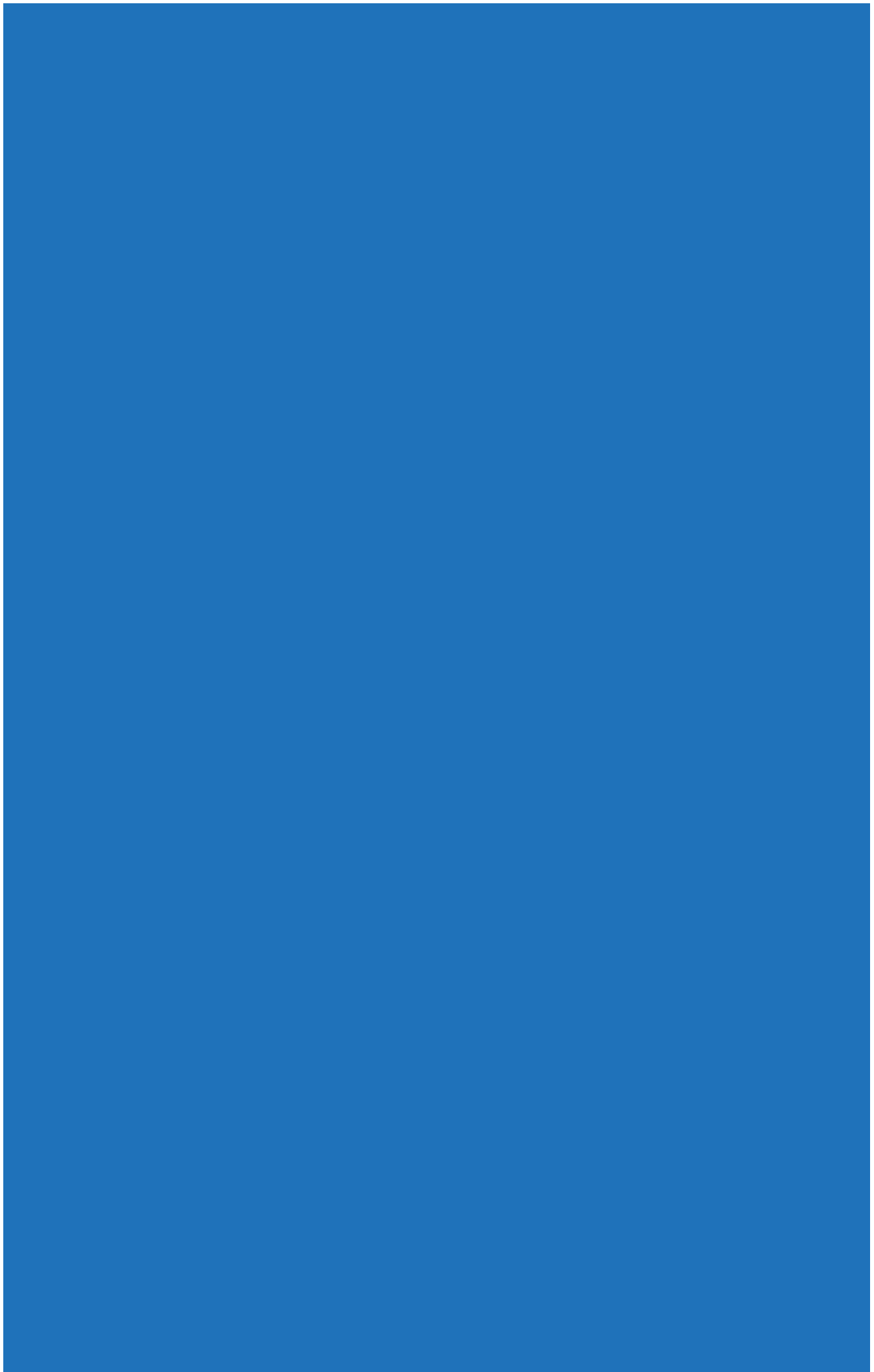
³⁶ Evidence submitted by CER

³⁷ Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998

³⁸ The BRC notes that EU-wide systems for product certification, authorisation, and registration have been largely successful

³⁹ Evidence submitted by Dougan, p13

- 2.68 That said, it is possible to summarise the nature of the constraints and obligations on Member States in broad terms. They must, unless they can establish a clear justification for not doing so, allow the free circulation of goods from anywhere in the EU; allow companies formed under another Member State's laws to set up on the same basis as their own; allow individual or corporate service providers to set up in any Member State or deliver services across a border, and allow their citizens to receive those services; allow capital (investment, dividends, interest) and payments to flow freely within and outside the EU; allow nationals of other Member States and family members access to the labour market on broadly the same basis as nationals; and allow the free movement and (within the rules) residence for EU citizens and in some cases third country citizens.
- 2.69 In short, any situation where there is a restriction of movement on people, goods, services, or financial flows is potentially unlawful, is certainly susceptible to legal challenge, and must be shown to be objectively justified in the public interest.



Chapter 3:

The Single Market and the UK's national interest

Introduction

3.1 The Centre for European Reform's evidence summarises the nature of the Single Market. It is:

... a continuous bargaining process between member-states, who want both the growth in trade that arises from integration and also regulatory sovereignty – but must choose. The degree of integration reflects how far nation-states are willing to go. Negotiations between nation-states will not arrive at a magic formula that perfectly balances national regulators' knowledge of local markets and firms, democratic accountability, and trade opening. Trade-offs and deals, based upon member-states' perceptions of their interests, predominate.¹

3.2 In other words, the level of integration is determined by a mixture of purely economic but also more broadly political factors.

3.3 There are many ways of looking at the effects of increased integration. This chapter looks at it as follows:

- **Effects on the economy** – increased trade versus diverted trade, increased competitive pressures, innovation, and economies of scale;
- **Effects on economic actors** – increased opportunities and market access, against regulation and compliance costs;
- **Effects on policy making** – the trade-off between imposing our own policy choices on others, against having others' imposed on us; and whether increased integration in one area forces it in others too.

Economic integration

3.4 The creation of the Single Market involved the reduction and removal of tariffs and quotas between Member States to create a free trade area, the establishment of a common tariff to the rest of the world to create a customs union, and the gradual integration of the various factors of production to create a true Single Market.

¹ CER

- 3.5 The theoretical results should be increased trade between Member States, though perhaps with some trade diverted from and to third countries; increased competitive pressures on domestic markets, with benefits to consumers (through price reductions and greater choice) and businesses (through greater technical and allocative efficiency within and between firms and industries); greater innovation as it becomes easier to exchange ideas and methods across national borders; and greater economies of scale through a larger home market, with firms operating on a larger scale so they are more productive and more able to compete globally, and production moving to where it is most efficient. Some of the gains will be **static**, i.e. permanent increases in GDP levels through greater efficiency in use of resources, better supply chain integration, and increased specialisation. But there will also be **dynamic** gains, i.e. increases to economic growth potential on a sustained basis, from greater competitive forces, experimentation, and innovation.

Air transport in the EU

Air transport had been traditionally a highly regulated industry, dominated by national flag carriers and state-owned airports. Liberalisation began in 1987 but the key element was the Third Air Transport Package, agreed in 1992, and coming into force fully in 1997. Liberalisation covered carrier licensing, market access, and fares. The result was that decades of restrictions that had limited air transport markets in Europe and prevented cross-border investment by European airlines were removed.

The internal aviation market now gives every EU carrier freedom to carry out flights within any EU Member State and/or between them, whatever the airline's home country, and complete freedom to set tariffs. The regulatory framework ensures appropriate safety and security. It also allows Member States to serve certain areas which are not economically viable, but have to be served for reasons of territorial cohesion, by imposing a public service obligation on such a route.

This means that Europe has the world's most open and competitive market for airline passengers. Passenger traffic has doubled. The number of intra-EU air routes increased by 140% between 1992 and 2010. As early as 2000, economy fare prices had fallen by 5% in real terms and promotional prices by about 30%. New business was generated, including new low-cost airlines, now more than a third of all EU airlines.

Figures drawn from http://ec.europa.eu/transport/modes/air/internal_market/doc/2011_fitness_check_roadmap_def.pdf

- 3.6 There is much evidence of integration in practice. For example, HM Treasury estimated in 2005 (in internal work, subsequently released) that trade between Member States was boosted by 38% by membership of the EU and by a further 9% because of the Single Market programme, with only 5% of trade diverted from non-member countries. However, UK trade with EU members was increased by only 7%, with 4% trade diversion, probably reflecting the relative openness of the UK economy already compared to other large European economies².
- 3.7 The situation differs from sector to sector. In **goods**, there is significant, and increasing, integration, and those countries most deeply integrated have seen an improvement in their price competitiveness³. In **services**, integration is some way behind, and is not catching up. Indeed, in recent years prices have become more dispersed, especially in the older Member States, probably reflecting lack of competition in services. **Labour** markets

² HM Treasury, *EU membership and Trade*, 2005; http://www.hm-treasury.gov.uk/d/foi_eumembership_trade.pdf

³ Europe Economics (2013), p58-60

are not very integrated at all, with wage dispersion levels still greater than one would expect in a well-integrated single market, in part because of the low levels of labour mobility compared to the US, Canada or Australia. This is obviously in part for cultural and linguistic reasons, but also because of non-tariff barriers such as pension rules or tax and social security differences. Labour productivity has not converged significantly relative to global trends since the early 1980s, with the specific exception, as one would expect, of convergence between the Member States who joined after 2004 and the then fifteen members⁴. In **capital**, cross-border investment and financial integration have fallen off dramatically since the 2007 peak, although they are now growing again slowly⁵. It is worth noting that integration in all these areas is not one-directional: it can reach a plateau or even reverse out, for example, pharmaceuticals price dispersion has increased since 2006⁶.

3.8 The nature of the market also varies from sector to sector, inevitably so given the complex legal framework described in Chapter 2, with its mixture of harmonisation and mutual recognition methodologies.

- In the movement of goods, of financial services, and capital and payments, a range of EU-wide standards and an array of regulation and legislation mean that it is practical to treat the EU as one single market. Many major firms, for example in the car industry, aerospace, banking, or insurance, do exactly that. Indeed, in such areas production has become fragmented across European supply chains, with many final goods made up of inputs from many different sources, and increasingly with services bundled into the final product⁷.
- But in other areas markets are still essentially national, with the Treaty regulating both the conditions which prevail on that market, for example, through competition policy, and the interaction of that market with others, for example, through sustaining, or not, the barriers which impede access by other Member States' firms or individuals to that market. This is particularly true of the network industries – energy, telecoms, transport – or areas where EU regulation has not kept up with technical developments, for example the Digital Single Market. It is also true of much of free movement of persons, the freedom of establishment, and services more broadly.

3.9 What is the impact of this integration on economic growth? It is not easy to get a single authoritative view. The analytical task is formidable, because:

- The Single Market has continuously evolved in order to address the continual rise in new barriers to its operation and in technological developments;
- The additional impact of EU-level policies is difficult to isolate from wider developments, for example the general movement towards trade liberalisation, changing patterns of supply internationally, or enlargement of the EU. Longer-term impacts on GDP and growth, through, for example the effect on innovation and changing market structures, are particularly difficult to determine;
- It is not always easy to determine the correct counterfactual or baseline against which comparisons should be made.

⁴ Europe Economics (2013), p43

⁵ Further details may be found in *State of Single Market Integration 2013: COM(2012)752*

⁶ Europe Economics (2013), p36

⁷ For a fuller discussion of the issues this raises, see for example: Baldwin, *Trade and Industrialisation after Globalisation's Second Unbundling*, NBER Working Paper 17716 2011; or the joint WTO/OECD work on Trade in Value Added, at <http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm>

3.10 Nevertheless, despite these difficulties, serious attempts have been made to assess the impact of the creation of the Single Market or some of its constituent parts. The various studies have different objectives, use varying methodologies, including the range of uncertainty around central estimates, and cover different time periods or geographical areas. Most but not all of these studies suggest that the GDP of both the EU and the UK is appreciably greater than it otherwise would be, thanks to economic integration through the Single Market. The studies are discussed in more detail in Appendix 1, with a summary table on page 72; but the main points are:

- The Cecchini Report⁸ from 1988, was one of the first *ex ante* estimates. It suggested that the Single Market 1992 programme could increase GDP by 4.25-6.5%, with Baldwin's subsequent study from 1989⁹ suggesting these estimates might be on the low side because they did not take into account likely dynamic effects on productivity;
- However, later *ex post* studies suggested that the outcome, while positive, had been less significant. Monti and Buchan¹⁰, in 1996, found that the Single Market had increased output by 1.1-1.5% by 1994. The most commonly cited study, by Ilzkovitz, Dierx, Kavocs & Sousa in 2007¹¹, suggests that in 2006, EU GDP was 2.2% higher than it would have been in the absence of the Single Market, with an additional 2.75 million jobs created, and a 0.5% boost to total factor productivity. In 2008, Boltho and Eichengreen¹² concluded that, looking at the whole period since the creation of the original Common Market i.e. a longer period than other studies, EU GDP was 5% higher than it would otherwise have been;
- The work of the team led by Minford¹³, at Cardiff, took a different approach, estimating the costs of trade diversion, and looking at the wider costs of EU membership associated with the Single Market, such as regulation and the Common Agricultural Policy (CAP). It argued that the UK was 2-3% worse off because of EU membership. These figures are also drawn on by Congdon in his report *How much does the EU cost Britain?*¹⁴ which concluded that overall the UK was 10% worse off because of EU membership, mainly because of the high cost of regulation (see the next section for a fuller discussion of this point).

3.11 These and other studies also emphasise the potential for significant future gains, either through better enforcement or through deepening the Single Market in existing and in new areas. For example:

- The 2007 study notes that future action could double the potential impact, through full implementation of existing directives and tackling remaining barriers;

⁸ Cecchini, P., M. Catinat & A. Jacquemin (1988) *The European Challenge 1992: The benefits of a Single Market*, for the Commission of the European Communities

⁹ Baldwin, R. (1989), *On the Growth Effects of 1992*, NBER Working Paper No. 3119, published in *Economic Policy*, 9, p248-81

¹⁰ European Commission (1996), *The Impact and Effectiveness of the Single Market* – Communication from the Commission to the European Parliament and Council, 30 October 1996

¹¹ Ilzkovitz, F., A. Dierx, V. Kavocs & N. Sousa (2007) *Steps towards a deeper economic integration: the Internal Market in the 21st Century – a contribution to the Single Market Review* (European Commission – DG ECFIN; European Economy No. 271)

¹² Boltho, A. & B. Eichengreen (2008) – *The Economic Impact of European Integration* (CEPR Discussion Paper No. 6820)

¹³ Minford, P., V. Mahambare & E. Nowell (2005), *Should Britain Leave the EU – An Economic Analysis of a Troubled Relationship*, Edward Elgar/Institute of Economic Affairs

¹⁴ Congdon, T., *How much does the EU cost Britain?* (2012 edition), at <http://www.timcongdon4ukip.com>

- Deeper and more consistent implementation of the Services Directive could deliver a gain of 0.4-0.8% of GDP through moving the worst performers up to the average, and 1.8-2.6% of GDP through moving Member States up to an average of the five best performing countries¹⁵;
- Poor implementation and application of EU legislation in areas such as taxation, services and public procurement may have dampened EU GDP by around 0.8%¹⁶;
- EU GDP could increase by 27 billion euros to 55 billion euros per annum (or 0.22% to 0.44% of GDP) if the EU becomes as competitive in telecoms markets as the current best-performing Member State. This could increase further if the potential gains from economies of scale are included¹⁷.
- Full energy market opening in the EU15 could increase cross-border trade electricity by 31% leading to an increase in output of 3% and a reduction in prices by up to 13%.¹⁸ Given the importance of infrastructure/network industries across all aspects of the economy, reduction of the costs of these inputs can have significant knock-on effects, leading to more efficient allocation of available resources.

- 3.12 One other important area in assessing the economic benefits of the Single Market is **Foreign Direct Investment (FDI)**. This is universally accepted to be important for long-term economic growth. Outward investment enables firms to take advantage of new opportunities, increasing their productivity and profitability. Inward investors tend to be of higher productivity, improve competition, and enable extra knowledge and skills transfers.
- 3.13 The UK is the world's second largest foreign investor, second only to the US¹⁹, and has a stock of outward FDI of just over £1.1 trillion in 2011, a record high and having risen by around 75% since 2002. It is also a major recipient of inward investment, with a stock of around £775bn at the end of 2011. These figures are however dwarfed by portfolio and other investment, which is 10-15 times as large.²⁰ In 2011, almost half of the UK's stock of FDI came from other EU Member States (48%), with just over a further quarter coming from the US (27%)²¹.
- 3.14 Investment from outside the EU is particularly significant to the UK, compared to other EU Member States. The UK is the top destination for firms looking to establish their European headquarters: half of all European headquarters of non-EU firms are based in the UK, and the UK hosts more headquarters of non-EU firms than Germany, France, Switzerland and the Netherlands put together.

¹⁵ Monteagudo, J., A. Rutkowski, & D. Lorenzani (June 2012), *The Economic Impact of the Services Directive – A first assessment following implementation*, European Commission, European Economy – DG Economic and Financial Affairs, Economic Paper No. 456

¹⁶ *Delivering a Stronger Single Market*, Nordic Innovation Report 2012:12, June 2012 (by Copenhagen Economics)

¹⁷ Ecorys (2011), *Steps towards a truly Integrated Market for e-communications in the run up to 2020*

¹⁸ Copenhagen Economics (2006), *The potential gains from full market opening in Network Industries*

¹⁹ ONS (2013) *Foreign Direct Investment involving UK companies*

²⁰ ONS Pink Book 2012, Table 8.1

²¹ ONS (2013) *Foreign Direct Investment involving UK companies*

Japanese inward investment to the UK

The increasing internationalisation of Japanese companies, and the desire to gain access to the wider market of the European Community, led to a rapid increase in the number of Japanese affiliates operating in Europe during the 1980s. The average annual increase was 15% per year, and the number of Japanese manufacturing affiliates operating in Europe increased from just under 200 in 1979 to 1,091 established at the end of 2010 (834 in Western Europe and 257 in Central and Eastern Europe).

The UK has most Japanese affiliates established since 1980, with 248 affiliates operating in 2010, followed by Germany (146), France (133), Czech Republic (94) and Poland (80). Most of this is in car and motorcycle manufacture, machinery and electronics.

Ernst & Young recently confirmed that the UK was still the number one destination in Europe for FDI overall and for Japanese FDI in particular, accounting for 22% of Japanese projects. The stock of inward FDI from Japan into the UK at the end of 2011 was worth £31.4 billion, up from £27.6 billion at the end of 2010, around 4% of the total investment stock in the UK.

Various factors affect the location of FDI – e.g. the size and growth potential of the host market, the degree of openness, economic stability and the quality of the institutions, cluster benefits, local industrial output, educational attainment and English-language ability. However, it is generally accepted that much Japanese investment within Western Europe was motivated by a desire to service the European market, and that the Single Market Programme has supported such investment.

Ernst & Young (2013), *Ernst & Young's Attractiveness Survey – UK 2013: No room for complacency*

Ford, S. & Strange, R. (1999), *Where do Japanese manufacturing firms invest within Europe, and why?*, Transnational Corporations

JETRO (January 2012), *Japanese Manufacturing Affiliates in Europe and Turkey – 2011 Survey*, Japan External Trade Organisation – Overseas Research Department.

ONS (March 2013), *Foreign Direct Investment Involving UK Companies, 2011 (MA4)*

Strange, R. (1993), *Japanese Manufacturing investment in Europe – Its impact on the UK Economy*, Routledge

- 3.15 The UK's membership of the EU and the Single Market is plainly significant to investment decisions, though of course the broader economic and legal environment and the English language also play an important role. The CBI, British-American Business, the US Chamber of Commerce, Vodafone, and the Bioindustry Association highlight the importance of the UK's presence in the Single Market for attracting foreign investment²². This seems to be particularly so in areas where EU markets are deeply integrated, in goods, for example, where companies are looking to establish regional manufacturing hubs or in financial services, when many companies located in the UK are foreign-owned, benefiting from access to 28 markets via the EU passport for financial services²³. One older study suggests that if the UK were not part of the Single Market it could lead to lower FDI and hence lower productivity growth and GDP²⁴, though the evidence base is limited.

²² Also Open Europe (June 2012), *Trading places: is EU membership still the best option for UK trade?*; Fresh Start Group (July 2012), *Options For Change – Green Paper: Renegotiating the UK's relationship with the EU*

²³ Evidence submitted by City of London Corporation, TheCityUK

²⁴ Pain, N. & G. Young, *Macroeconomic Impact of the UK Withdrawal from the EU*, 2004

- 3.16 To conclude, there is already significant and growing integration, though it varies from sector to sector. Most studies suggest that the GDP of both the EU and the UK are appreciably greater than they otherwise would be thanks to economic integration through the Single Market. Finally, studies also suggest that the potential future gains from further deepening integration are at least as great again.

The impact on UK firms and economic actors

- 3.17 This macro-level picture will, of course, impact upon UK firms and economic actors in different ways. Consumers have been some of the greatest beneficiaries of the Single Market, as increased competition has reduced prices and increased choice. This increased openness and competition will see some firms prosper because of the greater opportunities, while others will be unable to compete and will eventually cease trading. All UK businesses, just like others across the EU, also have to deal with the regulatory and process consequences of Single Market rules.
- 3.18 Assessing the overall impact of the opportunities against the burdens is not straightforward. One particular difficulty is the need to make a judgement about how much the UK would itself have regulated if there was no EU-level regulation. That is inherently unknowable, but in such circumstances the likely outcome would be rules developed independently at the nation-state level across Europe, supplemented in some areas by a global framework, either negotiated within international bodies such as the G20 or OECD, or through extra-territorial dominance of one national standard in practice. UK firms could then face divergent regulatory standards with significant transaction costs if they sought to export across Europe. However, it is also argued by some that UK firms might find national regulation easier to manage because it would be “invented here” and closer to familiar practices; and that regulation on a continental scale is inherently more likely to be onerous, because compliance may need to be more complicated in order to bring into line the wide range of national systems and practices. Open Europe argue, for example, that UK national regulation is 2.5 times more cost-effective than EU legislation²⁵.
- 3.19 Overall, there is a clear view from the evidence submitted that UK firms gain from the Single Market in terms of access to EU markets. Most accept that a degree of Europe-wide regulation is essential in getting this to happen. To take one example, TheCityUK²⁶ notes that the EU framework for financial services has had a “very marked and highly positive effect” on major UK financial services businesses and their clients.

Harmonisation of regulation across the EU (in certain defined areas only) is necessary for the internal market to function effectively. Whilst Next may not agree with the detail and manner of implementation of some of the regulation derived from the EU (which can be both burdensome and expensive to comply with) we need to balance this against the benefit to Next of having a single set of rules which apply across the EU.

Evidence from Next plc

- 3.20 But the **extent and nature of the regulatory burden** emerges strongly as a preoccupation. Measuring the burden is difficult, with estimates varying significantly and often not comparable. There is some evidence that the costs of achieving additional

²⁵ Open Europe, ‘Still out of Control? Measuring Eleven Years of EU Regulation’, June 2010

²⁶ TheCityUK

integration may be rising as more integration is achieved²⁷. Open Europe argued in 2010 that 72% of the regulatory costs imposed in the UK over 1998 – 2009 came from EU legislation²⁸. TheCityUK notes that there are forty pieces of legislation relevant to them in the pipeline and that the UK’s influence is vital in getting them right²⁹. There is recognition that reducing the burden is a more visible political issue within the EU and with the Commission than in the past, with more political energy behind it: for example, the British Chambers of Commerce say that “the EU Impact Assessment Board is making welcome progress in recognising the costs to SMEs from EU business”³⁰. But there is also evidence, especially from small firms, of what appears to be unnecessarily burdensome regulation. The Commission itself summarised the results of a recent consultation of SMEs across Europe in a communication³¹ highlighting the most burdensome pieces of legislation. The British Chambers of Commerce cites, for example, the need to retain documentation for ten years under the Toys Directive, or the rules on chemical content in products³². Some take a slightly different view, with the Trades Union Congress arguing, for example, that high regulatory standards help UK competitiveness and productivity³³.

- 3.21 Sometimes it is argued that participation in the Single Market disadvantages the large number of UK firms who do not export, by forcing them to abide by EU regulatory standards without their ever wishing to do the selling into wider markets which this facilitates. The evidence is not clear-cut and of course it depends very much on what assumptions are made about the likely degree of UK-level regulation in the absence of EU rules.
- 3.22 On the one hand, the FSB notes that UK SMEs have different views on this point, but argues generally that standards need to be cheap to implement and easy to use for SMEs.³⁴ TheCityUK notes that financial services companies largely focused on the UK get fewer benefits and that these can be “offset by the challenge of dealing with the pattern, extent, and characteristics of EU legislation”.³⁵
- 3.23 On the other, some firms and bodies operating at this level highlighted that a well-designed regulatory framework can be an advantage to regional or global competitiveness. BAE Systems said “there can be substantial market benefits from the establishment of technical standards for new products driven by collaborative research; and to the extent that those standards are exported to other countries or contribute to wider international agreements, they can enhance industry competitiveness outside the EU”.³⁶ The Bioindustry Association noted that “The European Medicines Agency headquarters are based in London, giving the UK access to, and the opportunity to influence, regulatory affairs across the whole of Europe. The Central Division of the Unified Patent Court that covers the pharmaceutical and life sciences industries is to be based in London. This will enhance the UK’s pre-eminent position in the provision of legal expertise for European life science IP. This will reduce costs and time for companies looking to defend or enforce their patents across Europe.”³⁷

²⁷ Europe Economics (2013), p75

²⁸ Open Europe, ‘*Still out of Control? Measuring Eleven Years of EU Regulation*’ June 2010

²⁹ Evidence submitted by TheCityUK

³⁰ Evidence submitted by BCC p4

³¹ COM(2013)122 and SWD(2013)60 final

³² Evidence submitted by BCC p3

³³ Evidence submitted by Trades Union Congress para 12

³⁴ Evidence submitted by FSB p6

³⁵ Evidence submitted by TheCityUK

³⁶ Evidence submitted by BAE Systems

³⁷ Evidence submitted by BIA

The Internal Market has given the EU extraordinary standard-setting power internationally that has also benefited UK firms. Other regions and countries have followed EU standards and norms, from bottle sizes in Japan to car-exhaust emissions in China.

Evidence from Heather Grabbe, Open Society European Policy Institute

- 3.24 It is also important to note that the effect of regulation is not only to be assessed by its impact on **existing** firms. The intent of much EU regulation is to liberalise markets and reduce barriers to entry by new players, for example allowing firms from one Member State to operate in another. This would have pro-competitive effects, bring down costs overall, and benefit consumers³⁸.
- 3.25 **Enforcement** is also cited by many as an issue. Much of the evidence to this report suggests that there is a significant problem with enforcement across the Single Market, with standards being applied differently in different Member States³⁹. The Centre for European Reform highlights problems caused by differential enforcement by national courts of the e-Commerce Directive⁴⁰. The British Retail Consortium argues that many Member States take advantage of the ambiguous drafting of the Services Directive to create barriers to new retail investment⁴¹. BAE contends that “implementation of the existing EU Data Protection Directive, and in particular the operation and functioning of national DP regulators, appears to differ greatly from Member State to Member State.”⁴² The Bioindustry Association says there are “issues with the implementation and interpretation by Member States creating obstacles to the free movement of medicines in the EU market”⁴³.

The UK has long been diligent in enforcing...legislation in a timely manner, whilst some other Member States have taken a more proportionate approach to enforcing legislation

Evidence from Consumers for Health Choice

- 3.26 There is also a view that the UK plays by the book more consistently, placing UK firms at a competitive disadvantage to companies in other jurisdictions. The Convention of Scottish Local Authorities argues that UK scrutiny bodies such as the Audit Commission and Audit Scotland monitor and scrutinise local authorities more thoroughly than the authorities in other Member States⁴⁴. The British Banking Association claims that the former Financial Services Authority had stronger sanctions than other Member States’ regulators⁴⁵. Vodafone argue that the UK is more rigorous in enforcement than other Member States⁴⁶. The British Chambers of Commerce argues that other Member States are much less

³⁸ A point made by Europe Economics (2013), p75 and conclusions

³⁹ Evidence submitted by CBI p4, Vodafone para 34

⁴⁰ Evidence submitted by CER p5

⁴¹ Evidence submitted by BRC p5

⁴² Evidence submitted by BAE p3

⁴³ Evidence submitted by BIA

⁴⁴ Evidence submitted by The Convention of Scottish Local Authorities, see also Consumers for Health Choice submission

⁴⁵ Evidence submitted by BBA

⁴⁶ Evidence submitted by Vodafone para 50

rigorous in enforcing state aid rules than the UK⁴⁷. The Road Haulage Association argues that “several operational requirements are more onerous on UK operators, including a lower limit on certain vehicle weights, periodic maintenance inspections, operating centre requirements and the threat of revocation of an operating licence.” However, Kingfisher notes that it is over-enforcement of REACH and the Late Payments Directive in **France**, not the UK, which causes them difficulties.⁴⁸

The EU timber regulations are an example of an environmental policy which is essentially desirable in and of itself – it supports many member states’ own endeavours to address the challenge of driving out unsustainable timber from the market – and which is also necessary for the single market.

B&Q in the UK has a long-standing policy on only sourcing and selling sustainable timber to its customers. Whilst going early on an ethical timber policy made sense to the UK business, before the adoption of the EU timber regulations the business was put at a competitive disadvantage with its European competitors; the introduction of the EU timber regulations has therefore created a more level playing field, and ensures that we are not put at a commercial disadvantage for “doing the right thing”.

That said ...where national authorities are not enabled to enact the provisions of the Regulations, potential loopholes exist, potentially allowing some not to comply fully with the regulation.

Evidence from Kingfisher PLC

3.27 **Gold-plating** of EU legislation, i.e. over-implementation in the UK of rules set at EU level when transposing nationally, is a further, related, issue that emerges from the evidence. Gold-plating can occur because of a deliberate policy decision to exceed the minimum requirement required by an EU Directive, to extend the rules in a Directive to additional areas not strictly governed by it, or to go into more detail than the Directive in order to try to avoid uncertainty as to the domestic legal requirements.

3.28 There are different perspectives on the extent to which the UK gold-plates EU legislation.

- (i) **Gold-plating occurs and is damaging.** The Davidson Review in 2006, cited by many respondents, found that “there are...some cases of over-implementation in the stock of existing legislation that should be addressed.”⁴⁹ A 2011 survey by the Financial Services Practitioner Panel found that over 80% of firms felt that the UK had transposed EU directives into UK legislation in more detail than necessary⁵⁰. The CBI and British Chambers of Commerce argue that the Agency Workers Regulations implementing the Agency Workers Directive, and the Working Time Regulations, have been goldplated⁵¹. The Institute of Directors, in their recent report *The Midas Touch*⁵², argues that the Agency Workers Directive, the Parental Leave Directive, the

⁴⁷ Evidence submitted by BCC p5

⁴⁸ Evidence submitted by Kingfisher

⁴⁹ BIS, *The Davidson Review*, 2006; Road Haulage Association

⁵⁰ Financial Services Practitioner Panel, 6th Survey of the FSA’s Regulatory Performance, February 2011 as cited in City of London Corporation evidence

⁵¹ Evidence submitted by CBI, p6

⁵² *The Midas Touch: Gold-plating of EU employment directives in UK law*, IoD (2013), Philip Sack

European Works Council Directive, and several others have been gold-plated. The National Farmers Union says that the UK over-implemented the Tether and Sow Stall Ban, the Good Agricultural and Environmental conditions within Cross Compliance, the Welfare of Meat Chickens Directive, and the Environmental Liability Directive⁵³.

- (ii) **Gold-plating is sometimes necessary or even desirable.** The CBI notes that in some cases it is essential to provide extra detail over and above the broad text of Directives⁵⁴. The Trades Union Congress argues that the UK does not gold plate and indeed does not implement effectively where it should take opportunities to improve protection for workers⁵⁵. The City of London Corporation notes that the decision to extend the scope of the Market Abuse Directive was welcomed in the City⁵⁶.
- (iii) **Evidence for gold-plating is limited.** The Davidson Review also noted that “inappropriate over-implementation of European legislation may not be as widespread as is sometimes claimed.” A BIS review published in March 2013 examining draft UK regulations prepared between July 2011 and December 2012 found that there was no evidence of new gold-plating that placed additional burdens on business.⁵⁷ Vodafone also found limited evidence of gold-plating in their sector.⁵⁸

3.29 The Institute of Directors summarises the case by noting that “the extent and cost of ‘gold-plating’ is an unresolved empirical question. There is however considerable anecdotal evidence of it.”⁵⁹

3.30 With all this in mind, it is the Government's policy to minimise regulatory burdens when implementing EU legislation and to ensure that the UK does not go beyond the minimum requirements of EU legislation when transposing it into UK law. The Coalition Agreement included a commitment to “end the so-called ‘gold-plating’ of EU rules, so that British businesses are not disadvantaged relative to their European competitors”. This was implemented through the Government's Guiding Principles for EU Legislation, published in June 2011 and recently revised, which aim to prevent gold-plating of EU legislation by putting in a strong scrutiny and challenge process in assessing how EU legislation is implemented in the UK. This includes the principle that the Government will always copy out the Directive for transposition where possible, except where doing so would adversely affect UK interests e.g. by putting UK businesses at a competitive disadvantage compared with their European counterparts. The Government is also committed to rooting out historic gold-plating with a view to removing any unnecessary gold-plating from the stock of UK legislation.

3.31 To conclude, the EU Single Market brings with it legislative and regulatory obligations that are necessary to make the market work. These may perhaps have grown in recent years, and weigh more heavily on SMEs than larger companies, but there have also been renewed and increased efforts to reverse the process at EU level. There is mixed evidence of domestic gold-plating, but a clear Government policy to avoid this for the future. The standard of implementation and enforcement varies greatly across the EU and this forms a significant barrier to UK firms' ability in practice to take advantage of the Single Market's opportunities.

⁵³ Evidence submitted by NFU

⁵⁴ Evidence submitted by CBI, BCC

⁵⁵ Evidence submitted by TUC paras 31-33

⁵⁶ Evidence submitted by City of London Corporation p9

⁵⁷ <https://www.gov.uk/government/publications/gold-plating-review-operation-of-the-transposition-principles-in-the-government-s-guiding-principles-for-eu-legislation>

⁵⁸ Evidence submitted by Vodafone

⁵⁹ Evidence submitted by IoD

The impact on broader integration

- 3.32 The existence of the Single Market has had a significant influence on political and economic debate across the EU. Two aspects have been particularly prominent.
- 3.33 **The first of these stems from the interaction between different Member States' policy preferences.** A single market project enables a Member State such as the UK, if it can exert influence effectively, to set policy so that ways of doing things familiar in the UK can become the norm across the EU. Equally, of course, other Member States can do the same and impose, through EU legislation, policies which do not suit the UK or which would not be chosen nationally. There are also subsidiarity costs with a large market: i.e. costs which are intrinsically associated with centralised policy-setting, making any final policy less likely to be optimal in any given area.
- 3.34 Much of the evidence highlights the strong influence the UK has had in practice on the development of the Single Market, in particular its evolution in a broadly liberalising direction. Vodafone, for example, cites the influence of UK privatisations in the 1980s on the “European Commission, led first by a Belgian and then by an Italian Competition Commissioner, [which] forced other Member States to follow Britain’s lead in the late 1990s. This was part of a Single Market programme which itself owed much to British leadership in the 1980s and 1990s.” The development of financial services legislation is another area where UK practice has – at least until recently – been influential in establishing EU-wide norms⁶⁰. Indeed, the UK’s own relative economic success over the period in which the Single Market has been developing has been a powerful soft power element in projecting the UK’s influence more broadly.⁶¹

The stated ambition of EU directives and regulations and judgements of EU competition authorities and the European Court of Justice ...has been, in general, “liberalisation” across most industries. More specifically, it has been to strip away government subsidies, government-created monopoly power, and legal impediments to trade and competition (both explicit and implicit). It is, of course, strongly disputed how ideal or complete EU-level decisions are in delivering upon these stated objectives. However, as a sweeping generalisation, one might observe that it is not uncommon for EU directives and regulations, seen as increasing the level of regulation in the UK, to be regarded as reducing it in many other Member States.

Evidence from Europe Economics, p82

- 3.35 This could well continue into the future and would be a strong reason for the UK to remain fully engaged economically and politically in Single Market developments. Some commentators claim, however, that this process is reaching its limits and that economic developments since 2008 are moving the EU’s centre of gravity in a less free-market direction which the UK will find harder to influence and might be less to the UK’s benefit in, for example, financial services⁶². Still others argue that the UK’s success in driving Single Market liberalisation has come at the price of accepting regulatory and legal arrangements that are different to UK norms, or more social and employment legislation than the UK would have chosen given a free choice, as part of explicit or implicit political bargains⁶³.

⁶⁰ Evidence submitted by Open Europe, Europe Economics (2013)

⁶¹ Evidence submitted by Vodafone paragraph 1

⁶² Europe Economics (2013), pp88-90

⁶³ Cited, though not wholly endorsed, in evidence from Senior European Experts Group

- 3.36 **The second area stems from the relationship between the Single Market and other areas of EU competence.** The argument is that the existence of the Single Market generates the need for EU-level policy-making in many other areas, facilitating and constraining Member States' freedom to set national policy. That debate has two aspects: whether this is economically necessary for the efficient operation of the Single Market, and whether it is inevitable as part of a wider political bargain.
- 3.37 Some EU competences are generally accepted to be economically integral and intrinsically linked to the establishment and development of the Single Market.
- **Competition policy and state aids** establish the conditions under which the Single Market can operate effectively. They have been in the Treaty from the start. They are intrinsically linked to the Four Freedoms. For example, an effective cross-border merger regime is a significant element of the Right of Establishment, and state aids are a form of non-tariff barrier which can impede the free movement of goods or services if it is not regulated. They operate on a highly integrated basis: they are an exclusive competence of the EU, with extensive enforcement powers for the Commission, and with Member States' authorities operating within a framework set at EU level. British businesses and policymakers are often most aware of the restrictions on state aids at the point as which they restrict some desired course of action, such as interventions to encourage investment. However, without such restrictions, there would be the risk of a free-for-all subsidy race, where nations distort competition by funding domestic undertakings and hence undermining the level playing field within the Union.
 - Equally closely linked is the **Common Commercial Policy**, the logical consequence of the creation of a customs union. It too is an exclusive competence of the EU, giving the Commission power to negotiate on Member States' behalf on international trade, with Member States having no freedom to conclude their own trade agreements or set their own customs duties. The existence of a common policy enables the weight of the Member States to be brought to bear in international negotiations and, as trade agreements become broader in nature, gives the EU the ability to help set international standards⁶⁴.
 - Competences in the network industries such as **energy, telecoms and transport** are also closely linked. Economically they are specialised forms of the free movement of goods and services, sometimes now with their own legal base within the Treaty (energy, transport) with other policy objectives in play, such as energy security or diversification of supply, sometimes operating under the basic Single Market arrangements described in Chapter 2.
 - Finally, aspects of **taxation**⁶⁵ are intrinsically linked to the Single Market. There are specific provisions within the Treaty preventing differential taxation of other Member States' goods. VAT is applied on a harmonised basis and with minimum rates across the EU for the same reason. Direct taxation has been much affected by the development of CJEU jurisprudence, which in this area has taken a different route to the generality of Single Market jurisprudence, allowing Member States to distinguish in certain situations on the grounds of nationality. The City of London Corporation argued that differences in tax *rates* are also relevant to Single Market arrangements, since they affect pricing and competitiveness of products, notably in financial services⁶⁶. This is perhaps most obvious in the excise area. British American Tobacco and Imperial Tobacco claimed that widely differing rules on taxation of tobacco products and

⁶⁴ Evidence submitted by CBI, Schroders

⁶⁵ EU competence on taxation is being considered in parallel with this review in Semester 1

⁶⁶ Evidence submitted by City of London Corporation

labelling meant that the Single Market in this area was a myth.⁶⁷ The Road Haulage Association argued that differing levels of fuel duty between Member States distorted competition between companies based in different Member States.⁶⁸ Others, for example the Wine and Spirit Trade Association, argued that national discretion within a broad EU framework remained important.⁶⁹

- 3.38 Certain other areas of competence have become gradually established at EU level over time because of the existence of spillover effects. The **environment** competence⁷⁰ is one area where, though not inherently part of the Single Market as defined in the Treaty, some common standards are generally thought to be needed to avoid a Member State getting free-rider benefits in relation to cross-border pollution and to protect the environment more generally.
- 3.39 Still other areas of competence have become gradually established at EU level over time for broadly political reasons and where the need for EU policy-making, at least in its current form, is much debated. One example is EU **regional policy**⁷¹, which was developed in large part for political reasons, to help poorer regions of the EU catch up with the richer. The UK, as one of the poorer Member States in the 1970s, was instrumental in the early development of this policy, but it expanded massively as new members joined from the late 1980s, and became a quid pro quo for the greater competitive forces to which poorer Member States were exposed through the Internal Market and, for some, monetary union. The evidence about the effectiveness of regional policy in actually achieving this goal is controversial. Regional policy will be covered in the Cohesion report later in the year.
- 3.40 Another, and still more controversial example, at least in the UK, is **social and employment** policy⁷², and the extent to which this is felt to be necessary for the operation of the Single Market. These issues are the stuff of domestic political controversy within the UK, and, given the divergent positions taken, it is hard to define a clear national interest. The evidence submitted to this report suggests strong views on both sides of the debate. Consumer associations and trades unions tended to consider social and employment policy as an essential part of the Single Market. Large corporations and business trade associations tended to hold the opposite view.
- 3.41 Some – the Bioindustry Association, the Trades Union Congress, the GMB and the Senior European Experts Group – argued that some elements of common employment law could be helpful in ensuring free movement of persons and in facilitating cross-border establishment and provision of services, for example in regulating drivers' hours to enable the provision of transport services across the EU⁷³; or that EU social and employment policy was necessary to ensure that competition in the Single Market was based on increasing productivity and innovation, rather than on undercutting of labour costs and “social dumping”⁷⁴, and to ensure that the benefits of liberalisation were equitably distributed⁷⁵. The CityUK argued that “some employment legislation, conferring common basic standards for employment, may facilitate the operations of international businesses working across borders... and may reduce the overall regulatory burden by requiring

⁶⁷ Evidence submitted by BAT, Imperial Tobacco

⁶⁸ Evidence submitted by Road Haulage Association

⁶⁹ Evidence submitted by Wine and Spirit Trade Association

⁷⁰ EU competence on the environment will be considered in Semester 2

⁷¹ EU competence on regional policy will be considered in Semester 3

⁷² EU competence on social and employment policy will be considered in Semester 3

⁷³ Evidence submitted by SEEG

⁷⁴ Evidence submitted by GMB

⁷⁵ Evidence submitted by TUC

compliance with only one set of norms. Equally, however, an absolute identity of rules seems unnecessary and impractical, given the range of local factors in play in any market; and intrusion into terms of employment... may create distortions.”

- 3.42 But many major businesses or associations – the CBI, the Institute of Directors, the British Retail Consortium, Next, BAE Systems, the American Chamber of Commerce, and the Wine and Spirit Trade Association – argued variously that EU social and employment policy was not necessary for the efficient operation of free movement of persons; that it could distort the Single Market by having a differential impact in different Member States because of differing national legal frameworks⁷⁶; that competition was needed between different social models to deliver the most efficient outcome and to ensure experimentation and innovation; that there was little evidence in practice of differences in social and employment protection distorting competition^{77 78}; and that, since wages were primarily set by market forces and productivity levels, the primary impact of employment legislation was simply to reduce cash wages, because indirect wage elements, such as increased social protection, constituted a larger share⁷⁹.
- 3.43 To conclude, the existence of the Single Market, and law and legislation on the Four Freedoms, generates a range of political pressures. Some of those pressures are about how to exploit, or resist, the opportunities to extend one country's laws, norms, or practices, across the EU more widely. In this area the UK has been broadly successful in enshrining its more liberal economic model into at least some of the DNA of the Single Market. Other pressures are about whether, over time, more EU-level policy-making is necessary to make the Single Market work, for economic or political reasons. That powers exercised at EU level have increased since the Single European Act is a matter of fact, though the existence of the Single Market is only part of the reason, and views vary on whether that is a necessary or a good thing, and on whether they are still increasing or should be diminished.

Conclusion

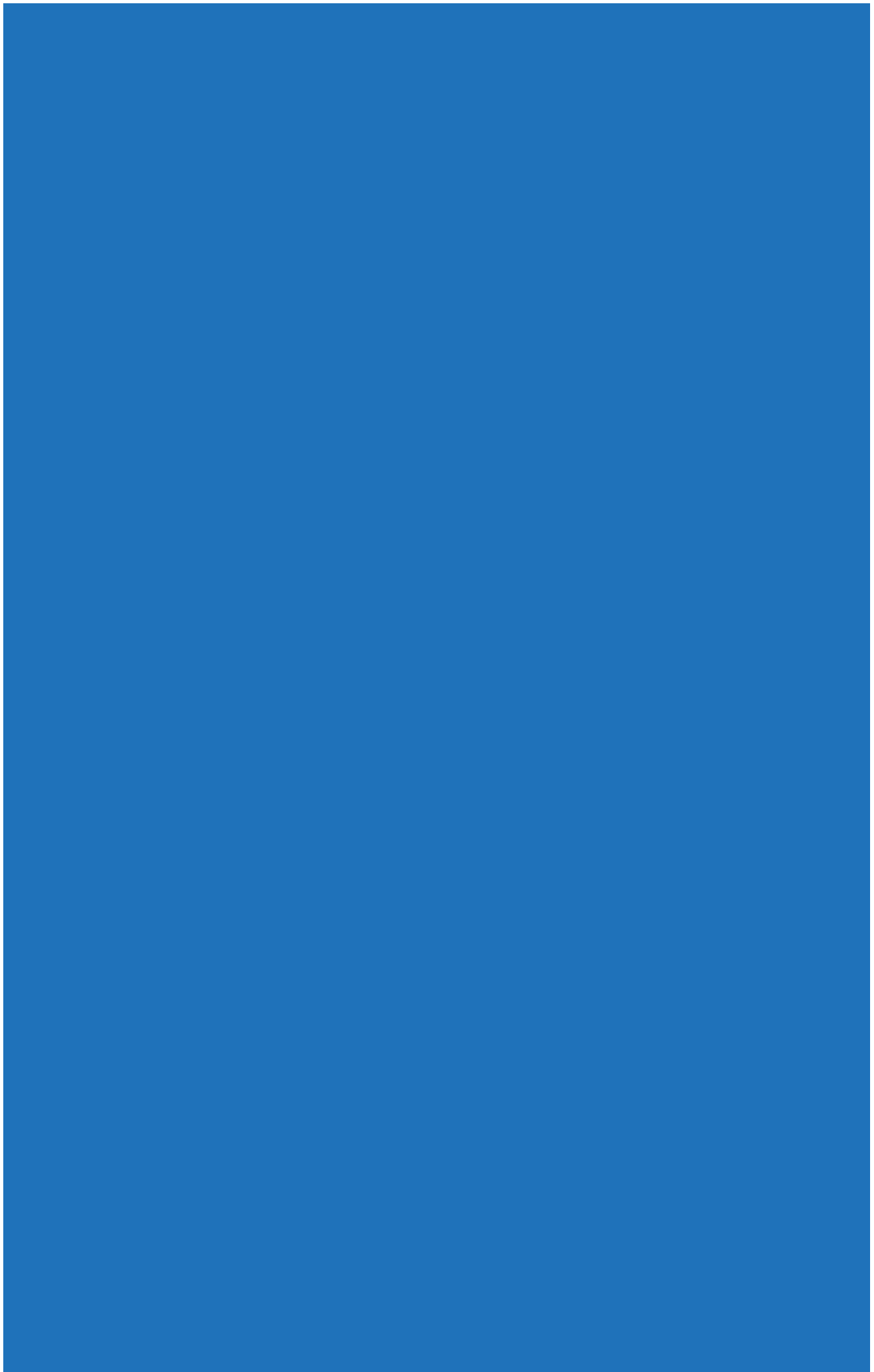
- 3.44 The broad legal framework established for the Single Market does not necessitate any one model of economic integration. It is consistent with many. Indeed, the extent of integration is under permanent negotiation by Member States, influenced by a range of economic and political factors. The trend has been towards deeper integration over time, for political as much as economic reasons. That integration has brought to the EU, and hence to the UK, in most if not all observers' opinions, appreciable economic benefits. It has also spread the UK's liberal model of policy-making more widely across the EU. But it has brought with it constraints on policy-making of varying kinds, and a regulatory framework which some find difficult to operate within or find burdensome, even if the obligations are not necessarily any greater than would have been imposed nationally.
- 3.45 Is that trade-off, between cost and benefit, between economics and politics, of overall benefit to the UK? It is not possible to give a simple, unambiguous, and universally accepted response. But most observers, and indeed most of the evidence received for this report, answer positively. They do so, not without qualifications or reservations, but with a focus on the economic benefits already achieved, which have made the EU's and UK's GDP appreciably greater than what it would otherwise have been, and on those potentially available in the future. They also often note that much depends on the future direction of the Single Market and of the EU more broadly, to which this report now turns.

⁷⁶ Evidence submitted by CBI

⁷⁷ Evidence submitted by SEEG

⁷⁸ Evidence submitted by CER

⁷⁹ Evidence submitted by IoD



Chapter 4:

Future options and challenges

The context

- 4.1 The financial crisis and subsequent economic downturn have caused many to focus on the prospects for deepening the Single Market to generate new growth across Europe.
- 4.2 In the **short run**, the Commission has acknowledged and supported this, through bringing forward two packages of measures – two Single Market Acts – in 2011 and 2012. These packages, endorsed in broad terms by Member States, constitute political commitments to legislate in specific areas in order to deepen the Single Market and to develop more impetus around reform more broadly. They were responses to the Monti report and, as the Commission put it, aim at:

...putting an end to market fragmentation and eliminating barriers and obstacles to the movement of services, innovation and creativity strengthening citizens' confidence in their internal market and ensuring that its benefits are passed on to consumers . A better integrated market which fully plays its role as a platform on which to build European competitiveness for its peoples, businesses and regions...¹

- 4.3 A new strategy will need to be shaped under the new Commission and new European Parliament, nominated and elected in 2014. That **longer-term** strategy, and the future of the Single Market, will be shaped by two major developments.
- 4.4 The first is the continued process of **globalisation** of the world economy and the growth of centres of economic power outside Europe and North America. The evidence for this report showed very strongly how important it is that the Single Market should be, and remain, open to that wider world economy². The Single Market was conceived in an era when globalisation was only just beginning. During the 1980s and 1990s some Europeans argued for a “fortress Europe”, a Single Market behind high protectionist barriers, and a rival to other centres of economic strength. That argument ceased to be viable as globalisation developed, and protectionism is no longer respectable as a policy position within Europe. But constant vigilance is still needed to avoid the temptation of measures which are protectionist in effect if not in name.

¹ COM(2011)206: Single Market Act

² Among others Open Europe, CBI, Vodafone

- 4.5 Winning that argument, and keeping the EU open, is vital to the continued competitiveness of the EU and of the UK. Otherwise the balance of advantage for UK businesses operating beyond Europe – almost all the major ones and many of the smaller ones – could shift significantly. Europe also needs to keep focus on maintaining a business environment that is competitive at the global level and that does not impose excessive regulation, both for reasons of domestic competitiveness and to enable regulatory coherence with other major economic powers.
- 4.6 Europe's record in this area is good but could be better. The EU has been outward-looking in the WTO and through an ambitious programme of FTA negotiations, notably the Transatlantic Trade and Investment Partnership just launched with the US. Europeans have a liberal regime for inward and outward investment. The EU's record of openness to the emerging markets is good. But EU tariff barriers are still relatively high: the average Most Favoured Nation (MFN) tariff is 5.3%, 2.8% on a trade-weighted basis, compared to 3.5% and 2.1% for the US³. Some evidence points to the risk of (perhaps disguised) protectionism, or to the imposition of "reciprocity" requirements which have the effect of closing the EU market in practice⁴. The EU has a home bias for EU products three or four times that of the United States, risking poor specialisation and weak exploitation of comparative advantage⁵.
- 4.7 The second development is the move to strengthen the architecture of the **Economic and Monetary Union**. As a result of the financial crisis, Euro area Member States have taken steps to reinforce both their political institutions and decision-taking apparatus, e.g. through the creation of euro summits and stronger support for the Eurogroup) and the financial, fiscal and economic rules of the single currency, e.g. the Treaty on Stability, Coordination and Governance and the Single Supervisory Mechanism. The President of the European Council is leading a process to look at what further measures may be needed in the area of economic coordination and to ensure the ongoing democratic legitimacy of the EU. It is unclear yet how far this process will go, but the logic of monetary union points to the eventual development of closer fiscal integration, and greater financial and economic policy coordination within the euro area.
- 4.8 This could present risks to the Single Market, of two kinds. It could **fragment**, if the euro area develops into a clear political entity, deepening its cooperation such that in practice it creates a single market within a market. Or it could become **dominated by euro area Member States**, with the market remaining coherent, but with norms set in practice by the euro area.
- 4.9 **Fragmentation** could lead to the loss of some of the economic gains that have been achieved from market integration to date. It could also weaken the collective commitment of all Member States to maintain and deepen market liberalisation and competition.⁶ It could put non-euro area countries at a competitive disadvantage. Alternatively it could reduce competitiveness within the euro area, with a positive impact on relative competitiveness for UK firms but a negative economic impact on the EU as a whole.⁷

³ WTO figures: http://stat.wto.org/TariffProfiles/E27_e.htm, http://stat.wto.org/TariffProfiles/US_e.htm

⁴ Evidence submitted by CBI

⁵ Evidence submitted by Open Europe

⁶ Evidence submitted by City of London Corporation

⁷ Evidence submitted by CBI

There is a risk that excessive attention on the management of the eurozone detracts from the wider ambition of completing the single market. In addition, the creation of a more integrated core of member states with a separate supervisory regime or a banking union may hasten the shift to a multi-speed Europe, prompting concerns over the integrity of the single market.

Evidence from Kingfisher plc

- 4.10 All that said, so far, with the exception of some narrow areas such as the European Central Bank (ECB)'s insistence that clearing houses handling significant Euro business be based in the euro area, currently being challenged by the UK at the Court, there is little sign of significant fragmentation in areas central to the Single Market. EU leaders have consistently acknowledged that the Single Market must be protected in the different legislative proposals brought forward to strengthen economic and monetary union.
- 4.11 **Euro area dominance** is perhaps a stronger possibility. The European Banking Authority now has power to regulate the operations of financial service providers across the EU, including those based outside the euro area, but would have had a permanent euro area majority were it not for the deal secured by the UK in December 2012 requiring decision-making majorities among both Euro members and others. The direct supervision of major banks in euro area countries by the ECB will cover UK-based banks subsidiarised into euro area markets.⁸ Lloyd's argue, in their evidence, that this ECB supervisory role could arguably set a precedent for replacing national supervision of insurance with pan-European supervision⁹. The proposed Financial Transactions Tax, through formal enhanced cooperation, is potentially another example, although this is not a euro area measure. Looking beyond the financial sector, there is clearly a possibility of the euro area agreeing deeper monitoring of and intervention in a broader range of economic policies, to drive structural reform. This could have a positive dynamic for the Single Market, as structural reforms become more politically possible. Equally, some argue that it might generate pressure to extend this tighter regime to non-euro area countries to prevent euro area economies being undercut by the others. The use of Article 114 for any of these measures could have significant implications for the integrity of the Single Market in future.
- 4.12 All this means that safeguards to preserve the Single Market and the rights of Euro "outs" within it could well be necessary in the coming years. The precise shape of any safeguards is not clear and will depend on the nature of the proposals that are put forward. They will need to be designed carefully, for example to avoid them being over-robust and hindering further economic integration in the Single Market as a whole.¹⁰
- 4.13 There will of course be other broader developments, notably **enlargement**. As in the past, enlargement offers further economic gains – through new opportunities for specialisation and through increasing the size of the Single Market.¹¹ The successive waves of enlargement have positively influenced competition, specialisation, and economies of scale, and have enhanced growth and employment opportunities. Moreover, the obvious geopolitical advantages of enlargement, as regards extension of democracy, the rule of law, respect for human rights, non-discrimination and free markets, all have a positive

⁸ Evidence submitted by BCC, TheCityUK

⁹ Evidence submitted by Lloyd's

¹⁰ Evidence submitted by CBI

¹¹ Evidence submitted by SEEG

impact on trade levels both within and without the EU.¹² But only enlargement to Turkey – currently a distant possibility – would have anything other than a trivial effect on economic prosperity in the rest of the EU.

Where would the UK gain from the EU doing more?

- 4.14 Against this background, is further deepening of the Single Market likely, and is the UK likely to gain from it?
- 4.15 There is little question that further deepening of the Single Market would produce economic gains. Full liberalisation of all areas where there are significant non-tariff barriers could increase EU GDP by 14% and UK GDP by 7%.¹³ But to achieve that would require a major drive on both legislation and enforcement, largely in areas which have so far proved resistant to liberalisation for political reasons. There is little sign that this is possible, and trying might undermine political support for the market as it stands. Indeed it is unrealistic to think that every barrier can be removed. Expecting everyone in Europe to speak a single language¹⁴ would undoubtedly eliminate a huge range of non-tariff barriers and therefore boost growth, but no-one would think the political costs were worth it.
- 4.16 The issue is therefore whether there are areas where further liberalisation is politically plausible, and what the balance of advantages would be. There are possibilities both in substance and in process.

Substance

- 4.17 The EU could make a new drive towards network liberalisation. EU markets in network industries such as energy, telecoms and some transport services, or in the broad area of the Digital Single Market, are still fragmented and progress towards creating a single market in some of these areas has been slow and uneven. Greater integration could deliver significant economic gains, both to consumers and the wider economy, by promoting greater competition, service innovation and choice. As set out in Chapter 3, this is fundamentally because markets in some of these areas are still national, with only the conditions of operation of the market and the interaction with others being set at European level. The Government has been working for some time to support the further development of the Digital Single Market.

¹² Evidence submitted by British Influence

¹³ Aussilloux, V., Boumellassa, H., Emlinger, C. & Fontagné, L. (February 2011), *The economic consequences for the UK and the EU of completing the Single Market*, BIS Economics Paper No. 11.

¹⁴ Europe Economics (2013)

What is the Digital Single Market?

The Digital Single Market is the catch-all term used to describe the modernisation of the Single Market framework to ensure that the Four Freedoms can be effectively enforced in the new situation created by the internet and e-commerce.

Fuller development of the Digital Single Market by 2020 could result in **a 4% increase in GDP in the EU**.¹ Companies with a strong web presence grow twice as fast as those offline, and the potential for cross-border trade gives businesses an incentive to expand their operations and tap into new markets.

According to McKinsey, within Europe, **the UK is the largest and most advanced e-commerce market**.²

As part of its *Digital Agenda for Europe*, the European Commission is taking forward the following proposals to update the rules of the Internal Market to make them fit for purpose in the digital era:

- Simplify the pan-European licensing for online works;
- Preserve ‘orphan’ works [a copyrighted work whose copyright owner is unknown or untraceable] and out of print works;
- Open public data for re-use;
- Simplify the distribution of creative content;
- Revise the e-Signature directive;
- Update the e-Commerce Directive;
- Develop new means for redress in relation to e-commerce transactions.

¹ European Policy Centre, *Establishing the Digital Single Market: policy recommendations*

² *Internet Matters: The Net's sweeping impact on growth, jobs, and prosperity* (2011).
http://www.mckinsey.com/insights/high_tech_telecoms_internet/internet_matters

4.18 A similar further effort could be made on services liberalisation. Services make up 71% of total EU GDP, but the Services Directive only covers half of the services sector, and is only partially implemented.¹⁵ As Open Europe says in its report *Trading Places*, “the failure to liberalise services within the Single Market and Member States’ reluctance to compete on the global stage in this sector means the EU is punching below its weight in global talks on services, to the detriment of UK interests.”¹⁶ Fuller services liberalisation could produce considerable GDP gains, even though 60% of barriers to cross-border trade in services are natural, as a result of services being local, personal or dependent on cultural or language, rather than regulatory.¹⁷

¹⁵ Whilst many of the sectors outside of the Services Directive are covered by other EU legislation, the approaches between these sectoral Directives are at times incoherent, leading to inadvertent barriers to cross-sectoral service provision.

¹⁶ Open Europe (June 2012), *Trading places: is EU membership still the best option for UK trade?*; Fresh Start Group (July 2012)

¹⁷ PWC study for DTI, as cited in TUC evidence

4.19 Better enforcement would also make a big difference: the peer review and mutual evaluation process introduced by the Services Directive has been a welcome innovation, but legal action may be needed to make a real difference. The Services Directive itself could also be reopened and reformed to remove many of the restrictions to cross-border trade that are currently permitted, or to be move more firmly towards the country of origin principle, as originally envisaged. However, further gains from services integration are likely to require deeper intrusion into Member States' laws and processes, notably because many of the sectors not included in the scope of the Services Directive are government or public services of one kind or another. Much of this would be sensitive across Member States and some of it could be sensitive even in the UK.

Process

4.20 The Single Market is much more heterogeneous than its designers originally anticipated, with significant variation in capability to implement and enforce legislation. For the Single Market to adapt to an enlarged EU, further reform is required. The EU could strengthen its own enforcement efforts. At the moment, Commission efforts tend to focus more on timely and correct transposition of legislation than on its enforcement once in place. Member States have little incentive to change that in the short run, since the political difficulties of eliminating an illegal non-tariff barrier can easily outweigh the minimal economic gains. TheCityUK argues that the current infringement process does not seem to be having a deterrent effect across all Member States, not least because of the excessive time it takes for cases to come to court.¹⁸ Enforcement actions could be prioritised on the basis of economic impact or the damage caused to the Single Market by the offending measures, and be made faster, less bureaucratic and more transparent, in order to drive greater compliance with Single Market legislation¹⁹. The Commission could also reprioritise internally so that more resources go to DG Markt and to enforcement within it.

4.21 A more radical idea would be to establish more pan-European enforcement of Single Market legislation. The extent of market integration depends to some extent on how coherent and consistent enforcement is by different national regulators and enforcement bodies. Giving these powers to a European institution would improve the consistency of enforcement and hence increase the extent of integration. But this would clearly be politically sensitive.

4.22 Greater enforcement, especially if by a European regulator, would certainly raise political difficulties in many Member States, not least the UK. It would also require a significant increase in the proactivity and resourcing of the European Commission's enforcement arms, greater determination by Member States to collaborate, and a swifter CJEU. That would bring its own political problems since it is precisely the remaining non-tariff barriers which have most political support and which would be most resistant to change.

¹⁸ Evidence submitted by TheCityUK

¹⁹ Evidence submitted by Austrian Federal Economic Chamber

4.23 A package of institutional reform could help progress in this area. Structural changes to the Council, such as establishing a dedicated Single Market Council, and to the Commission, including splitting the overly extensive Single Market and financial services portfolio, might give greater focus and leadership to the Single Market agenda. Thought could also be given to establishing a Single Market Authority, charged with market studies, research, annual health check and audit of the Single Market, to ensure that implementation and enforcement is adequately resourced and not the poor relation to the legislative process. The recent Single Market Integration report, published as part of the EU Annual Growth Survey, is a welcome development.

Where would the UK gain from the EU doing less?

- 4.24 The Single Market is one of the areas where the “bicycle theory” of EU politics, i.e. that forward movement is necessary to keep things on track, seems to apply most clearly. Unless there is a consistent and determined attempt to keep up with technological and commercial progress and best practice, either through legislation or enforcement, the result is likely to be the growth of non-tariff barriers to trade, and the entrenchment of incumbent economic actors with a vested interest in the status quo. This is why there appears to be a never-ending pipeline of EU legislation presenting difficult regulatory choices and political trade-offs.
- 4.25 So a decision to do less in this area could be a decision to weaken the depth of integration over time. It is hard to see how that could be in the UK’s interest. Depending on the view taken of the economic benefits, as set out in Chapter 3, it is possible to make a case that the UK would benefit from not participating in the Single Market at all, though it is not one that the Government agrees with. But it is hard to make any kind of case for remaining within the Single Market framework but encouraging it to function defectively or not at all.
- 4.26 Accordingly, although it is easy to say that the EU should regulate less, it is important to look at what might fill the vacuum. The EU could certainly try to do less legislatively, and rely on better application of Single Market principles and CJEU jurisprudence to drive liberalisation and to improve conditions for economic actors within the Single Market. This would make a lot of sense economically. Global competitiveness is not static but depends on the EU’s ability to respond to changing market conditions and opportunities,²⁰ so less legislative harmonisation and more emphasis on mutual recognition would make it easier to adjust rules to evolving conditions. Some might see this as analogous to the way the common law system in England and Wales evolved by proving itself capable of dealing with a wide range of very different situations. But it would be important to couple it with the effective enforcement mechanisms described above if mutual recognition were to work well in practice. And such arrangements would be significantly less predictable for businesses, particularly SMEs, operating across the Single Market.
- 4.27 Less and better legislation would be of benefit to the UK and the EU more broadly. Since the Lisbon Treaty was agreed, there has been greater use of delegated and implementing acts, reflecting the speed at which the legislative machine is having to operate. This pressurised legislative process also tends to encourage the political machine to focus inwards, and to encourage a sense that passing legislation is the most important task, rather than focusing on external competitiveness. The EU could help itself in this area by, for example, ensuring it has a properly-functioning mechanism that screened legislative proposals more systematically and objectively, for example that a proposal would only proceed if it clearly had a positive impact on growth²¹. A “red card” mechanism giving

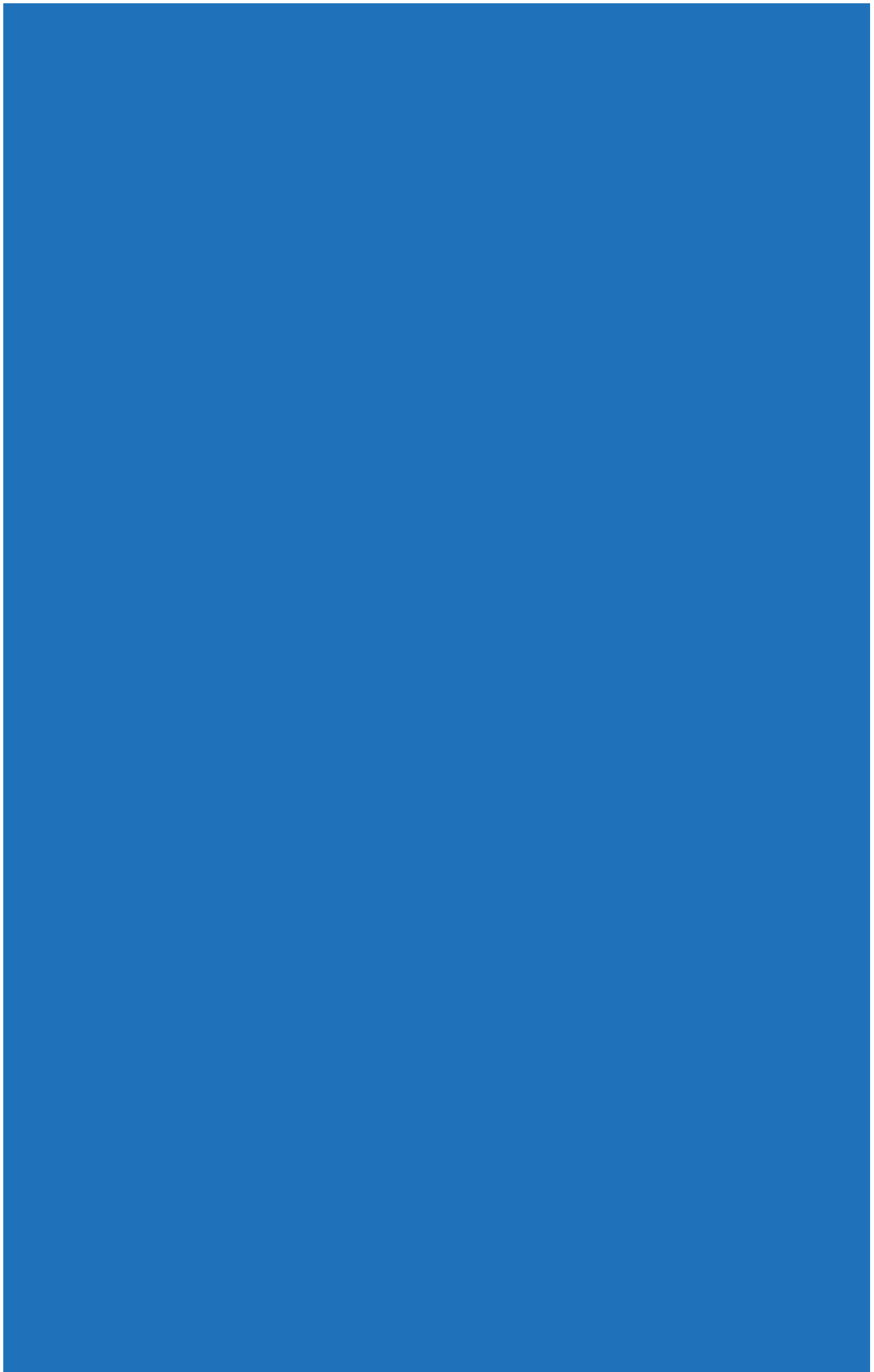
²⁰ Evidence submitted by City of London Corporation

²¹ Evidence submitted by BT suggests such a “competitiveness test”

national Parliaments a bigger role could also help. There is also the potential for a more consultative approach to policy development and for better appraisal of likely costs and benefits to give rise to higher quality legislation that can be implemented more readily.

Conclusion

4.28 The Single Market is entering its most challenging period since its creation in the late 1980s. There is still a broad consensus that it is at the core of the EU's development, that it has driven growth and prosperity in the Member States, and that it should continue to do so. At the same time the political will to drive its development into more politically sensitive areas is under challenge. The "free good" of significant enlargement of the market may not be on offer in the near future. Institutional developments in the euro area could also influence it significantly, for good or ill. All this means that the Single Market could once again be more at the centre of European political debate, which could open up opportunities for Britain.



Appendix 1: Comparative analysis of economic studies on the impact of the Single Market

1. Many studies have attempted to quantify the impact of the creation of the Single Market. It is not an easy task. The gradual and continuous nature of action to remove internal European barriers to trade presents considerable difficulties in quantifying the full ‘impact’ of the Single Market. Furthermore, the wide range, complexity and interdependence of policies and measures, and the need to control for the various stages of EU enlargement, complicate the analysis. Estimates are therefore often not comparable and depend on the objective and nature of the study, the methodology used, the geographical area and time period covered.
2. Moreover, not all studies cover both *static gains* from, for example, increases in market size, economies of scale, changes in market structure, and productivity gains from increased competition, leading to a one-off permanent increase in GDP; and *dynamic gains* from, for example, a wider range of different products, and impacts on rates of accumulation of factors of production, leading to a permanent increase in the growth rate. While static gains predominate in the short term, dynamic gains dominate in the long term.
3. This appendix summarises the methodologies and headline results of some of the main studies in this area, highlighting the similarities and differences in the approaches undertaken, and hence whether they are comparable. The intention is not to attempt to deliver a ‘consensus view’ on what the impact of the creation of the Single Market has been. Nor will this paper single out a preferred methodology or analytical approach. Papers are considered in order of publication.

Cecchini Report (1988)¹ – 1992 – The European Challenge – The Benefits of the Single Market

Background:

4. In 1988, the European Commission launched a series of reports aimed at a comprehensive quantitative assessment of the economic gains that could be achieved from a Single Market through targeting non-tariff barriers that kept the European market fragmented – ‘the costs of non-Europe’. The report specified the conditions for establishing the Four Freedoms by examining the costs and benefits of a Single Market.

¹ Cecchini, P., M. Catinat & A. Jacquemin (1988) *The European Challenge 1992: The benefits of a Single Market*, for the Commission of the European Communities

5. The Report argued that nationally fragmented markets generated three types of barriers to trade – physical barriers, for example, customs controls and associated paperwork, technical barriers, for example, divergent national product standards and technical regulations and fiscal barriers, for example, differing rates of VAT and argued that reducing these barriers would lead to both significant static gains such as increases in output and lower prices and dynamic gains from greater competition and economies of scale by improving the rate of innovation and productivity.

Overview of Methodology²

6. The Report used various techniques to estimate the potential impact of the Single Market Programme. At its heart was a static approach to assessing the impact, through comparing to a status quo baseline the costs of trade between Member States after the implementation of the programme. Competition effects were estimated as one-time shocks to the economic system, and hence did not include long-term dynamic impacts. Much of the detailed analysis was undertaken for seven Member States³, and then scaled up to deliver a whole economy 12 Member State picture.
7. The analysis assessed the *effects of market barriers* through looking both at horizontal issues affecting many different industries⁴ and at vertical assessments of specific goods and services sectors.⁵ The sectors covered by the latter accounted for 28% of the economy's total value added, just over half services and just under half goods.
8. It also assessed the *effects of market integration* by using partial equilibrium analysis to capture size and competition effects⁶ from the removal of Non-Tariff Barriers (NTBs) and from the greater integration of European markets in ten industrial sectors. Tariff-equivalents of barriers were calculated to model the impact of a reduction in the costs of intra-Community trade, with further scenarios taking account of the extent of potential market integration.
9. In addition, various macro-economic scenarios⁷ assessed the timeframe over which the impacts would be felt and considered the impact on other macro-economic indicators such as employment and inflation. The analysis also modelled scenarios with more active economic policy measures (increased public investment and a reduction in direct taxation) that would be enabled through the creation of room for manoeuvre from integration that would lead to, for example, easing of constraints on public finances.

² Cecchini, P., M. Catinat & A. Jacquemin (1988) *The European Challenge 1992: The benefits of a Single Market*, for the Commission of the European Communities.

³ Germany, France, Italy, the United Kingdom and the Benelux states (together approximately 88% of GDP of the EC).

⁴ The analysis of market barriers included a survey of around 20,000 enterprises across all 12 Member States to ascertain which barriers were considered most significant (from technical standards and regulations and frontier formalities to restrictive procurement procedures).

⁵ Nine in-depth micro-economic studies – Manufacturing: telecoms equipment, automobiles, foodstuffs, building materials, textile and clothing, pharmaceuticals; Services: business services, financial services, telecommunication services.

⁶ The effects are: (i) welfare gains associated with increase product variety; (ii) technical efficiency gains through exploitation of economies of scale – generated by increased output in the short term and restructuring in the long-term; and (iii) the fall in prices and costs resulting from greater competition.

⁷ The analysis uses the Commission's Hermes model, and the OECD's Interlink model which both look at bilateral trading relationship. For more information see: Annex B of Emersen et al (1998)

10. Critics of the Cecchini Report analysis either suggested that gains were over-estimated, on the basis that not all NTBs would be removed in practice by the Single Market Programme, or alternatively that they were under-estimated given the focus on the short-term effects of the removal of NTBs rather than the longer-term, more dynamic impacts associated with increased competition (and increased innovation) and thereby a permanently higher growth rate for the EU economy.
11. There were also some weaknesses in the partial equilibrium approach. It assessed the impact on individual product markets before aggregating the results to deliver a macroeconomic assessment. This suggests that interactions between sectors were not accounted for, a significant omission given the integrated nature of supply chains across many different areas of activity.
12. Moreover, the welfare costs of adjustment were not included in the estimates due to difficulties in quantification. But they certainly existed, and could affect individuals and businesses in all sectors of the economy in all regions through needing to adapt to new competitive pressures.
13. Finally, the analysis did not consider the impact of further enlargement.

Headline results:

14. Overall, the Cecchini Report estimated the “costs of non-Europe” to be between 4.25% and 6.5% of GDP, depending on assumptions (see below). This was a range of around ECU⁸ 170-250 billion at 1988 prices for the 12 Member States, with an oft-quoted mid-point of around ECU 200 billion. The gains associated with reducing costs were expected to deliver a short-run impact, while the effects associated with changes in market structure were expected to persist for longer.

Table 1: Micro-economic estimates of potential economic gains for the EC resulting from completion of the single market

	Gains from...	Billion ECU	% of GDP
(1)	... elimination of trade barriers	8 – 9	0.2 – 0.3
(2)	... elimination of production barriers	57 – 71	2.0 – 2.4
(3) = (1) + (2)	... reducing cost-increasing barriers (sub-total)	65 – 80	2.2 – 2.7
(4)	... exploiting economies of scale more fully	60 – 61	2.0 – 2.1
(5)	... competition effects	46	1.6
(6) = (4) + (5)	... from reducing market-entry restrictions (sub-total)	62* – 107	2.1* – 3.7
(7) = (3) + (6)	Total Gains from Single Market programmes:		
	- for 7 Member States at 1985 prices	127 – 187	4.3 – 6.4
	- for 12 Member States at 1988 prices	173 – 257	4.3 – 6.4

Source: Commission of the EC (European Economy paper No. 35); *if (4) and (5) are computed jointly; Note: All lines except the last reflect the results for 7 Member States at 1985 prices.

15. The analysis suggested that the impact would be felt over the medium-term, with a cumulative impact of around +4.25% on GDP and -6% on the price level expected to be achieved in five to six years. The Single Market was also estimated to deliver a positive impact on employment of around two million jobs, even after taking account of the significant productivity and restructuring effects that would come from greater market integration. It was thought these could be further improved upon if macroeconomic policy

⁸ The European Currency Unit (ECU) was introduced on 13th March 1979 as the unit of account of the European Community (a basket of Member State currencies). It was replaced by the euro on 1st January 1999, at parity.

measures designed to harness the development potential of the Single Market were employed. In this instance, the impact on GDP would increase to approximately 6.5%, with the positive impact on employment arising around five million jobs.

16. The study did not systematically estimate how these gains would be distributed across Member States. However, the analysis suggested that while all stood to gain from the removal of these barriers, new Member States could potentially realise above average gains given that many of the potential benefits arose from achieving lower costs and more efficient production methods.

[Baldwin, R. \(1989\), On the Growth Effects of 1992, NBER Working Paper No. 3119, published in Economic Policy, 9, p248-81](#)

Background:

17. Building on the Cecchini analysis, this ex-ante study sought to include the impact of several types of dynamic trade effects in the analysis of the impact of the 1992 Single Market Programme. Instead of viewing the Programme as a simple exercise of trade liberalisation, it saw it as one of significant market liberalisation and deregulation, with wide ranging (static and dynamic) impacts across the economy.

Overview of Methodology:

18. This was a first exploratory attempt to quantify some of the dynamic effects of the Single Market, and the quantitative challenges were particularly difficult given the lack of robust data available for key aspects of the analysis. The author applied models from New Growth Theory to provide an indication of the potential dynamic impact.
19. The key premise was better incorporation of the impact of increasing returns to scale on an economy-wide basis. It emphasised that economies of scale delivered by accessing a larger market could have a dynamic impact, i.e. on the *growth* rate of GDP over the medium term (and possibly permanently), as well as a static impact on the *level* of GDP.
20. Using Romer's growth model, Baldwin showed, like Cecchini, that on this basis there would be an initial static impact on output per worker and on the capital-labour ratio, corresponding by assumption to Cecchini's 4.25-6.5% of GDP. But there would also be an additional shift leading to a higher, dynamic, impact on both measures. Baldwin concluded that market liberalisation had an indirect impact on the investment climate in Europe, inducing higher saving and investment, and hence a larger impact on growth than the static analysis suggested. The size and longevity of this growth bonus depended on how important were economy-wide increasing returns to scale.
21. The analysis also considered the impact of innovation on the long-run growth rate of GDP, highlighting the potential impacts of reduction in trade costs, pro-competitive affects and regulation standardisation. Baldwin highlighted that the difficulties associated with modelling impact of this kind, including lack of robust data (for example, on profit margins, R&D costs, the rate of technological dissemination and spillovers and so on), had an impact on the precision of results, and required calibration of data to deliver an assessment of the long-term impact.
22. These data constraints limited the report to tentative results. As with the Cecchini report, this study did not take account of the enlargement effect, shown to have had a significant impact on increased specialisation of economic activity across European Member States.

Headline results:

23. The study suggested that the Cecchini numbers significantly underestimate the potential economic benefits from establishing the Single Market, by at least 40%, and possibly as high as 250%, though this upper estimate was considered implausible.
24. The paper further argued that the long-term growth effects on EC GDP of the 1992 Internal Market Programme (due to technical change) could be very significant, potentially adding between close to 0.3 and approximately 0.9 percentage points to the EC's long-term GDP growth rate.
25. However, there were difficulties in cumulating these results, given the different approaches used. Baldwin therefore used the results to highlight the argument that the original estimates did not fully take account of the potential impact of the 1992 programme, rather than focusing on the numbers themselves.

Monti, M. & D. Buchan (1996), *The Single Market and Tomorrow's Europe – A Progress Report from the European Commission*, European Commission⁹

Background:

26. This study was the first ex-post analysis by the European Commission to assess the Single Market's achievements. The analysis focussed on the original measures as outlined in the Commission's 1985 White Paper (282 measures tackling various barriers to the Four Freedoms), pre-existing legislation required to deliver the Single Market, additional measures not originally considered in 1985, such as the liberalisation of some network industries, and additional "flanking" policies such as competition and regional cohesion.

Overview of Methodology:

27. In a similar approach to the original Cecchini report, the analysis was based on a series of 38 in-depth (cross-) sectoral analyses and an extensive survey of business opinions. However, the assessment was clearly badged as an attempt to assess the impact of the proposals undertaken thus far, and not a "Cecchini Mark 2" which would have the objective of validating the earlier analysis.
28. The 38 reports assessed the degree of implementation of the Single Market in various European industries, and across them:
 - a. 19 studies of manufacturing and services sectors – each of these studies assessed the extent of reduction in barriers in cross-border transactions, and identified residual issues;
 - b. 6 "barrier studies" – technical barriers, public procurement, customs and fiscal formalities, industrial property protection, currency management and capital market liberalisation;
 - c. 13 'further impact' studies – analysing the economic impact of removing barriers (trade and investment flows, price convergence, competition and competitiveness, employment and labour markets, and economic cohesion);

⁹ Drawn from European Commission (1996), *The Impact and Effectiveness of the Single Market – Communication from the Commission to the European Parliament and Council*, 30 October 1996

- d. Plus a survey of business opinion to rate the impact of the success of the Internal Market programme and the impact that it had had on their strategies and operations – responses from 13,000 enterprises across 12 Member States;
29. The more “vertical” sector reports provided a “bottom-up” approach to assessing the impact, and the “horizontal” studies on cross-sectoral barriers helped to give a more macroeconomic perspective by considering the impact on trade and investment, and competition, at the aggregate and regional level.
 30. The assessment highlighted key assumptions, including on what the economy would look like in the absence of a single market (the counterfactual) and how the actions taken under the Internal Market Programme may have interacted with other factors and trends over the same period to affect the economy. A counterfactual and a number of scenarios were constructed and modelled using the GEM-E3 model, an applied multi-country, multi-sectoral dynamic Computable General Equilibrium (CGE) model of the 12 EU Member States.¹⁰
 31. The key limitation to this study was that it was undertaken very soon after the implementation of the Single Market in 1992. As such, limited data availability, particularly regarding the longer-term and more dynamic impacts, constrained the analysis. The headline figures could therefore also not consider the implications of enlargement.

Headline results:

32. The analysis found that the Single Market had increased output by 1.1-1.5% by 1994 and created 300,000-900,000 new jobs. It further suggested that:
 - a. Inflation rates were 1-1.5% lower than they would have otherwise been;
 - b. The programme had stimulated investment in the EU by an additional 2.7% and attracted additional foreign direct investment to the EU, an increase in world FDI inflows from 28.2% between 1982 and 1987, to 44% in the early 1990s; and
 - c. There had been falling costs in a number of industries, for example, a 7% reduction in the price of telecommunications equipment, saving buyers between ECU 1.5-2 billion a year.
33. The results also suggested an increase in economic integration and convergence between Member States, such as intensified intra-EU trade (with the share of intra-EU exports of manufacturing and services increasing by 14% and 7.6% respectively over the previous decade – although not at the expense of trade with the rest of the world), an increase in the share of public sector purchases from other Member States (from 6% to 10%) and higher growth rates in poorer Member States than richer ones.
34. The analysis suggested that around half of the effects seen came from improvements in competition and efficiency (in both manufacturing and services sectors), and half from technical progress associated with the Single Market. In particular, there was a wider range of products and services available at lower prices (particularly in newly liberalised services sectors), industrial restructuring had improved the competitiveness of companies, and there was greater mobility of labour across Member State borders and greater economic convergence and cohesion between different EU regions.

¹⁰ Further details of the modelling can be found in: National Technical University of Athens (1998), *Aggregate Results of the Single Market Programme*, Single Market Review, Sub-Series VI – Aggregate and Regional Impact, Volume 5

35. However, the report highlighted that the effects measured were lower than might have been expected. This was attributed to the impact of the recession in the early 1990s and to the slower than expected implementation of the Single Market proposals. As such, the analysis suggested that there was potentially significant further benefit to be gleaned from continued progress.

Minford, P., V. Mahambare & E. Nowell (2005), *Should Britain Leave the EU – An Economic Analysis of a Troubled Relationship*, Edward Elgar/Institute of Economic Affairs

Background:

36. This study took a different perspective from others covered in this appendix, although there were some common elements in approach. In particular, it made a broader assessment of the costs and benefits of the UK's membership of the EU rather than trying to isolate the impact of the Single Market. As such, it considered additional areas of policy, such as the impact of the CAP, the euro, and broader aspects of proposed harmonisation such as those around social welfare. In particular, the study contended that, rather than reducing barriers between markets, the EU had led to increasing levels of protection in trade, in labour markets, and against take-overs of domestic firms by foreign companies by protecting its firms from world competition.

Overview of Methodology:

37. The study considered the “tariff-equivalent” impacts of non-tariff measures, such as quotas, anti-dumping, and informal agreements, focussing on the impacts for goods and services sectors. Estimates of tariff-equivalents across sectors were drawn from an earlier paper by Bradford (2003).¹¹ The author then estimated the welfare impacts on the UK and the rest of the EU (REU) by using these figures in a CGE world model built by Minford *et al*, 2005¹², which looked at the changes in trade resulting from removing protection in these areas – the comparison was between being inside the EU customs union and being outside under free trade. The analysis was more forward-looking, with the status quo as the benchmark, and the scenarios being tested representing potential futures:
- a. If the UK withdrew from the EU trade arrangements in favour of unilateral free trade;
 - b. If the EU also moved to unilateral free trade.
38. Welfare effects considered by the authors included terms of trade gains/losses of real income, the customs union transfers effected through trade-diversion of RoW sourcing to customs union partners, and the consumer surplus lost through higher internal prices.
39. The model used did not impute scale economies from greater integration, but did include gains from greater competition, where it was assumed in the benchmark that the maximum gains from competition had already been achieved under the status quo. As such the Cecchini-style competitive processes from the creation of the Single Market were considered to have already been incorporated into the benchmark, and were therefore not reflected in the estimates. However, the longer-term dynamic impacts associated with innovation do not seem to have been fully incorporated.

¹¹ Quoted in Minford et al (2005) – Bradford S. C. (2003), *Paying the Price: Final Goods Protection in OECD Countries*, Review of Economics and Statistics, 85(1)

¹² The model divides the world economy into 4 blocs – the UK, NAFTA, rest of the EU, rest of the world. (see p.26)

40. The analysis also provided a high-level sectoral break-down of the results – agriculture, basic manufacturing, hi-tech manufacturing and traded services – and the impacts on for example, terms of trade, consumer surplus etc were discussed in each before the overall estimate of the impact is given.
41. Finally, the assessment did not take account of the 2004 enlargement. Data for the model base run was taken from 1998 as the most comprehensive dataset available at the time.

Headline results:

42. The headline results suggested that, far from an economic gain, there was an economic cost to membership of around 3% of GDP for the UK and around 2% for the rest of the EU. Specifically, the analysis suggested that a move by the EU and UK to unilateral free trade in goods and services would deliver a gain for the REU of 2% of REU GDP, and for the UK 3.8% of UK GDP, and that even if the EU did not make the move, the UK would still gain around 2.5% of its GDP, with a small loss to the REU of 0.2% of its GDP. These results postulated considerable structural changes resulting from this liberalisation, with competition under free trade largely eliminating manufacturing in favour of traded services for the UK.

[Ilzkovitz, F., A. Dierx, V. Kavocs & N. Sousa \(2007\) Steps towards a deeper economic integration: the Internal Market in the 21st Century – a contribution to the Single Market Review \(European Commission – DG ECFIN; European Economy No. 271\)](#)

Background:

43. In 2007, the European Commission undertook another review of the Single Market, which aimed at providing evidence of the benefits achieved since inception in 1992. The review sought to analyse the effects of implementation of the Single Market Programme and to suggest areas where further improvements could be made. In particular the study sought to address the following three questions:
 - a. To what extent was the environment in which the Single Market operated in 2007 different from that of the late 1980s-early 1990s?
 - b. What was the latest empirical evidence on the economic impact of the Single Market? and
 - c. Why had the Single Market failed to live up to early expectations?

Overview of Methodology:

44. The study highlighted various challenges reflecting the changing nature of the Single Market, including the growing importance of services the rapid technological development since its inception, greater integration through Economic and Monetary Union (EMU), and enlargement.
45. The analysis identified micro-economic effects associated with increased competition pressure, less price-setting behaviour in firms, and changes to industrial structure, including the specialisation of activities across European borders, through assessing trends in trade flows/integration, FDI activity, price convergence and the impact on competition across Member States.

46. The study also made an assessment of the macro-economic impact of the creation of the Single Market. Given that the creation and evolution of the Single Market was based on a series of microeconomic reforms, for which there is a potential “whole economy” impact, the analysis was divided into three strands:
- a. Estimation of the macroeconomic impact of EU15 market integration in manufacturing through simulating competition and innovation effects. The parameters were based on a range of earlier studies on the impact of the creation of the Single Market on price-cost mark-ups and total factor productivity (TFP). (EU15 only).
 - b. More targeted simulation of the impact of opening up electricity and telecommunications markets to competition. Estimates for the decline of aggregate price-cost mark-ups for network industries were based on earlier studies and anticipated impact due to the observed pace of liberalisation.
 - c. Simulation of the impact on competition and innovation from increased trade following enlargement to EU25. The enlargement effect was simulated through isolating the trade effect of enlargement, calculating the impact on mark-ups and TFP, and introducing these into QUEST.
47. The analysis was carried out by DG – Economic and Financial Affairs using their QUEST model (a Computerised General Equilibrium, CGE, model)¹³ over the period 1992-2006, with the impacts of the creation of the Single Market simulated through the introduction of “shocks” to calculate the extent of deviation from the baseline. The focus on the period 1992-2006 meant that the study did not include the progressive benefit in the period leading up to 1992: for example the benefits of eliminating tariffs with the EU were excluded.
48. The final part of the study focused on simulations of the impact of the removal of additional barriers in future, suggesting substantially larger gains could yet be achieved, particularly with reference to the opening up of services markets and reduction of fiscal barriers.

Headline results:

49. The paper found that the creation of the Single Market had acted as a powerful instrument of delivering economic integration and increasing competition within the EU. However, the micro-economic analysis suggested that integration had lost momentum over the most recent years covered by the study, but that this should perhaps be expected in the process of European product market integration as remaining barriers become more difficult to remove. This part of the analysis also suggested that integration had not led to a shift towards a higher-technology-intensive sector, suggesting that the EU had not yet established itself as an innovation-driven technology leader.
50. It concluded that the Single Market had been the source of large macro-economic benefits, raising the level EU GDP by around 2.18% (€223 billion) by 2006 and creating 2.75 million additional jobs across the EU25. It had resulted in a 0.9 percentage point decline in the aggregate price-cost mark-up and boosted total factor productivity by 0.5% over the period 1992-2006. A breakdown of the headline GDP respects for the EU15/EU10 and the cumulative impact on the EU25 is given in the tables below.

¹³ The current version of QUEST (III) is a global macroeconomic New-Keynesian Dynamic Stochastic General Equilibrium (DSGE) model. This class of model is highly utilised by international institutions and central banks for macro-economic modelling. The models have detailed microeconomic foundations and cater for frictions in goods, labour and financial markets. A number of different versions of QUEST III have been constructed to cater for a wide range of policy issues – each has a specific focus, with a regional and sectoral disaggregation

Table 2: GDP effects of the Single Market (SMP), the liberalisation of network industries and enlargement (deviation from the baseline), 2002-2006

Years	EU15						EU10	
	Network + SMP		Enlargement		Network + SMP + Enlargement		Enlargement	
	€bn	%	€bn	%	€bn	%	€bn	%
2002	164.5	1.79	15.9	0.17	180.4	1.96	8.8	1.96
2003	168.4	1.81	18.9	0.20	187.9	2.01	11.4	2.45
2004	172.2	1.81	21.2	0.22	193.4	2.03	12.8	2.62
2005	176.1	1.83	24.5	0.25	200.6	2.08	14.8	2.90
2006	179.9	1.83	27.1	0.27	207.0	2.10	15.6	2.91

Table 3: Total GDP and employment effects of the Single Market (SMP), the liberalisation of network industries and enlargement (deviation from baseline level), 2002-2006

Years	EU25			
	Total GDP effect		Total employment effect	
	€bn	%	1000 p.	%
2002	189.2	1.96	2637.4	1.35
2003	198.7	2.05	2644.1	1.34
2004	206.2	2.08	2660.8	1.34
2005	215.4	2.15	2711.2	1.35
2006	222.6	2.18	2750.5	1.36

51. The 2007 study also suggested that the potential of the Single Market had not yet been fully exploited and that there was still some way to go in removing barriers between Member States. The study concluded by suggesting that if further progress was made (both in terms of full and proper implementation of existing directives and, where possible, tackling remaining non-tariff barriers) the benefits achieved could be doubled.¹⁴
52. In 2012, the Commission released an update to this estimate which extended the assessment period to 2008. This update suggested that the Single Market had raised EU GDP by a fractionally lower figure, 2.13%, and created 2.77 million additional jobs across Europe over that period.

Boltho, A. & B. Eichengreen (2008) – The Economic Impact of European Integration (CEPR Discussion Paper No. 6820)

Background:

53. This paper took a different approach to its predecessors, through focussing more deliberately on what the counterfactual might have been without the Single Market programme. The study was an ex-post assessment and considered many different stages of European integration from the creation of the European Payments Union in 1950 to the European Monetary Union.

¹⁴ The analysis estimates that progress on: services could deliver a 0.5-1% increase in EU GDP; financial markets 1.1%; energy 0.6-0.8%; and tax cooperation 0.2%.

Overview of Methodology:

54. The paper discussed the various stages of European economic integration¹⁵ and looked at possible alternative scenarios for the counterfactual. In particular the paper considered to what extent European living standards, growth rates, and economic structure would have developed as they have even in the absence of the EU's institutions and processes.
55. From a review of the literature, the authors concluded that European economic integration had had a positive effect compared to the counterfactual. They then undertook a two-step qualitative evaluation to attempt to quantify these effects by:
 - Selection and evaluation of potential channels of transmission between a particular episode and economic growth, often relying on estimates available in the literature; and
 - An assessment of what part of the evaluations reflected genuine unification effects. The authors deliberately sought to minimise the positives.
56. The assessment considered the specialisation of countries, the diversification of products, and the impacts of innovation.

Headline results:

57. The analysis suggested that there has been a much clearer boost to EU output than might have been expected to be delivered purely by global movement on trade liberalisation over the same period. The authors suggested that EU GDP could be around 5% higher in 2008 than it would otherwise have been. This was considered to be a lower-bound estimate.

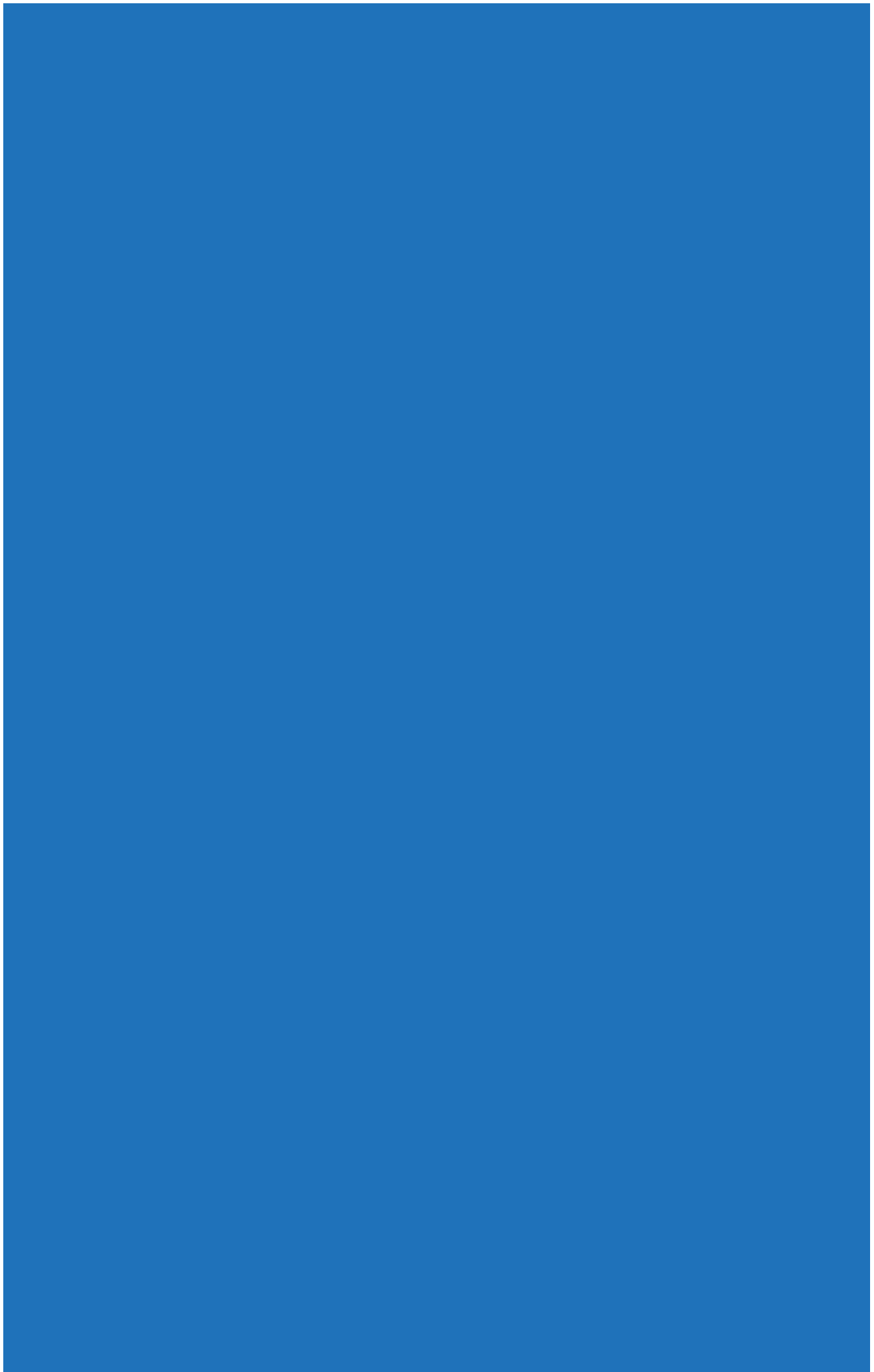
Conclusions

58. A wide range of assessments have been undertaken to consider the impact of the creation of the Single Market. The selection of papers covered above represents only the most significant of these, but even so demonstrates the variability in approach, geographical coverage, and time period. Comparability between studies is therefore not easy or often appropriate. The table below attempts to summarise the key elements of the different studies.
59. With the exception of Minford *et al* (2005), which separates out the potential impact for the UK, none of the studies provide estimates of the benefits for individual Member States. There are various reasons why individual states may gain differently to their proportionate share in GDP (e.g. extent of liberalisation already undertaken, industrial make-up etc).

¹⁵ European Payments Union; European Coal and Steel Community; Common Market; European Monetary System; 1992 Single Market Programme; European Monetary Union

Table 4: Summary of study headline figures and key characteristics

Study	Headline results	Geographical coverage	Time period	Static Impacts	Dynamic Impacts	Other considerations
Cecchini (1998)	+4.25-6.5% GDP	EU 12 (no enlargement)	5-6 years	Included	Not included	Ex-ante
Baldwin (1989)	+0.3-0.9% long-term GDP growth	EU 12 (no enlargement)	Long-term	Included	Included	Ex-ante Provisional findings
Monti (1996)	+1.1-1.5% GDP; 300,000-900,000 jobs. in 1994	EU 12	Impact to 1994	Included	Limited (data availability)	Ex-post – limited data
Minford <i>et al</i> (2005)	-3% GDP to remaining in EU	EU15 (no enlargement)	Forward look (baseline = status quo)	Included	Not fully included	Forward assessment Broader than Single Market
Ilzkovitz <i>et al</i> (2007)	+2.2% GDP in 2006; + 2.75 million jobs	EU25	1992-2006	Included	Included (e.g. impact on TFP)	Ex-post
Boltho & Eichengreen (2008)	+5% GDP in 2008	EU25	Impact to date	Not explicit in numbers	Not explicit in numbers	Ex-post – greater focus on counterfactual Common Market and Single Market



Annex A:

Certain third-country relationships with the Single Market

Note: the following factual discussion focuses on aspects of the arrangements which are relevant to the Single Market. It should not be taken as a comprehensive analysis of the pros and cons of these arrangements more broadly.

The European Economic Area (EEA) is a Treaty-based arrangement between the EU and **Norway, Iceland and Liechtenstein**, three of the four members of the European Free Trade Association (EFTA). It is based on an Agreement of Association which came into force in 1994. It extends to these three non-EU EEA Members the Four Freedoms and the EU's state aid and competition rules, and provides for broader cooperation in the areas of social policy, the environment, education, and half a dozen other areas. It excludes the Common Agricultural Policy and Common Fisheries Policy and external trade policy, plus some other areas like foreign policy, defence, and Justice and Home Affairs not relevant to the Single Market, though Norway has since chosen to cooperate voluntarily with the EU in some. Disputes are ultimately settled in (the EFTA) court. The relevant provisions in the Agreement very largely mirror those in the EU Treaty.

These arrangements mean that EEA members:

- Have no say on the Single Market legislation by which they are bound – domestically as well for exports to the Single Market proper;
- Are not part of the EU customs union. As a result, they are not part of the EU's common trade policy and they may negotiate trade agreements with third countries;
- Have their exports to the EU bound by rules of origin. These are detailed rules which lay down how much non-EEA content a product may have before it can no longer be considered an EEA product and hence exempt from duty when entering the Single Market. (They stop, for example, China exporting a good to Norway and then Norway selling it on within the EU as a “Norwegian” product.) Demonstrating compliance with these rules can be administratively burdensome.

The **Swiss** arrangement is different. Switzerland is a member of EFTA but not of the EEA. The Swiss relationship involves a series of bilateral Treaties between Switzerland and the EU, beginning with a Free Trade Agreement from 1972, and supplemented by sets of bilateral packages mostly agreed in 1999 and 2004. These deals give Switzerland free trade in most goods with the EU, including some agricultural ones; provide for free movement of persons; give access to public procurement markets; and access to EU research programmes. There is only limited access for trade in services.

These arrangements mean that Switzerland:

- Has free access to the Single Market only to the extent that this is provided for in the bilateral arrangements;
- Has no say on Single Market legislation, but is not bound by it domestically either;
- Has its exports to the EU bound by rules of origin;
- Is not part of the EU customs union or of the EU's common trade policy, and may negotiate trade agreements with third countries.

The **Turkish** relationship is different again. Since 1996 Turkey has had a customs union with the EU covering industrial and processed agricultural goods (not non-processed agricultural goods or coal and steel products). Turkey has to adopt EU provisions on technical barriers to trade and EU product regulations, and have competition and state aid rules equivalent to EU practice.

These arrangements mean that Turkey:

- Has free access to the Single Market for most goods, without rules of origin;
- Must rely on bilateral agreements to provide for access to the Single Market in other areas of the Four Freedoms;
- Has no say on the development of EU Single Market legislation in areas where it must mirror it;
- Must try to negotiate FTAs with third countries covering goods where the EU has negotiated such an FTA, or otherwise find that third countries can export freely to Turkey (via the EU) without giving free access to Turkish goods;
- May negotiate trade agreements with third countries in areas not covered by the customs union.

Annex B: Submissions to the Call for Evidence

The following formal responses to the Call for Evidence were received:

AB Sugar
All-Party Parliamentary Group on Modern Languages
American Chamber of Commerce to the EU
Australian Government
Austrian Federal Economic Chamber
BAE Systems
Bar Council
Bioindustry Association
British American Tobacco
British Bankers' Association
British Chambers of Commerce
British Influence
British Irish Chamber of Commerce
British Retail Consortium
BT
Building Societies Association
Business for New Europe
CBI
Centre for European Reform
City of London Corporation
Commercial Broadcasters Association
Consumers for Health Choice
Convention of Scottish Local Authorities
Dogan, Michael
Euclid Network – European network of civil society professionals
European Commission
Faure, Jean-Pierre
Federation of Small Businesses
The Freedom Association

Fresh Start
GMB Trade Union
Government of Japan
Hodge, Michael
Imperial Tobacco Ltd
Industry Council for Packaging and the Environment
Institute of Directors
Jones, Barry M
Kingfisher plc
Law Society of England and Wales
Levitt, Malcolm
Liberal Democrat European Parliamentary Party
Lloyd's
National Council for Voluntary Organisations
National Farmers Union
Next plc
Open Europe
Open Society European Policy Institute
Road Haulage Association
Rotherham, Dr. Lee
Safelincs Ltd
Schroders
Scotch Whisky Association
Scott, Alan
Scottish Highland Institute for Peace
Senior European Experts Group
Smiths Group plc
Standard Life plc
Swiss Confederation
Tams, Svenja
TheCityUK
Trades Union Congress
UK European Consumer Centre
UK Weighing Federation
United Utilities plc
Vodafone
Waring, D
The Weir Group plc
The Wine and Spirit Trade Association
WPP plc

Two submissions to this report were specifically commissioned. Professor Catherine Barnard, Professor of European Union Law, University of Cambridge, was commissioned to provide a legal analysis of the development of European competence on the Single Market. Europe Economics was commissioned to consider the economic structure of the Single Market.

In addition to the formal submissions to the Single Market Call for Evidence, the following responses to other reports have been considered:

The Scotch Whisky Association – submission to the Taxation report

Senior European Experts Group – submission to the Foreign Policy report

Annex C: Engagement events

A number of engagement events were held during the duration of the Call for Evidence period to explore the issues raised in the Call for Evidence. These events included:

Roundtables with business stakeholders, 9 & 31 January, London
Legal forum with experts in EU law, 16 January, London
Roundtable with think tanks and opinion-formers, 23 January, Brussels

In addition, presentations and discussions on the Review were held with a number of other bodies, including:

The Secretary of State's Panel on Monitoring the Economy
Bruegel Workshop on the role of the EU for a stable and efficient Single Market
American Chamber of Commerce to the EU (AmCham) Single Market Task Force, Brussels
Discussion organised by Malcolm Harbour MEP
The States of Guernsey and Jersey

Attendees at these events included:

ABPI
AB Sugar
Aviva
Bar Council
Barclays
Barnard, Prof. Catherine
Black Country Chamber of Commerce
British Chambers of Commerce
British Retail Consortium
CBI
CBI Brussels
City of London Corporation
Construction Industry Council
Council of British Chambers of Commerce in Europe (COBCOE)
Craig, Prof. Paul
Delphi Automotive

Eeckhout, Prof. Piet
Federation of Small Businesses
Hinarejos, Dr. Alicia
Imperial Tobacco Group
Lloyd's
Pearson
Shell
TheCityUK
Tridimas, Prof. Takis
TUC
UK Weighing Federation
United Utilities Group plc
Weatherill, Prof. Stephen
The Weir Group plc
Whitbread Group plc

Annex D: Other sources used for the review

The following list is not exhaustive but sets out some of the main sources drawn upon in preparing the analysis.

The Decline of the Single Market, March 2006 – *Open Europe*

Britain Should Not Go Swiss – *John Springford – Centre for European Reform*

Single Market – Wallflower or Dancing Partner? February 2008 – *House of Lords Select Committee*

Relaunching the Single Market, April 2011 – *House of Lords Select Committee*

The economic consequences for the UK and the EU of completing the Single Market, February 2011 – *BIS publication*

Twenty Years On: The UK and the future of the Single Market, October 2011 – *BIS publication*

Davidson Review of EU legislation, November 2006 – *BIS publication*

Securing EU Growth from Services – *Jacques Pelkmans – Centre for European Policy Studies*

The case for more Single Market – *Jacques Pelkmans – Centre for European Policy Studies*

Mutual Recognition in Goods and Services: An Economic Perspective – *Jacques Pelkmans – Centre for European Policy Studies*

The Digital Single Market 2.0 – *Hans Martens and Fabian Zuleeg – EPC publications*

The Economic Impact of a European Digital Single Market, Copenhagen Economics – *EPC publications*

Europe, globalisation and the Single Market: lessons and comparisons – *EPC publications*

Delivering a stronger Single Market – Copenhagen Economics – *EPC publications*

Why our EU membership offers access to global trade opportunities – *John Cooke – TheCityUK*

In Depth: Series on the EU's Single Market – *BNE*

The Wall Street Journal – Europe Must Complete its Single Market – *BNE*

Building a Digital Single Market: delivering benefits of the digital economy to Europe's citizens – *BNE*

How can the UK lead the completion of the EU's Single Market? – *Lord Brittan speech, Jan 2011*

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