BIS Department for Business Innovation & Skills

THE UK AND THE SINGLE MARKET

Trade and Investment Analytical Papers
Topic 4 of 18

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Contents

Summary

The Single Market is vital to the UK's prosperity. It gives UK business access to the world's largest market with 500 million people generating about £10 trillion economic activity. European markets account for half of the UK's overall trade and foreign investments. As a result, around 3.5 million jobs in the UK are linked to the export of goods and services to the EU.

The Single Market has been a key driver for economic growth in the UK and in Europe. EU countries currently trade twice as much with each other as they would do in the absence of the Single Market. As a result, the Single Market may be responsible for income gains in the UK between 2% and 6%, that is between £1100 and £3300 a year per British household.

Businesses have benefited from the opportunities provided by the Single Market. Such benefits include: better connected and cheaper networks; mutual recognition of standards; and easier access to cheap and competitive inputs for British manufacturers. In addition greater competition within the single market has fostered innovation. For consumers, the single market has created more choice and lowered prices and facilitated travels for leisure as well as for business.

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1. Europe is the natural backyard of British companies

Europe is the world's most important trading area with 500 million people generating a total GDP of close to about £10 trillion in 2010. The EU is vital to the UK's growth and prosperity, with European markets accounting for half of the UK's overall exports of goods and services. Eight out of the UK's ten main export markets are in the EU. As a result of this economic exchange, around 3.5 million jobs in the UK are linked to the export of goods and services to the EU.

Other EU Member States are both the main source and the main destination of foreign direct investment (FDI) in and from the UK. In 2008, 49% of the total of inward FDI came from these countries. The stock of inward FDI coming from other Member States has risen from £151bn at the end of 1999 (EU15) to £465bn at the end of 2008 (EU27) – i.e. from 35% to 49% of the total. In 2008, 44% of total outward UK FDI flows went to other EU27 countries. The stock of outward FDI into the EU (£465bn) generated 48% of total earnings from UK investments abroad.

In the last decade, although Germany, Netherlands, France and Ireland remain the principal destinations for UK exports, the EU's enlargement has opened up new export markets for British companies. UK exports of goods and services to the 12 new member states were worth over £11.6bn in 2009, almost three times the £4.5bn of exports ten years earlier.

Free movement within the EU allows 1.5 million British citizens to study and work in the EU without requiring a work permit. Reciprocal rights for EU citizens bring valuable skills, experience and money into UK universities and businesses.

2. The Single Market is a key driver for economic growth in the UK and in Europe

In comparison with the early 1980s, the single market programme has clearly reduced "domestic bias" in the EU. EU countries trade nowadays twice as much with each other as they would do in the absence of the Single Market.[1] Given that, according to the OECD, a 10 percentage point increase in trade exposure is associated with a 4 per cent rise in income per capita, increased trade with Europe since the early 80s (around +15 percentage points) may be responsible for around 6% higher income per capita in the UK. This represents £3,300 a year per British household.

These estimates are in line with the recent research literature on the benefits of the Single Market. Taking into account further aspects like specialisation of countries, diversification of products, and innovation, Boltho and Eichengreen (2008) conclude that economic integration in Europe led to 5% additional income gains for the member countries under a lower-bound estimate. This is also in line with the results from CPB Netherlands Bureau for Economic Policy Analysis (2009) which point to between 3% and 10% gains from European trade integration. The European Commission estimates that the Single Market has increased EU GDP by 4.8% to 5.7% since 1987.[2] This does not take into account the effect of the suppression of tariffs across Europe which took place well before that year.

Various economic mechanisms drive the positive impacts of the Single Market on economic growth in the UK and in Europe. First the reduction of trade barriers within the EU has provided UK and European firms with access to a larger market, fostering higher exports and creating jobs. Second, the Single Market has created greater potential for efficiency improvements by encouraging specialisation, exploiting comparative advantages and economies of scale, and so facilitated access to cheap and competitive inputs. Finally removing informal and formal barriers between Member States has had second-order dynamic effects generated by greater competition within the Single Market. To survive in a larger and more competitive "home" market place, firms have been driven to reduce their rents and mark-ups, reduce slack and use their resources – labour and capital – more efficiently, putting downward pressure on costs. There have been also greater incentives for innovation and investment - both key drivers of global competitiveness.

3. There is still substantial scope for further gains from a better functioning Single Market

Despite all the progress made, intra-EU trade for manufacturing good is around 70% below intra-US states as a percentage of GDP despite the fact

[1] Fontagné et al., 2004.
[2] European Commission (2010).

that the EU population is much more concentrated (twice the population on a territory half the size the US). While domestic bias has decreased in Europe since the late 1970s, trade in goods across European borders is still 4.2 times lower than what it should be if the EU was as economically integrated as the US, even when correcting for language and geographic factors. It means that Europeans consumers and businesses purchase 4.2 times more from domestic producers than from equally distant foreign ones.[3]

Available estimate for services are more fragile due to the poor quality of services statistics, however evidence points to similar under-performance: according to the Netherland Bureau for Economic Analysis (CPB) services trade in Europe has a potential to increase by a factor 3 to 5. However, given that it is built on the strong assumption that there is not such under-performance for goods, such estimate clearly underestimates this potential.

Recent economic evidence shows that significant non-tariff trade barriers remain in the single market and that current trade between the UK and the EU may run 45% below potential.[4] Completely removing these obstacles to trade would translate into 7% additional income per capita per UK household (14% at the EU level). In value terms, removing all the remaining obstacles could most increase exports to the Benelux ($30bn additional exports), France ($24bn), and Germany ($21bn). Spain and Italy follow with between $15bn and $14bn potential for additional trade. The potential additional trade to the rest of the EU could amount to $57bn.

The persistence of regulatory obstacles to trade within the Single Market is confirmed by the companies themselves. British companies put legal and regulatory barriers as the first obstacle of their development in the European Economic Area, with 31% experiencing difficulties. By contrast, 25% face difficulties to get the right contacts, 20% face a domestic bias by potential business partners, and 15% face cultural barriers.[5]

The complete elimination of obstacles to trade across the Single Market is a very ambitious scenario, not realistic in the short to medium term. It remains however that achieving only half or a quarter of that objective has the potential to change substantially EU growth path for the years to come. For instance the European Commission estimates that the full implementation of the Services Directive combined to the improvement of financial integration, the reduction of administrative and regulatory burden and promotion of open public procurement could lead to an increase of EU GDP by around 4% over the next 10 years. This would mean a yearly extra growth of 0.39% up to 2020.[6]

[3] Head and Mayer, 2002.
[4] Aussilloux et al., 2010.
[5] OMB Research, 2010.
[6] European Commission (2010).

Conclusion

European growth has been impacted severely by the 2008-2009 crisis and the process of fiscal adjustment that followed. Moreover, the recovery from the 4.1% contraction in GDP suffered in 2009 will be further slowed by long-standing structural weaknesses in the European economy, in particular product and labour market rigidities. If the current growth forecasts prove correct, it could take more than three years for output in Europe to return to pre-crisis levels, and unemployment is unlikely to fall below 10% according to the European Commission.

Given the importance of the European market for British exporters and investors, finding new sources of growth in the EU is of central importance to the UK economy At a time of major fiscal constraints, strengthening the Single Market has the capacity to lift up substantially European countries' growth by further opening borders for goods and services, delivering greater choice and lowering prices to consumers, opening up new business opportunities for companies, and ultimately creating jobs. It will play a key role to retain and develop the global competitiveness of European businesses.

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