Aleksander Rutkowski*

THE REALISED AND UNREALISED BENEFITS OF THE EU SINGLE MARKET: CURRENT VIEWS

The article presents current views from the Commission staff and independent analysts on the types and the magnitude of the economic benefits provided by the EU Single Market as well as channels through which they materialise. The article first looks both at the already obtained and yet-to-be reaped gains, from the macroeconomic, sectoral and firm perspective. The article concludes that whilst gains have already materialised, significant benefits are still to be reaped, especially with more national reform effort.

Keywords: *economic integration, institutional arrangements, economic growth.*
JEL Classification: *F15, F43, F55.*

1. Introduction

The Single Market of the European Union (EU) is a globally unique economic area and institutional system, composed of different yet open and tightly integrated regional and national markets; it is in fact a core of the European integration process and an indispensable element of the EU. It should not probably be seen as a stand-alone growth engine, but as a fertile ground for entrepreneurial activity (including risk-taking, experimentation, exploration of new market niches) and, thus, a potent catalyst of growth *(*Mariniello *et al.,* 2015*)*. Still, both policy makers and citizens want to know what type and amount of gains we obtain thanks to the existence of the Single Market in the EU.

This article reviews, inevitably selectively, a wealth of the up-to-date literature in economics and related research on the benefits of the Single Market, providing a typology and, wherever possible, the magnitude of the benefits, both the ones already obtained and the potential ones which can be still reaped.

It starts with a macroeconomic bird's-eye view, looking also at the benefits of the wider benefits of the EU (since if there was no Single Market, there would not be EU). The macroeconomic approach, though comprehensive, may be insufficiently tangible or convincing to everyone because the macro estimates are highly aggregated. Thus, we also zoom in and review selected specific benefits of the Single Market. The sector —and firm— level analyses, though selective and incomplete, offer a more detailed view of the benefits provided by the Single Market.

* Member of the Chief Economist Team, Directorate General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW), European Commission.

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2. The economy-wide perspective

Benefits from the accomplished level of the Single Market integration

The Single Market programme of 1980s and 90s (the process of implementation of the Single European Act) proved effective in increasing the level of economic integration between the Member States as indicated e.g. by the reduced price differences (Ogrokhina, 2015), expanding labour mobility, increasing trade and foreign-direct-investment intensities, or rising portfolio capital flows (Nitsch and Berger, 2015; European Commission, 2016, chapter 6), though it is often difficult to decompose the changes resulting from the European integration vis-à-vis those resulting from other factors, e.g. globalisation or technological progress.

The nature and magnitude of the benefits yielded by the Single Market can be simulated counterfactually as losses due to a hypothetical scenario of no Single Market. In a very recent comprehensive study, the experts of the Centre for Economic Studies Institute (CESifo) estimated the effects of a supposed dismantling of the Single Market (Felbermayr *et al.,* 2017): statistically significant and economically sizeable income slump in all the Member States, with small countries and those that joined the EU this century hitting the hardest (permanent income level losses reaching 20 per cent and 11 per cent respectively); losses of competitiveness, enhanced by output and demand reduction, reflected in the collapse of intra-European trade (by about 30 per cent); production relocation to non-EU countries, driving down wages in the European countries.

The Single Market has not only widened the market access for end products but also for intermediate goods, providing a very fertile ground for the emergence of a web of tightly interdependent producers: modern European value chains (Figure 1).

The integration into the value chains is imperative for policy makers, as it correlates positively with high income levels (Xing *et al.,* 2017). The Single Market has been indeed a critical force behind the formation of international value chains in the EU: a bottom-up process with free entry supported by low trade costs (Pomfret and Sourdin, 2016). European standards have been one of the mechanisms which made the trade costs low. They reduce information asymmetries between the value chain participants in the Single Market (Blind *et al.,* 2017).

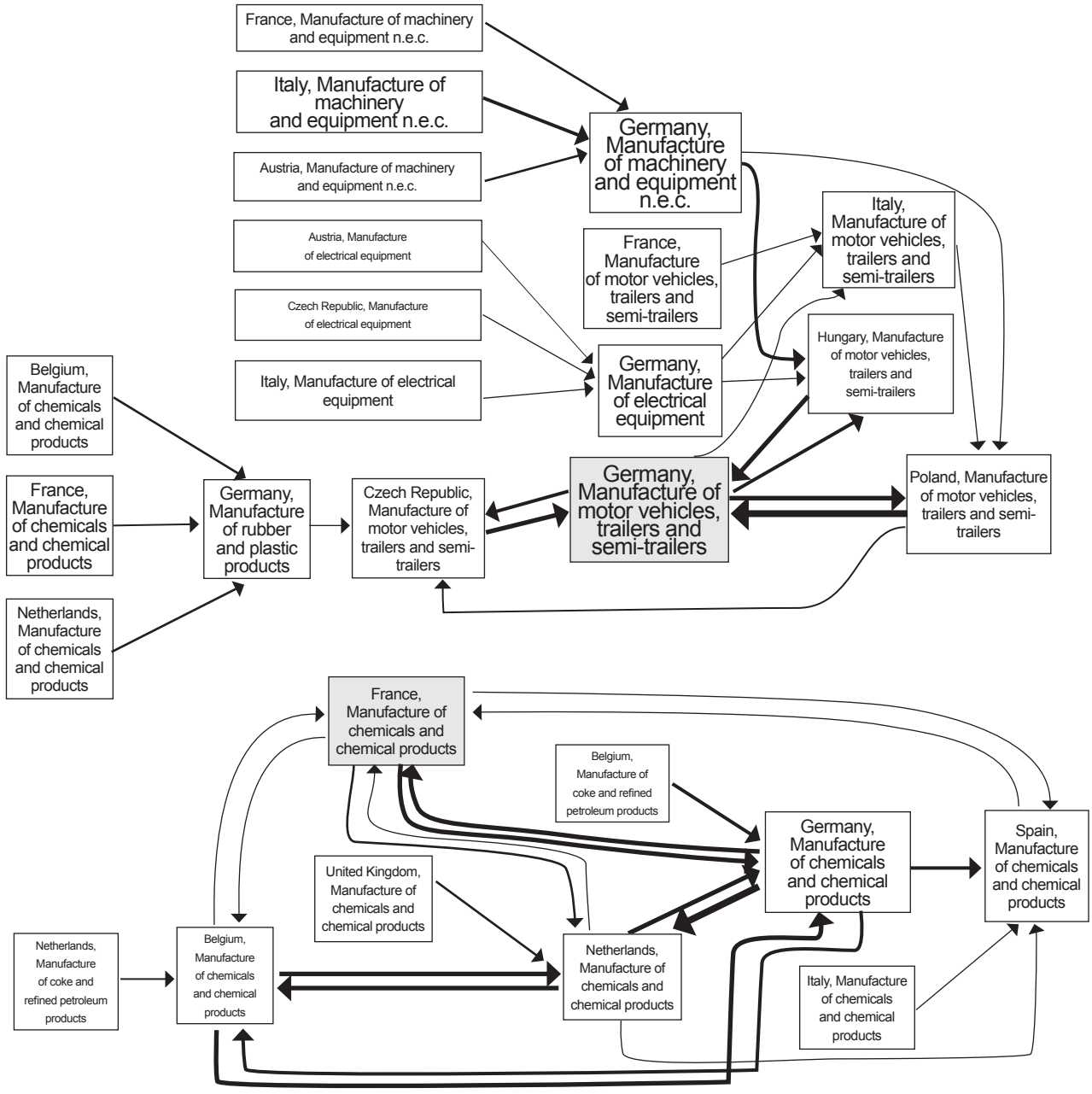
Katsimi and Zoega (2016) estimate the investment-saving equation (a Feldstein-Horioka model) with the difference-in-difference methodology and demonstrate that the Single Market and, later on, the euro have increased capital mobility among the Member States beyond what is observed in the control group of countries outside the analysed agreements. Consequently, one can conclude that the institutional changes following the Maastricht Treaty have improved capital allocation in Europe from a macroeconomic perspective. Furthermore, Aghion *et al.* (2015) show that product market reforms induced by the Single Market programme have enhanced innovative investment in manufacturing industries of countries with strong patent rights.

The EU has successfully supported the catching-up process in Europe, to large extent via a remarkable inflow of foreign direct investment (FDI): the investors from the old Member States (those who joined the Union before 2004), encouraged by the safe economic environment created by the membership, dominated the FDI in the new Member States. However, that surge in the intra-EU FDI has also produced a positive feedback effect: the enhanced global competitiveness of western European firms (Medve-Bálint, 2014).

Consequently, the Single Market is assessed overall as the best example of both successful market opening and avoidance of the middle-income trap through smart intervention (Taglioni *et al.,* 2017, p. 191), thus ensuring that both economic efficiency and growth as well as social cohesion (i.e. via structural funds, Egger *et al.,* 2014) are effectively combined as complementary goals. Still, the construction of the Single Market

FIGURE 1

THE THREE EXAMPLES OF THE EUROPEAN VALUE CHAINS

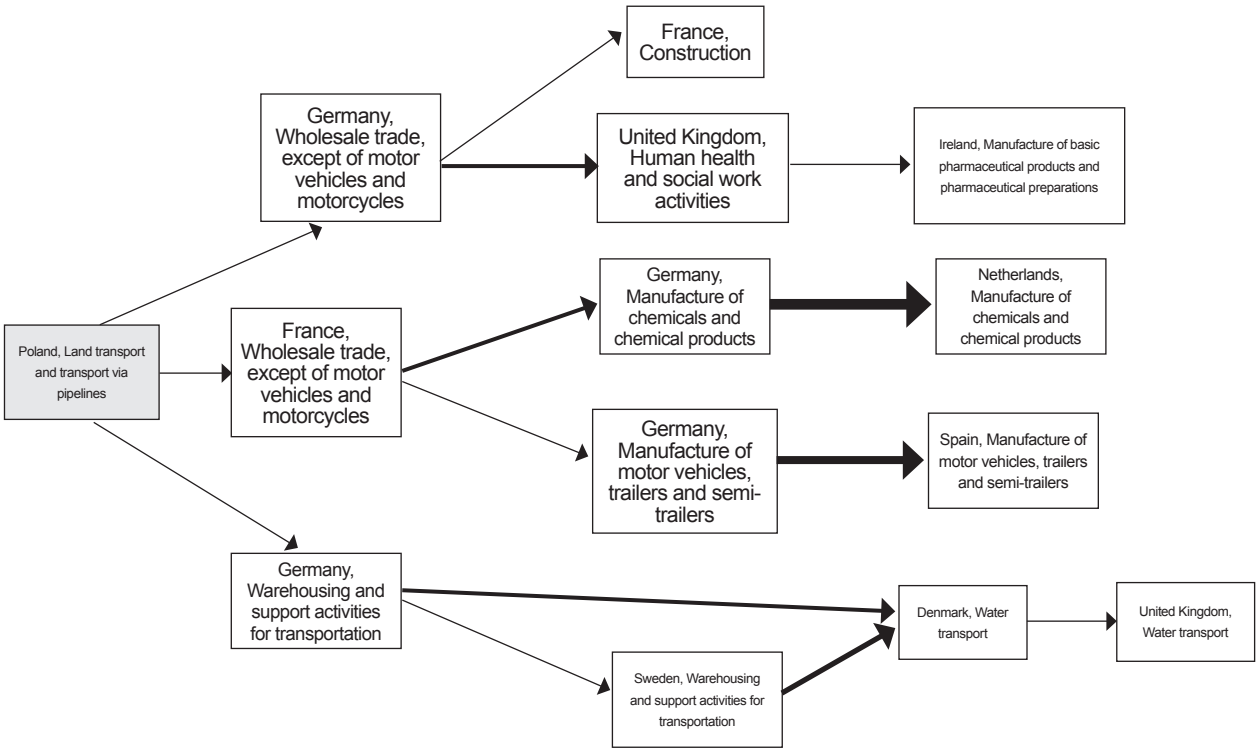


NOTE: Each graph presents the strongest linkages (importing sector's intermediate consumption of the goods or services exported by the origin sector) for a value chain where the sector highlighted in grey is a starting point of the path analysis. The sizes of the arrows and the font sizes in the boxes correspond to the magnitudes of the flows (the intermediate consumption mentioned above) and sectors (their output, in logs) respectively.

SOURCE: Analysis by the European Commission staff based on the World Input-Output Table for 2014 (latest year available) from WIOD *http://www.wiod.org/database/wiots16.*

FIGURE 1 (Cont.)

THE THREE EXAMPLES OF THE EUROPEAN VALUE CHAINS



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SOURCE: Analysis by the European Commission staff based on the World Input-Output Table for 2014 (latest year available) from WIOD *http://www.wiod.org/database/wiots16.*

is not completed and substantial further gains can be obtained, as discussed in the next section.

Further benefits of the completion of the Single Market: the untapped potential

Although the overwhelming prediction from the literature is that the European integration has generated positive and significant aggregate effects, studies suggest that there is still significant progress to be made towards the full implementation of the Single Market, especially in such areas as the Single Market for services and labour mobility (Dorrucci *et al.,* 2015).

Modelling the effects of the completion of the Single Market in trade, production and market structure shows that the benefits are yielded by both the *removal of border costs* and *increased competition* thanks to the greater ability of EU buyers to substitute among the products of different EU producers. The increased competition is the main effect as it more than doubles

the estimated benefits, and the steady-state growth effect more than quadruples the welfare gains. The increased competition arises from the Single Market standards, government procurement, and dynamic learning effects (Harrison *et al.,* 2014).

How can this untapped potential be realised? The Bruegel thinktank analysts believe that the gains so far have been smaller than they potentially might be because of basically two reasons (Mariniello *et al.,* 2015*)*: barriers remain in many areas covered by the Single Market governance while the progress in complementary policies, which should support the Single Market, has been insufficient, leading to insufficient room for entrepreneurial experimentation and exploration (Schumpeterian «creative destruction»). Among the remaining barriers, the analysts mention specifically: inconsistent and unambitious implementation of the directives, insufficient mutual recognition, too closed public procurement, heterogeneous regulations in services sectors, and administrative barriers to the free flow of labour. As regards the complementary policies, too heterogeneous tax codes, discrepancies in environmental and consumer protection, insufficient investment in interconnecting infrastructure, and the overdue structural reforms (national regulations protecting rent-seeking, rigid labour market regulations, industrial policy supporting national champions, prevailing public monopolies, cumbersome procedures to set up new businesses). It is however also noted, that the positive effects of «creative destruction» can be achieved only if those losing their employment face the environment in which they may move on to other jobs.

Concerning the structural reforms complementary to the Single Market, OECD experts estimate, with an augmented gravity model, that if they are ambitious enough (defined as resulting in an alignment of the OECD Product Market Regulation indicators with the average of the top half of the best performers, cutting the regulatory heterogeneity by about 20 per cent) would increase trade intensity within the EU by more than 10 per cent (Fournier *et al.,* 2015). IMF analysts stress the importance of structural reforms in the catching-up EU economies as determinants of the degree they benefit from the Single Market, mentioning: improvements in higher education, labour skills upgrade, job-seeking incentives, business environment friendly to foreign investment, and infrastructure facilitating the build-up of links with cross-border supply chains (Rahman *et al.,* 2015).

Last but not least, the benefits of increased integration of the Single Market's national economies can be obtained by improving the transposition of the directives which ensure the functioning of the Single Market. European Commission's Single Market Scoreboard (2017) shows that 20 Member States have had the transposition deficit above the 1 per cent target, with 8 of them with a deficit of 2 per cent or more.

Single Market as a necessary element of the European Union: the overall benefits

The Single Market can be seen as one of the fundamental stages of the process of the European integration and a necessary component of the EU (Dorrucci *et al.,* 2015*)* and the Economic and Monetary Union (including the Euro, the common currency) in particular (Pelkmans, 2016). Thus, the wider benefits of the EU, many of which are not easily quantifiable though very concrete, like the unprecedented period of peace, are not possible without the tight economic integration provided by the Single Market (Ludlow, 2016). Nevertheless, some authors try to distil the pure benefits of the political EU membership (on top of the benefits from economic integration). Here, the case of Norway is very useful because it completed negotiations and fulfilled all accession requirements, joined the European Economic Area (with full access to the Single Market), but at the very end decided not to join the EU. Campos *et al.* (2015) find substantial politically driven economic benefits from the EU membership: if Norway had joined the EU in 1995, its productivity levels between 1995 and 2001 would have been 6 per cent higher on average.

As far as the actual EU members are concerned, the total cumulative gains in the real gross domestic

product per capita resulting from the European integration between 1992 and 2012 —including all the economic and political synergies and calculated on the basis of a synthetic-integration-index approach— are likely to have been realised by every Member State economy (Petersen *et al.,* 2014). Another regression study, which uses the synthetic counterfactual method, suggests with statistical robustness that without deep economic and political integration, per capita incomes would have been, on average, approximately 12 per cent lower (Campos *et al.,* 2014).

Specific gains from the European integration are reaped by the catching-up Member States. The EU membership seems to limit their economic volatility in addition stabilising the relatively young democratic institutions (Epstein, 2013).

Finally, in the global perspective, the EU (and thus its Member States) enjoy some global market power since, thanks to its overall size and technological leadership in many sectors, it shapes the international standards and regulations by externalising its Single-Market-related policies goals and regulatory measures becoming effectively one of the few «global regulators» (Damro, 2015; Parker and Karlsson, 2017) or even a global leader, e.g. in environmental protection (Cacheux and Laurent, 2015). EU's external regulatory influence has emerged predominantly as an unintentional «byproduct» of setting up and then reinforcing the Single Market (Bradford, 2015). This improves the competitive position of European firms, which face globally similar standards to those already familiar.

Similarly, as one of the key global buyers of raw materials and energy goods, the EU counterbalances the monopolistic advantages of the exporting countries, thus stabilising the supply and transit routes (Goldthau and Sitter, 2015). The EU «Energy Union» for gas is a good example in this field: simulations with a spatial partial equilibrium model show that newly-constructed infrastructure should lead to some decrease of wholesale prices, the decline of suppliers' market power against the geographical periphery of the EU (predominantly the Baltic states and Finland, which are the most exposed countries), and increase consumer surplus in the EU by as much as 17.4 per cent (Baltensperger *et al.,* 2017).

3. The sector-level and microeconomic perspective

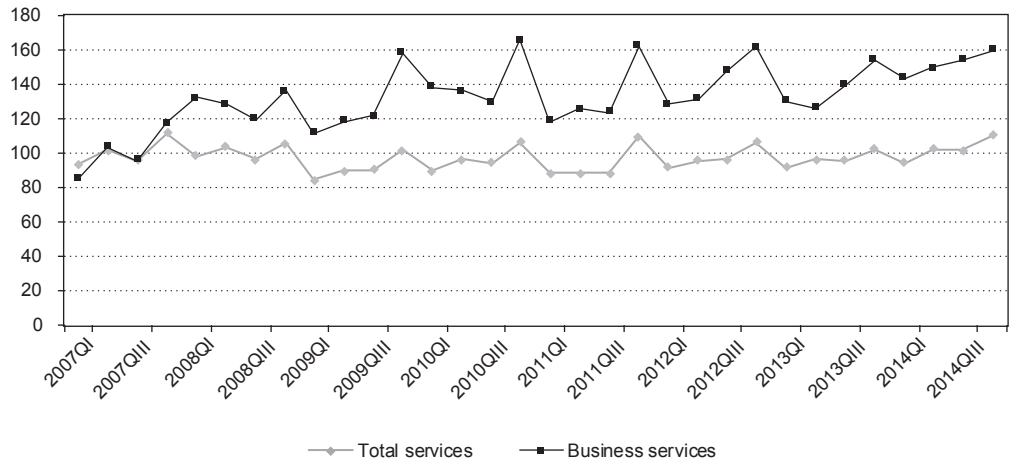
Benefits from the accomplished levels of integration: sectoral examples

The development of the Single Market has not only resulted in a strong increase in bilateral trade intensities but also has made exporting activities less concentrated across countries, especially in goods trade. The changes in the geographical patterns of intra-EU trade were mostly driven by the medium-quality segment which can be interpreted as a Vernon-style «climbing up» a quality-ladder by less advanced countries (Stehrer *et al.,* 2016). Although some limited protectionist barriers in trade in goods, the most integrated Single Market segment, have persisted across specific sectors and countries, Solvit (*http://ec.europa.eu/solvit/*) has turned out an informal, «light-weight», though effective tool for businesses to fight these barriers (Egan and Guimarães, 2016).

Experts largely agree that the Single Market —with freedom of labour movement bringing a better geographical balance of labour demand and supply in the EU, leading to higher returns on investment in human capital (education, training) and, hence, increased incentives to invest in skills, innovate and become an entrepreneur— has been an effective way to increase economic welfare, economic stability and cohesion (Krause *et al.,* 2017). In addition and complementarily, capital market integration keeps stimulating competition for mobile capital among countries, inducing Governments investment-friendly policies which also incentivise individuals to become skilled (Ogawa and Tsubuku, 2017). Consequently, as a recent thorough meta-analysis of empirical research finds, there has been a positive impact of cross-border direct investment on productivity, which is particularly significant in the EU (Bruno and Cipollina, 2017).

FIGURE 2

IMPORT OF SERVICES IN SPAIN, 2007-2014



NOTE: 2007 average = 100. Business services are those covered by the following NACE codes: M, N, J62, J63. Imports from all countries in the world are considered, given that intra-EU imports are not available as a separate time series.
SOURCE: Spanish statistical office (INE).

Related to enhanced labour mobility and the movement of firms, the adoption and implementation of the Services Directive was a major policy effort in the movement towards genuine Single Market. The Directive affects several services sectors adding up to more than 46 per cent of the EU GDP according to an assessment by the European Commission staff. Our study estimates conservatively that the EU-level long-term positive impact of the Directive, resulting from the implementing measures until 2012, is around 0.8 per cent of GDP and the corresponding figure only for Spain is as high as 1.4 per cent (Monteagudo *et al.,* 2012). The high figure for Spain is explained by its position among the very top reformers in that policy area. Specifically, a case study (done very recently by the Commission staff, preliminary results) on the effects of the reduction of Spanish regulatory restrictions affected by the Services Directive shows that the trend of imports in the business services sector (covered by the reforms under the Directive) has been upwards and evidently more intensive than the increase of imports across all services sector (only partially covered by the Services Directive) in Spain.

Furthermore, the same case study also shows that Spain has been integrating rapidly into the European value chains involving business services as production inputs (Figures 2 and 3). The share of the EU countries (other than Spain) in the Spanish intermediate consumption of business and construction services increased by about 1.2 percentage point, from 7.1 per cent in 2006 to 8.3 per cent in 2014, compared to practically no change in such a share for the whole Spanish intermediate consumption (the share of the EU countries, other than Spain, stabilised at about 10 per cent) of all services and goods. The imported services were used by Spanish firms as inputs for production consumed domestically and earmarked for export.

The Single Market construction process consists in not only liberalisation but also harmonisation. The

EU regulatory regime for public services (such as utilities and welfare services) is assessed as beneficial for consumers. All the more so, public services are seen as building blocks of the Single Market (Sauter, 2015).

The benefits of the rapidly emerging digital Single Market can be estimated by comparing price differences between online and offline retail channels in the EU. A study which employs this methodology and uses sales data for ten household appliance categories distributed both offline and online concludes that both online prices and online price dispersion are lower than offline. Consequently, the digital Single Market increases consumer surplus by 0.3 per cent of EU GDP (Duch-Brown *et al.,* 2014). Gómez-Herrera *et al.* (2014) confirm that distance-related trade costs are significantly lower in e-commerce transactions compared to offline trade in the same goods.

The untapped sector-level potential: selected examples

Since little further reform effort has been made in the recent few years in most of the Member States to reduce the persisting regulatory restrictions in the policy area covered by the Services Directive (European Commission, 2015a, sections 2.3 and 4.2, and European Commission, 2015b), the estimated remaining economic gains to be reaped still exceed 1½ per cent of GDP (Monteagudo *et al.,* 2012). The significant potential gains in that policy field are also highlighted by IMF experts (Corugedo and Ruiz, 2014; Rahman *et al.,* 2015).

An assessment of the economic impact of selected barriers specifically in four professional services (architects, civil engineers, accountants, lawyers) shows significant economic impact of regulatory restrictions (reserved activities, tariffs, restrictions on advertising, compulsory chamber membership, restrictions on corporate form, insurance obligations, authorisation requirements) on the «birth rate» of firms and, indirectly, on sector profitability and efficiency of resource allocation. Under an «ambitious scenario» with the simulated barrier levels reduced to the average of the «best 5» Member States in each sector, «birth rates» could increase by 10 per cent-18.3 per cent, sector-level average profitability by 13.7 per cent-34.2 per cent, and allocative efficiency index by 7.7-12.4 percentage points (depending on a sector, EU weighted averages, European Commission, 2015a, section 2.3).

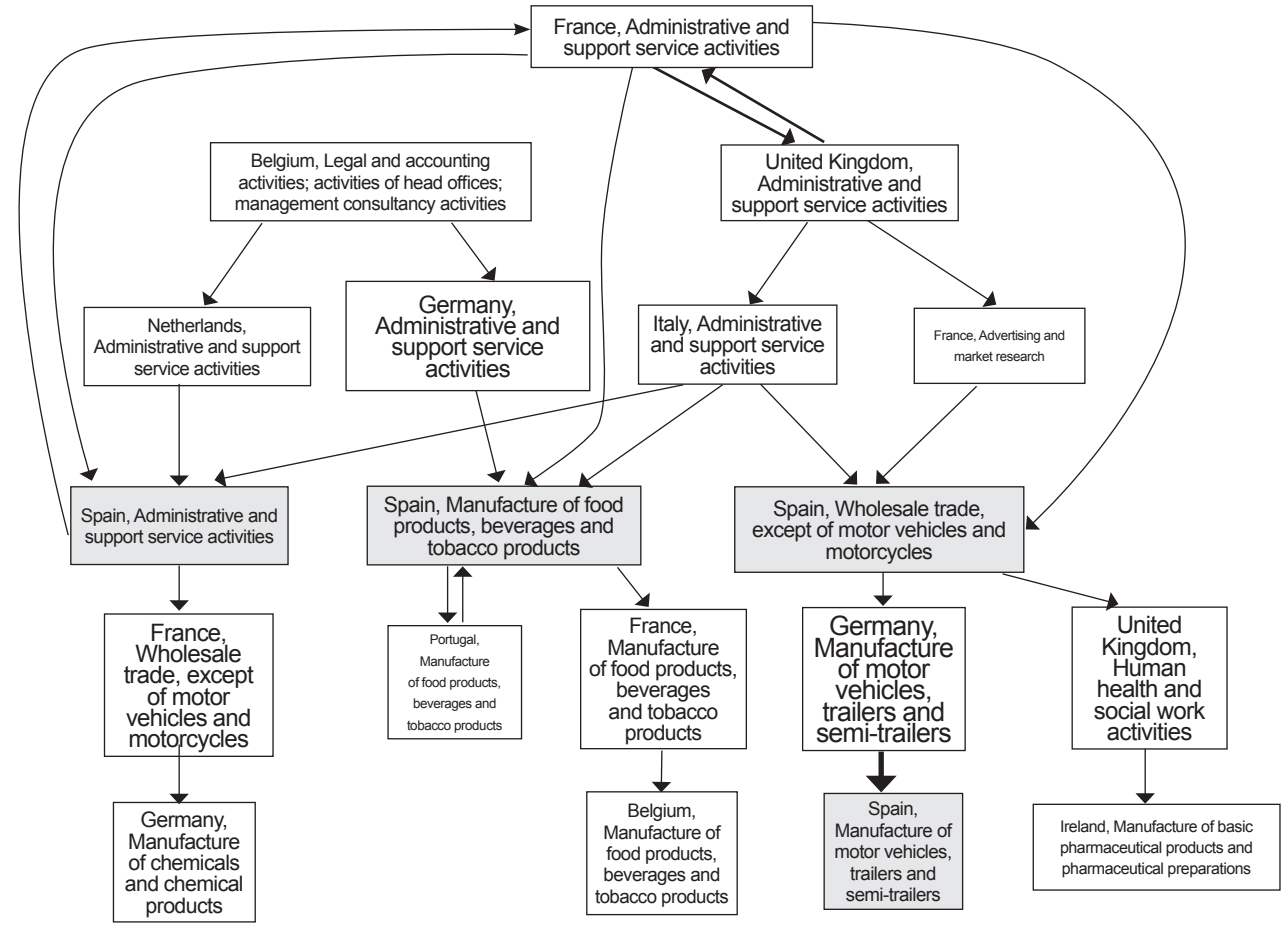
For consumer welfare, reducing the regulatory restrictions in retail trade promises significant gains. European retailers face persistent barriers to market entry due to retail store establishment conditions (e.g, burdensome and complex authorisation processes or restrictive constraints on the size and location of shops) as well as by operational restrictions (European Commission, 2015a, section 2.4).

The EU digital Single Market, though growing rapidly, may still benefit from further barrier reductions. It is estimated, based on a sample of household appliances, that full online price convergence across the EU towards the lowest observed average price would further increase welfare (Duch-Brown *et al.,* 2014). A developed digital Single Market will allow also the benefits of the collaborative economy to materialise (European Commission, 2015a, section 2.1) such as increased consumer surplus and total social welfare (Weber, 2016). There is a synergy between the development of the digital Single Market and the evolution of online financial services, hence it is estimated that a 1 per cent increase in the use of efficient and flexible cross-border payment systems could increase cross-border e-commerce by as much as 7 per cent (Gómez-Herrera *et al.,* 2014).

As indicated above, the financial services and, hence, the newly founded Banking Union and Capital Markets Union, are promising policy areas which may bring many additional benefits together with the Single Market. These initiatives are expected to effectively complete those of the Single Market in financial services (Prisecaru, 2014). The Euro has boosted the financial integration process in the Eurozone (and financial opening is found to positively affect intra-Eurozone trade: Esposito, 2017) but the process is not completed (Kilinç *et al.,* 2017).

FIGURE 3

PART OF THE EUROPEAN VALUE CHAINS WITH THE LARGEST BUSINESS SERVICES AS SPANISH PRODUCTION INPUTS



SOURCE: For explanatory notes and source information see Figure 1 in the article.

The Single Market also gives wider opportunities, compared to separated national markets, to benefit from R&D investment. The European Commission promotes the consolidation of Europe's intellectual property framework. In that policy area, the Commission staff has estimated, for instance, that the implementation of the «unitary patent» could lead to a gain of about ¼ per cent in EU's GDP (European Commission, 2015a, section 3.3).

The European electricity market (the EU Target Electricity Model) is another area which offers economic gains if the integration progresses. The potential benefits of coupling interconnectors —in order to increase the efficiency by quickly matching demand and supply not only within countries but also across borders— may exceed 100 per cent of the current gains from trade even in a short term. These benefits can be reaped by: eliminating unscheduled flows, avoiding the curtailment of renewables,

and making the investment in the cross-border links more commercially profitable (Newbery *et al.,* 2016). The interconnections and a trading scheme will allow for the full exploitation of renewables and will lead to the reduction of energy prices (Higgins *et al.,* 2015) thus eventually increasing the competitiveness of European firms.

Similarly, Austvik (2016) stresses the importance of extending West-East and intra-East interconnectedness in the EU in mitigating the still remaining security problems in the supply of gas. The security of gas supply is very important for economic growth since it limits investment through its impact on business uncertainty.

Also, another key network, roads, and the transport policies are likely to be still suboptimal in view of the needs of the Single Market. OECD analysts estimate that the road distance between two cities located in the same country is around 10 per cent shorter than that between cities located in different countries for the same direct distance and the same city size in continental Europe. They find that the average travel speed is higher between cities in the same country too (Braconier and Pisu, 2013). The importance of appropriate road network is confirmed by Salas-Olmedo *et al.* (2015), whose assessment of the accessibility impacts of new road transport infrastructure in the EU between 2001 and 2012 shows that the greatest improvements in accessibility, which correlate with exports, were experienced by peripheral countries with high road infrastructure investment.

The Single Market is likely to provide even more social return on large public infrastructure investment (like those discussed above) thanks to the transparency-boosting cross-border public procurement, (European Commission, 2015a, section 3.2).

The examples of firm-level benefits

The participation in the international value chains, which is significantly facilitated by the Single Market as discussed before, appears to be important for economic performance also at the firm level. Altomonte and Rungi (2014) find a positive relationship between a business group's complexity and productivity.

The increasing role of the value chains implies that the recent policy focus on reducing the regulatory barriers in services is likely to have a positive indirect influence on the performance of downstream manufacturing companies. Hence it may be considered a modern industrial policy. Specifically, firm-level research by experts of the World Bank demonstrates a strong impact of the barriers in services in the EU, especially anti-competitive policies affecting the operations of the firm (conduct regulations), on total factor productivity of partners: both other services firms and manufacturing enterprises. The barriers matter significantly more in the cases when a country is institutionally weak, an industry is close to a technology frontier or a firm is foreign-owned (van der Marel *et al.,* 2016).

Firms can also learn from each other and benefit through various *spillover* channels (e.g. imitation, joint-ventures, training and inter-firm mobility of skilled employees, access to better production inputs, etc.). Therefore, Single Market —which is a very open and low-risk environment for foreign direct investment— increases the firm-level productivity of even not-directly-trading companies, both in mature and catching-up economies as convincingly indicated by a very comprehensive and robust recent meta-analysis (Bruno and Cipollina, 2017).

Aggregated data analysis suggests that the EU-level product standardisation supported trade growth and the growth of the cross-border value chains in the Single Market (Ramel *et al.,* 2015). From microeconomic research, it also appears that firms with innovation and exporting capabilities that employ foreign labour are more likely to perceive benefits from advancing product standardisation than other companies. Thus, it is recommended that the EU, in particular in the catching-up and Southern Member States, increase the exploitation of the benefits of standardisation by enhancing the aforementioned firm capabilities (Ramdani *et al.,* 2017). A modernised, more inclusive system of EU standards should also help small and medium enterprises grow and reap the economies of scale (European Commission, 2015a, sections 2.2 and 3.1).

The Single Market, together with the revamped EU regional cohesion policy, will be providing more and more welcoming space for «smart specialisation» of small and medium enterprises based on innovation (McCann and Ortega-Argilés, 2016). The large market with an easy access to both diverse production inputs and to various customer groups with differentiated preferences makes the emergence and growth of even niche businesses economically feasible.

4. Conclusions

In view of the described numerous significant benefits of the Single Market, it appears logical to agree fully with Pelkmans (2016) that the Single Market will remain a core of the EU in the foreseeable future and its erosion is unlikely because the EU has powerful governance mechanisms to correct remaining deficiencies and further enhance the Single Market in order to keep on benefiting while all Member States would have to incur huge losses if the Single Market were dismantled (Rudloff and Schmieg, 2016).

At the same time, the Single Market and its benefits cannot be taken for granted. In the past decade we have witnessed instances of reversal in the functioning of the Single Market. This should be cause for concern as it reduces the allocative efficiency of the EU economy at a time when massive stimulus has been pumped into the economy, and when competition for investment is intensifying across global value chains.

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