MEMO
January 9th 2015

HUGE POTENTIAL FOR GROWTH IN THE EU'S INTERNAL MARKET

Contact:

Chief Economist, Mikkel Høegh
+45 21 54 87 97
mhg@thinkeuropa.dk

Senior Advisor, Jan Høst Schmidt
+45 53 76 27 08
jhs@thinkeuropa.dk

RESUME *The EU's internal market holds great untapped potential worth billions, which could make a vital contribution to stimulating growth in the European economy. A more offensive campaign to enhance the internal market by 2030 could give a permanent boost to Europe's GDP of 5-8 percent. This is revealed in a review of a number of financial analyses conducted by Think Tank EUROPA based on extensive studies of existing economic literature on the effects of the internal market. The review shows that if more open trade and greater competition is encouraged in the internal market, the total financial gain will reach between 653 and 1,046 billion euro by 2030.*

By carrying out a better and more consistent implementation of the EU rules and by opening up the internal market in areas such as services, digital technology, energy and transport, it could boost the European economy and in turn ensure better welfare and pave the way for new jobs.

Increasing trade and competition in the internal market will create a bigger and more long-term economic impact than the 315 billion euro Investment Plan European Commission President Jean-Claude Juncker launched on 26 November.

Think Tank EUROPA's review of the financial analyses points to a number of areas in which a new wave of reforms in the internal market could give a much needed boost to the EU's otherwise weak growth. Political leadership at national and EU levels will be crucial in securing support for the reforms.

It is important to communicate the value of reaching an agreement on the necessary reforms is communicated to the wider public, as an increasing proportion of the Danish population, like the rest of Europe, is in doubt over the benefits associated with the internal market and has concerns about welfare in light of the rule on free movement of workers. However, the shared European and economic benefits are so extensive that the politicians need to arrive at a mutual response to the social and economic challenges a stronger internal market will pose.

Main conclusions:

- The internal market has the potential to boost the EU's GDP by 5-8 percent by 2030. The financial gain could reach between 653 and 1,046 billion euro.
- Several studies show that Denmark will reap the benefits from a stronger internal market. Estimates show that this could create between 77,000 and 124,000 new Danish jobs by 2030.
- This demand that the EU countries agree on a series of new reforms, whereby the internal market is extended to energy resources and digital technology. A more consistent and smoother implementation of the existing regulatory framework will also be essential.
- Implementing reforms to extend the internal market to cover energy, capital and digital technology, as the newly appointed European Commission has announced in its work plan, is a step in the right direction. But it is yet to be seen whether it can foster a political agreement between the European Parliament and the member states. It is therefore essential to have strong political leadership.
- Public support of the internal market has waned in Denmark and the rest of the EU. Therefore, it is crucial to reach a general consensus on new reform packages in the individual member states.

Free trade, uniform standards and norms, greater mobility of labour across borders, investment, goods and services, as well as increased competition have been the cornerstones of European integration since the 1950s. At that time, Jean Monnet and other "principal architects" of the EU argued that trade creates more interaction and a better understanding of one another, which in turn leads to peace. This is worth remembering after a century in which Europe was plagued by both the First and Second World Wars.

The Single European Act (SEA) introduced the internal market in the mid-1980s and the Maastricht Treaty followed on to establish the four freedoms (free movement of goods, capital, services and persons) more formally at the beginning of the 1990s. The fundamental idea behind the internal market was, and still is, to create a large internal market among the European countries which increased trade, investment and competition in the EU's member states and in turn raise its citizens' prosperity.

The internal market is a bearing axis in the EU cooperation and a significant economic success story. Denmark is one of the countries that has gained the most from the internal market and it increased export of Danish goods and services has made it possible to finance the rising costs of welfare in Denmark. But there is still a lack of free and unhindered trade between EU countries in the when it comes to services, energy and digital technology. At the same time there is are inconsistent interpretations of the EU rules between the countries, which creates unnecessary barriers for trade. A new generation of legislation covering these areas of the internal market could make an important contribution to growth in an otherwise ailing European economy. The new Juncker Commission has stated in its Work Plan for 2014-2019 that the internal market should be expanded within the areas of energy resources, digital services and capital. This is positive, as the internal market possesses untapped potential worth billions.

Think Tank EUROPA's comprehensive review of a number of financial analyses shows that if the right reform initiatives are implemented, the EU's total GDP could increase by up to 5-8 percent over a 15-year period. However, this would require both a better implementation of the current regulatory framework and an enhancement and expansion of the internal market. This will give a permanent boost to the EU's prosperity that could equate to a sum of 653 to 1,046 billion euro by 2030.

This overall growth would correspond to an average annual surplus growth of between 0.3 and 0.5 percent. This therefore represents quite significant growth, as the European Commission has forecast an average long-term annual increase in wealth of 1.4 percent of Europe's GDP over the same period.

Increasing doubts among the public

Yet, although there is considerable wealth to be gained from expanding the internal market, signs of doubt are emerging among the population over its value. A contributing factor may be the heated debate leading into the European Parliamentary elections on so-called "welfare tourism" and welfare rights migrant workers from EU countries are able to claim. A memo published by Think Tank EUROPA based on a poll conducted by YouGov indicated that this debate had dampened Danes' enthusiasm for the internal market.[1] Moreover, an analysis published on the Danish website Ugebrevet A4, based on the extensive EUvox14 poll conducted in connection with the European Parliamentary elections, showed that four out of ten Danes want to limit other EU citizens' rights to work in Denmark.[2]

There could be many reasons for this shift in public opinion, but one of the challenges of making national markets more open is that it can put pressure on members of the population, such as unskilled workers and low-income earners, even though the overall benefits are substantial.[3] The economic literature indicates that the benefits of opening up the markets are so great that it would be possible to provide compensation to these groups, whilst still reaping the economic benefits of free trade. But it is crucial to secure jobs for vulnerable members of the workforce and a share of the increasing wealth.

Another reason for this shift in opinion could be that the benefits of free trade are rarely as visible as the challenges associated with it. Whereas new jobs or cheaper and better quality groceries, for example, typically go unnoticed, the closing of an abattoir would be fodder for the media.

The problem for those who feel challenged by more open markets is that they have to adapt themselves to a new world. This adaptation may require retraining or acquiring new skills, and that takes time. The textile industry around Herning is a clear example of this. The industry was once the home for seamstresses in Denmark, but these jobs have vanished due to fierce competition. This is not to say that there are no jobs left in the Danish textile industry. The seamstresses and tailors have subsequently found other and often better paid jobs, which the graduates from the Center for Corporate Performance at the Aarhus School of Business, for instance, have proven.[4] At the same time a variety of new jobs have emerged in fields such as design, concept development and logistics, which have

---

[1] Danes are generally lukewarm towards the EU, Think Tank EUROPA, 2014 (http://english.thinkeuropa.dk/node/185).
[2] Østarbejdere punkterer danskernes EU-begejstring, Ugebrevet A4, 26. november 2014 (http://www.ugebreveta4.dk/oestarbejdere-punkterer-danskernes-eu-begejstring_19924.aspx).
[3] Social dumping is not addressed in this memo, even though the topic often comes up in connection with the internal market. However, social dumping is a complex challenge that demands an independent analysis.
[4] The Confederation of Danish Employers (DA), Agenda, 18 March 2004 (http://arkivwww.da.dk/nyhed/agenda/frontpageagenda/2004/2004-5/Agenda5-net.pdf).

injected wealth into the Danish society.[5] Finally, it should be noted that pressure has not only been placed on jobs, but also on business models.

The internal market provides an economic boost

The economic impact of the internal market has been the subject of a number of theoretical and empirical studies since it was established. According to the majority of economists, the internal market has made a positive and meaningful contribution to growth in the EU and has thereby been a factor in enhancing EU citizens' prosperity.

The internal market has broken down barriers to trade and created a large, integrated market for goods and services. It has generated significant economies of scale and efficiencies. Increased competition can help boost productivity, which in turn gives consumers access to a wider variety of goods and services at lower prices. The regulation of the airline industry is a good example of this, as the internal market has helped bring airfares down. The internal market has also made it possible to adopt standard maximum prices for mobile phone roaming, so that EU citizens do not have to pay a fortune to use their mobile phones in other countries.

However, there are also several advantages that are not necessarily taken into account in the more traditional financial analyses. For example, the internal market gives students better opportunities to study across borders, and it also provides better options to buy goods and services online from other countries. These examples show that the internal market is about much more than trading goods, as the traditional financial analyses suggest. And the internal market is not only significant to exporting companies, but also to individual citizens who live in Denmark.

A distinction is made in economic literature between the traditional theory of trade, which sees trade as something which is carried out on the basis of specialisation, and the modern theory of trade, where the driving force behind the trade is believed to be economies of scale. According to the literature, there are elements of both theories at play in the internal market. There is also a broad consensus that establishing a free trade zone gives rise to increased trade between member states. The increased trade, along with greater specialisation and economies of scale, release resources for other consumption and production purposes.[6]

[5] Fashion retailer Bestseller is a good example of a company that has adapted to new market regulations in the textile industry. The company BoConcept is a good example from the furniture industry.

[6] See, for example, International Economics, Krugman, Obstfeld & Melitz, 2011.

But theory is one thing and practice is another. How are these advantages demonstrated in reality and how big are the benefits? The table below gives an overview of aspects of the economic literature that attempts to quantify the benefits of economic integration in the internal market. The table therefore shows the net increase in GDP that has either been or could be brought about by increasing economic integration among the member states.

Table 1. Free trade increases GDP
Overview of economic literature on the internal market

Author	Year	Result in percentage (Increase in GDP)	Coverage	Dynamic effects
Cecchini et al	1988	4,25-6	EU-12	No
Baldwin	1989	0,3-0,9	EU-12	Yes
Monti	1996	1,1-1,5	EU-12	Limited
Ilzkovitz et al	2007	2,2	EU-25	Yes
Gatto et al	2007	13*	11 EU member states	Yes
Bolto et al	2008	5	EU-25	No
Decreux	2012	4,7	EU-27	No
European Commission/London Economics and PWC	2013	1,6-3,1	EU-27	No
European Parliament	2014	Min. 5	EU-28	No
Campos et al	2014	12	EU18 minus the original 6 core countries**	Yes
Hafner et al	2014	Min. 7	EU-28	No
Böhmer et al****	2014	-1,3-2,3***	EU-15 minus Luxembourg	No

Note: The table only includes studies that examine the internal market from an overall perspective. There is also an extensive range of literature that only examines submarkets such as retail, energy and financial services. "Result in percentage" compares the current situation with and without the internal market, which makes it possible to see the net boost in GDP generated by trade creation.
*The study does not look at changes in GDP, but changes in productivity.
** The study includes the member states that have entered the EU during its ongoing enlargement and looks generally at participation in the European Union, which gives some countries big benefits from areas such as structural funds. This partly explains the high level of growth revealed in the study.
*** The report has not worked out an average of how much growth in the EU has risen. The growth rates given are for individual member states, with the lowest being in Greece (-1.3 percent) and the highest in Germany (2.3 percent). However the arithmetic average indicates a total growth of just over 1 percent. A weighted average raises the total growth to over 2 percent.
**** The study uses an integration index, which means that the boost in income can come from increased economic integration, which is not directly associated with the internal market.

The studies presented above are based on different methods; some are forward-looking, while others are historical. These studies are usually characterised by uncertainty and depict the EU as being under heavy development. Some analyse the evolution of the old EU-12 countries, while others look at the new members after the EU expansions or the consequences of removing the barriers to cross-border trade of goods and services. Others mention the benefits of opening up the telecommunications, energy and transport markets. However, what is common to all of the studies is that they, without exception, indicate that the overall economic impact of the internal market has been positive, and that there is great potential to reap even more benefits in the future. Considering that the studies use different methods and examine different countries and focus areas, the results are surprisingly similar.

The so-called ex-post studies, which are based on factual and historical data, operate with small but significant yearly growth-rates because of the internal market. Ilzkovitz et al. estimate that the internal market has added growth of 2.2 percent up to 2006. This equates to an average growth of 0.11 percent per year in the old and the new member states. The study also includes the effect of the introduced liberalisation of the networking industries (tele, transportation and energy), as well as the effect of the expansion of the internal market to new Eastern and Central European countries. The additional yearly growth of 0.11 percent on average should be seen in comparison to the total yearly growth of 2.5 per cent on average in the period from 1992-2006. Generally, there seems to be a broad consensus on a positive effect on income.

Denmark the big winner in the internal market

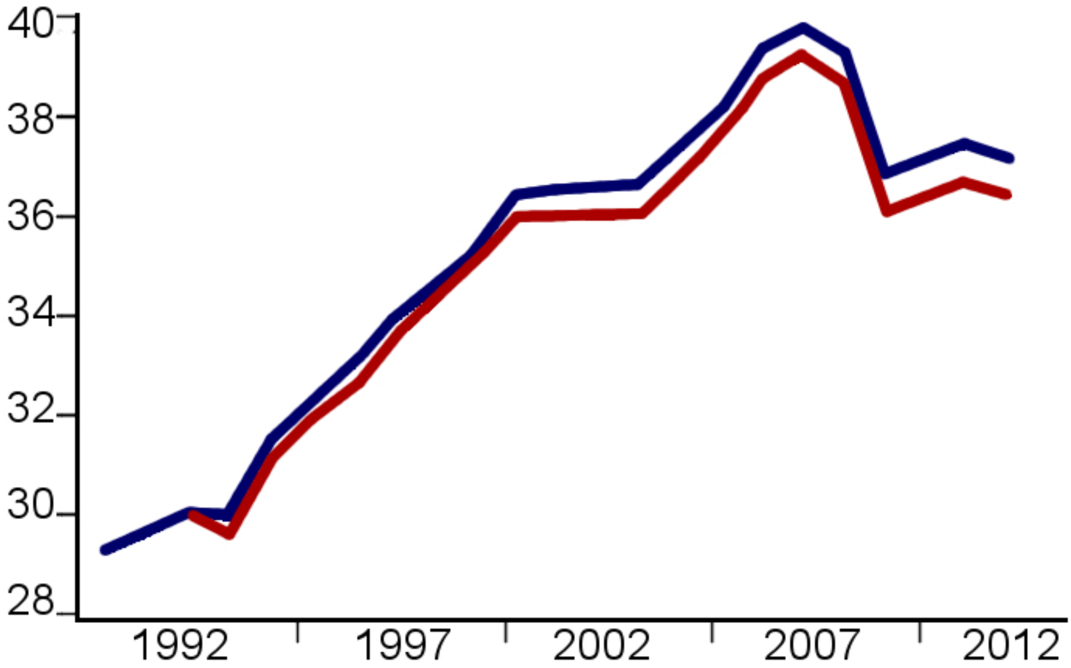
Several of the studies mentioned show that Denmark benefits greatly from the economic integration that has primarily occurred via the internal market. One of the most recent studies, by the German foundation Bertelsmann Stiftung (Böhmer et al), shows that Denmark's GDP per capita increased by 2 percent after the internal market was established.

In 2013, Denmark's GDP was 1.783 billion DKK. Using Bertelsmann Stiftung's studies as a basis, 35.7 billion DKK can be attributed to the increased economic integration between the European countries.[7] Overall, Denmark has gained the most advantages from the internal market, followed by Germany. However, in relative terms Germany has gained the most measured by the percentage growth in GDP per capita.

---

[7] Allen, Gasiorek & Smith (1998) Competition Effect of the Single Market, in: Economic Policy. Features an isolated study of the internal market's impact. (Original text: Har et isoleret studie af effekten af det indre marked.)

Figure 1. The internal market increases Danish prosperity
Denmark's GDP per capita in 2005 prices with and without the internal market



Note: The blue curve shows the actual growth in GDP. The red curve shows the growth of GDP without economic integration between the European countries.
Source: Böhmer et al., 2014.

Böhmer et al.'s (2014) works support Gatto's (2007) studies which present Germany as the country that has reaped the most benefits – followed by Denmark. Campos (2014) lists Ireland as the country that has benefited most from increased economic integration.

Although the results are generally very positive, it should be mentioned that Greece has taken a step back in living standard following its increased economic integration with other EU countries, according to Böhmer (2014) and Campos (2014). But one should keep in mind that during the period examined Greece was affected by bad economic policy and hit hard by the financial crisis.

Böhmer's analysis does not only look at the effect of the regulatory framework on the internal market, but also takes the effect of general economic integration, including the euro, into account. The study shows that the euro has not only reinforced the internal market's positive impact on euro countries such as Germany and Finland, but also on Denmark, which is not part of the Eurozone. This is where Denmark stands apart from other non-euro countries like Sweden and the UK.

A contributing factor could be the method used in the study, which first calculates an integration index for each country and then estimates the economic effect of the calculated increase in each country's integration. The study explained Britain's relatively modest gains by its decision to leave the European

Monetary System at the beginning of the period. This is in contrast to countries like Denmark, which chose to shadow the euro and bind itself to fixed exchange rate policy, earning a financial profit by doing so.

Considerable gains in particular sectors

The European Parliament commissioned a major study, *The Cost of Non-Europe*, which, in a number of reports published over the course of 2014, aimed to gauge the potential benefits within five areas of the internal market: free movement of goods, free movement of services, public procurement, the digital economy and certain consumer related issues. The reports demonstrate that there is still a need for comprehensive reforms of the internal market.[8]

The digital single market, comprising fibre optic networks, better 4G mobile net coverage, better access to the internet, E-commerce, copyright and data protection, can offer very large gains worth up to 260 billion euro. And according to an interim report compiled by English research consultancy GHK, specific aspects of the digital market (cloud computing, payments and postage delivery) could boost economic prosperity by 0.4 percent by 2020.[9] The study estimates that this would translate to 223,000 new jobs, plus additional positive effects for other industries.

In a country like Sweden, which has put a lot of effort into developing its digital economy, it is estimated that digitalisation is now responsible for up to a fifth of the nation's economic growth and that a quarter of all new jobs are connected to the new digital economy.

Another area with considerable potential for reform, broadly speaking, is services. According to the analyses, services can generate significant economic benefits worth around 235 billion euro in total. This is because the service sector, or the tertiary sector, is dominant in the European economies and constitutes around 70 percent of annual value added – or up to 80 percent in Denmark. Therefore, it is likely that Denmark will benefit economically from further development of the internal market. In addition, the service industries are more labour intensive than manufacturing and agriculture.

Ensuring better and more free trade of energy across EU borders could give a permanent annual boost in GDP of 50 billion euro, according to estimates in the European Parliament's report, *The Cost of Non-Europe*. A number of other economic studies suggest that a more integrated internal energy market will

[8] These studies estimate a potential benefit of the internal market of up to 11 percent of GDP. However, some of this impact is associated with a degree of uncertainty. Looking across these studies, Think Tank EUROPA therefore estimates that the income effect is between 5-8 percent.
[9] GHK, Digital Single Market, Part III, the European Parliament's *The Cost of Non-Europe* report series, 2014.

have a positive income effect.[10] Moreover, it will have a positive side effect for the environment. It will reduce CO2 emissions by establishing a more effective supply across national borders, whereby excess energy from wind farms or hydroelectric power stations can easily be sold to other EU countries that require energy resources.

Up to 10 million new jobs in the EU

It is not easy to equate a rise in GDP to new jobs, and it is difficult to determine whether labour-intensive industries will benefit most from new opportunities presented by the internal market. This depends on a number of factors, including the businesses' adaptability and whether they can manage to be innovative and add value to their goods and services in the face of tougher competition. In recent years Danish companies have been good at selling more products at the more expensive end of the export market, where there is higher added value per unit produced. The best Danish export companies are 35 percent more productive than the traditional domestic companies. The increase in trade has contributed to strengthening their competitiveness and has created a positive spiral. Greater prosperity will, naturally, also give rise to more jobs.

According to Ilzkovitz et al. (2007), the internal market increased Europe's GDP by 2.2 percent from 1992 to 2006. The same study estimates that this would equate to 2.75 million new EU jobs. A simple calculation based on Ilzkovitz et al.'s figures shows that a 1 percent boost in GDP would put 1.25 million into employment.

Think Tank EUROPA estimates that expanding the internal market could increase GDP by 5-8 percent over a 15-year period. When applying the same multiplier as above, it is evident that an increase in income of this proportion could create 6.25-10 million more jobs in Europe.

Employment in Denmark currently accounts for 1.2 percent of employment in Europe as a whole. Assuming that this proportion is fixed and can be viewed separately from the countries' own structural reforms, economic fluctuations, taxation agreement, etc. – which can have an impact on job creation – expanding the internal market could generate between 77,000 and 124,000 more jobs in Denmark.

[10] See, for example, Böckers et al (2013) "Benefits of an integrated European electricity market" Dice discussion paper, Zacmann (2012) "Reaping the benefits of globalisation" European competitiveness report and Booz & Co (2013) "Benefits of an integrated European energy market" Directorate-General Energy.

Increased economic integration will allow more multinational companies to settle in the EU. Multinational companies add value as they, on average, offer higher productivity, higher salaries and are more innovative.[11]

One could ask if the impact would be even greater in Denmark, as every fourth Danish job now depends on the export industry. However, it is worth keeping in mind that Denmark was also a small and open economy with substantial international trade before we were part of the internal market. If Denmark stood apart from the EU and the internal market, it would still trade with the outside world and the other European countries, but it would trade less with the countries that are part of the internal market.

Political leadership is needed to mobilise great potential

Today, the European economies are in deep crisis, but improving, expanding and deepening the internal market with a reform package could inject new life into the EU's growth. The existing economic research underlines that there is huge potential in the market that is waiting to be unearthed.

This is not the first time that the EU cooperation has found itself at an economic crossroads, facing a choice between prolonged stagnation and new growth. Back in the mid-1980s the European countries were also in an economic crisis and the then European Commission President, Jacques Delors, and British Commissioner for the internal markets, Lord Cockfield, subsequently convinced the member states of the internal market's value.

In a non-binding referendum in 1986, the majority of Danes voted in favour of endorsing the Single European Act, which aimed to establish the internal market. The act formally came into force in all EU countries in 1992. The European countries have, as mentioned, gained considerable economic benefits as a result of liberalisation and the new shared European regulations that were rolled out in the internal market. Several barriers to the free movement of goods, services, capital and people were removed through the internal market. The principals of a common market and free movement were written into the Treaty of Rome as early as 1957, but it was not until the Single European Act came into force that these intentions were put into action.

The internal market is under constant development. The globalisation of the economy, technological developments, the introduction of the euro and the expansion of the EU from 12 to 28 members has posed a number of challenges to the internal market and its regulatory framework.

Several reforms have been implemented since 1992 and these have gradually expanded the internal market. The liberalisation of a number of network

---

[11] *Konkurrence, internationalisering og regulering* (Competition, internationalisation and regulation, Report number 2). 2013. *Produktivitetskommissionen* (Productivity Commission).

industries, the adoption of the Services Directive in 2006 (Directive 2006/123/EC, 12/12 2006), the two action plans for the internal market adopted in 2011 and 2012 respectively (Single Market Act I, April 2011 and Single Market Act II October 2012), the European Commission's proposal for a digital agenda for Europe from May 2010 (COM (2010) 245) and its proposal for a European internal market regulation on electronic communication from September 2013 are notable examples of political initiatives to expand and enhance the internal market. In an overview of the implementation of the many individual elements of the two action plans for the internal market from 2011 and 2012, the European Parliament estimates that, as of October 2014, over 80 percent of the actions in the Single Market Act I and 50 percent of those in the Single Market Act II have been adopted.[12]

Right now there is a window of opportunity to put the turbo on the internal market. The new Juncker Commission has already announced in its work plan that it will propose a number of reforms and re-launch the internal market by establishing a digital single market, and energy union[13] and a single capital market.

In its latest Annual Growth survey, the Commission has indicated that it is necessary to implement several structural reforms. At the EU level, the expansion of the internal market is something which epitomises a structural reform that can help modernise our economies and make Europe more competitive and attractive to investors. Among the priorities is to remove the remaining regulatory and non-regulatory barriers across sectors such as energy, telecommunications, transport and the internal market for goods and services.

Seen in light of the above developments, an agenda is set for reforming the digital single market, a better integrated internal market for goods, services and energy, as well as a banking union and a more developed capital market.

But the proposals may well encounter political reluctance. There have, for example, been significant disagreements between member states (and across the telecommunications sector) when it comes to developing new common regulations for telecommunications.

National interests, old monopolies and established professions may come into play in the negotiation process. The has been evident several times before, for instance, when the liberalisation of pharmaceuticals and other liberal professions was placed on the agenda. But if Europe wants to gain anything from the internal market other than minor additional gains, then more needs to be done. Comprehensive reforms in the internal market could establish a solid foundation for new economic growth. However, this demands that the European Commis-

---

[12] European Parliament, IP/A/IMCO/2014-11.
[13] See also: Energy union should be the EU's next big project, Think Tank EUROPA, 2014 (http://english.thinkeuropa.dk/node/133).

sion, Parliament and EU member states demonstrate the leadership necessary to set highly ambitious goals for the reforms.

A reform package for the internal market must have an appropriate balance of new EU legislation, national legislation and amendments to administrative practice at an EU, as well as a national, level to facilitate the necessary changes in businesses', employees' and consumers' behaviour. The package should also be designed in a way that businesses, employees and consumers can see themselves as potential winners – if not here and now, then in the long term.