The Political Economy of Europe's Incomplete Single Market

Edited by
David Howarth and **Tal Sadeh**

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The Political Economy of Europe's Incomplete Single Market

Progress in European market integration over the past two decades has come at the expense of growing flexibility, or differentiation, in the laws that govern the Single Market (SM) as well as the way that these laws are implemented. This volume examines how the completion of the SM has been held back in the varied implementation of European Union competition policy, variation in national policies on services, corporate law, telecommunications, energy, taxation, and gambling, and the EU's uneven transportation network. These sectors and issue-areas form the frontier at which the main political struggles over the future shape of the SM have taken place in the past decade. Broadly, progress in economic integration in the EU has been complicated by the need to reconcile perfections to the SM with the global competitiveness of European producers, and efficiency gains with ideational and normative concerns. In services, there is a clash between deregulation and social policy. Financial integration has had to reconcile different institutionalized views among the member states about the place of finance in the economy and society. The SM notion supposedly entails a concrete set of substantive policy commitments that form the basis of the 'ever closer union'. However, increasing differentiation in the SM undermines the identification of the EU's core constitutional commitments.

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Preface

The approaching silver anniversary of the Single European Act (SEA) and the tenth anniversary of the Lisbon Agenda provide cause to assess the state of European market integration and, more specifically, focus attention upon those economic sectors where integration is far from complete or has stalled at the 'frontier' of the Single European Market (SM). This collection brings together nine contributions that apply the tools of political economy and political science to explain the success and failure of recent efforts to further market integration in a range of economic sectors.

The contributions in this collection originated as papers submitted to a project of the Political Economy Interest Section of the European Union Studies Association (EUSA), launched at EUSA's Tenth Biennial Conference in Montreal in the spring of 2007. Conference panels were organized by the editors of this collection at the University Association of Contemporary European Studies (UACES) Annual Conference in Edinburgh in September 2008 and at EUSA's Eleventh Biennial Conference in Los Angeles in the spring of 2009. The work of several participants in the EUSA project cannot be included in this collection, but we nonetheless wish to extend our gratitude for the vital intellectual contribution of these participants to the project over the past three years. Equally crucial has been the generous contribution of several dozen paper referees who must remain anonymous. The contributors to this collection are to be congratulated both for their thought-provoking contributions and for their patient co-operation in what has been a lengthy review and revision process. A final note of thanks must be extended to the Editor of *JEPP*, Jeremy Richardson, who was supportive of the idea of a special issue of the journal on the political economy of market integration from the early months of our project. As many will attest, Jeremy's combination of professionalism, flexibility, patience and good nature makes working with him an immense pleasure.

David Howarth and Tal Sadeh
Edinburgh and Tel Aviv, Spring 2011

The ever incomplete single market: differentiation and the evolving frontier of integration

David Howarth and Tal Sadeh

ABSTRACT Progress in market integration over the past two decades has come at the expense of growing flexibility in the laws that govern the single market (SM) as well as the way that these laws are implemented. This differentiated integration comes in four forms: soft; informal; multi-speed; and opt-out differentiation. We examine how the completion of the SM has been held back in the varied implementation of EU competition policy and variation in national corporate law, energy markets, services and taxation. These sectors and issue areas form the frontier in which the main political struggles over the future shape of the SM take place, and in which differentiation is most clearly manifested. The SM notion supposedly entails a concrete set of substantive policy commitments that form the basis of the 'ever closer union'. However, increasing differentiation undermines the identification of the EU's core constitutional commitments.

INTRODUCTION

The single market (SM) of the European Union (EU) is the world's most advanced and sophisticated multi-national project of economic integration. Its stated goal, as enshrined in the 1957 Treaty establishing the European Community (EC), is to enable the free cross-border flow of goods and services, labour and capital (the so-called four freedoms). With time, the EU member states have increasingly undertaken a comprehensive approach to this project, and market integration has increasingly encroached on national sovereignty. The 1987 Single European Act (SEA) was adopted to reinvigorate the process of market integration by way of the reassertion of existing goals but also institutional reform.

In view of the enormity of this task, the member states accepted that progress towards achieving the four freedoms in practice would be gradual, relying on Commission and Council initiatives and European Court of Justice (ECJ) rulings. This gradualism has several aspects. First, it means that agreed liberalization measures can take long periods to be implemented, whether a prolonged transition period is agreed in advance or political difficulties prolong the

implementation process in practice. Second, even where they share a vision of further market integration, it takes time for the member states to agree on practical measures to implement integration in ever more sensitive issue areas, and to transfer more authority from national to transnational and supranational bodies. Third, the completed SM is an essentially contested concept and what is acceptable in the different member states is in constant evolution. As technology and societies develop, the project is reinterpreted and new ambitious goals are formulated. Thus, the SM is an incomplete project and it is difficult to envisage its completion.

The approaching silver anniversary of the SEA and the 10th anniversary of the Lisbon agenda provide cause to assess the state of European market integration and, more specifically, focus attention upon those economic sectors where integration is far from complete or has stalled at the frontier of market integration. This collection is not an attempt to re-examine the causal variables behind the project.[1] Nor does it seek to analyse the implications of the SM for European and world politics and economics,[2] nor to study the SM in a historical perspective (Egan 2010). Rather, this collection brings together contributions that apply the tools of political economy and political science to explain the success and failure of recent efforts to further market integration in a range of economic sectors.

By way of introduction, we argue here that progress in market integration over the past two decades has come at the expense of growing differentiation, which is particularly present in the evolving frontier of economic integration. The next section explores the concept of differentiated integration in the context of market integration. This concept is then applied in the third section to examine how further integration has been held back because of varied implementation of EU competition policy and persistent differences in national corporate law, energy markets, services (especially financial services, transportation and telecommunications) and taxation. These sectors and issue areas form the frontier in which the main political struggles over the future shape of the SM take place.

DIFFERENTIATION IN THE SINGLE MARKET

Being at the core of the EU's constitutional order, the SM is supposed to be free from discrimination among its member states. However, the laws that govern the SM as well as the way that these laws are implemented demonstrate a surprising degree of flexibility in integration, or differentiation, which implies discrimination.[3] Differentiated integration in the SM comes in four forms (Andersen and Sitter 2006). The first two forms are soft and informal. Soft differentiation arises from legitimate discretion in the implementation of EU legislation by member states, whereas informal differentiation refers to the variance in *de facto* member states' compliance with EU legislation. Both forms represent discretionary differentiation, which is particularly relevant with regard to the implementation of SM, health and safety, and environmental legislation (Scott 2000).

There are three main reasons for these forms of differentiation. First, member states can design directives to be less specific in order to allow for greater

national margin of manoeuvre in implementation (Andersen and Sitter 2006). Second, policies that have been agreed at the EU level may encounter opposition from regional and local governments, which will result in distorted implementation. Finally, some rules designed to improve the SM may generate competitive disadvantages for producers interacting outside the European market. Temporary Commission toleration of non-compliance is one way in which the EU addresses this tension (Smith 2010).

The average EU transposition deficit (the share of directives yet to be transposed into national law and implemented by each member state) has fallen dramatically since the mid-1990s, from 6.3 per cent in 1997 to 0.7 per cent by the end of 2009. Likewise, the percentage of outstanding directives which one or more member states have failed to transpose in relation to the total number of SM directives has declined from 27 per cent in 1997 to 5 per cent in 2009 (European Commission 2010b). By November 2009, seven member states failed to meet the revised 1 per cent target and only four were far off. However, this improvement in transposition disguises the large number of directives that have yet to be fully transposed by all member states by the due date. By November 2009, there were 74 directives (five per cent of the outstanding total) still awaiting full transposition, with 16 of these being more than two years overdue (European Commission 2010b). Transgression in transposition is greatest in financial services, energy and transport markets. The Lisbon Treaty creates the possibility of imposing penalty payments upon member states for late transposition of directives, which will provide further incentive for member states to comply rapidly with their legal obligations.

While transposition delay has declined considerably as a source of differentiation, incorrect transposition and implementation of SM directives continues to contribute significantly to differentiation, with infringement greatest in taxation, customs union, environmental issues, energy and transport. Little action has been taken by the majority of member states to reduce the number of open infringement proceedings brought by the Commission in recent years and, at the end of October 2009, there were 1,206 open infringement cases (European Commission 2010b). Several member states are also often slow to comply with ECJ decisions, the average compliance delay being over 18 months (European Commission 2010b). There are substantial differences in terms of member states' responses to decisions on infringement.

The third form of differentiation, multi-speed, comes by way of temporary derogations from SM and SM-related secondary legislation. Temporary derogations are provided for either through specific legislative provisions or accession treaty provisions adopted with regard to the application of policies that have significant cost implications for industry. Named member states are explicitly exempted from an obligation but usually for only a specific period of time. One recent example of multi-speed differentiation is the regulation of chemicals (see Smith 2008, 2010). The Regulation, Evaluation and Authorization of Chemicals (REACH) directive allows for the application of a socio-economic analysis to permit derogation, and to the extent that this

might create a national bias the result is scope for more patterned and permanent differentiation.

Unlike treaty opt-outs, secondary legislative differentiation and transition periods for new member states on the SM still function 'within the context of a broader constitutional commitment, in the sense of an overall shared commitment to the same normative project' (De Búrca 2000: 143). The European Commission (1978) has optimistically presented such differentiation in secondary legislation as fulfilling, rather than breaching, the non-discrimination principle. The addition of Article 20 by the SEA established a treaty basis for existing practice. It allowed only for a particular kind of temporary, 'least disruptive' differentiation and on the basis of only one, albeit broadly conceived, justification: 'the extent of the effort that certain economies showing differences in development will have to sustain' (*Single European Act* 1987).

Opt-out and general derogation on secondary legislation form the fourth form of differentiation – the explicit legal sanction of potentially permanent differentiation in either treaties or legislation. General derogations or exceptions are established on grounds of public policy, public morality, public security and public health, as well as the protection of the environment, the working environment, health and life of humans, animals or plants, and industrial and commercial property. Explicit protocols appended to treaties have allowed for opt-outs or special provisions to specific member states. The 1991 Treaty on European Union (TEU) introduced differentiation through the opt-outs provided to the United Kingdom (UK) and Denmark on Economic and Monetary Union (EMU). A TEU protocol also allows Denmark to maintain its existing legislation on the acquisition of second homes.

Most multi-speed differentiation in secondary legislation is allowed for well-founded socio-economic reasons, notably capacity (level of economic development) and national economic structures. Indeed, in the wake of the recent enlargements of the EU, soft, informal, and especially, multi-speed forms of differentiation have increased exponentially. However, some cases of differentiation incorporated into SM legislation cannot be justified in terms of different levels of economic development. Other considerations have shaped multi-speed differentiation, general derogations and opt-outs, such as ideology (Della Sala 2010; Gerber 2001; Wilks 1996), domestic political circumstances and technical preferences.

DIFFERENTIATION AND THE SINGLE MARKET'S CHANGING FRONTIER

Competition policy and corporate law

EU competition policy tackles a range of non-tariff barriers to the four freedoms: market-distorting state subsidies; mergers leading to dominant market share; abuse of dominant market share; and discriminatory government procurement. That being said, the TEC allowed for some limited exemptions to the application of EU competition policy for the sake of interventionist national industrial policies.

In particular, state aid of a social character or aid designed to develop poor regions was deemed compatible with the SM. In addition, national competition law (affecting the operation of companies that are located primarily in the national market and thus not subject to EU competition policy) continues to be distinct (Eyre and Lodge 2000). Exemptions to the EU's state aid policy also include 'Services of General Interest' (i.e., energy, telecoms, transportation and water). However, even allowing for these exemptions, non-compliance by member states with EU competition policy constitutes an important contribution to differentiation in the SM. At least some of this differentiation reflects the persistence of different national forms of industrial policy. These forms include the provision of state aid, the maintenance of state ownership and intervention in mergers and acquisitions to protect some sectors from foreign ownership.

State aid policy is one of the most politically contentious aspects of the EU's competition policy. The provision of state aid to industry (within or outside EU law) varied considerably among the member states even before the distortions of the recent financial crisis. Sweden, Austria and Germany were large providers, while Britain provided relatively little state aid (European Commission 2007 and 2010a). The beneficiary sectors also varied among member states, but prior to the financial crisis the bulk of state aid in most member states went to manufacturing. The Commission was granted constitutional authority in the TEC, but it only slowly acquired formal implementing powers. Relying also on discretion, it managed to reduce aid in the 1990s and 2000s (Zahariadis 2010).

Several member states intervene regularly to encourage or block potential mergers and takeovers by foreign firms, action that can contravene both EU competition policy and the free movement of capital. France, Italy, Germany and Spain have engaged in interventionism on mergers with the aim of maintaining national ownership in identified 'strategic' sectors. For example, in 2005–2006, against EU law, the French government prepared a list of 11 strategic sectors, in which it planned to resist foreign ownership. Even companies such as Danone (dairy) and Carrefour (supermarkets), which are not strategically important and are not government owned, were brought under this policy. The ability of member state governments to block mergers rests in part on state ownership or control (through golden shares) of companies, which is not necessarily contrary to EU rules. Despite large privatization programmes over the past two decades, France and Italy in particular have several large companies in which the state retains part-ownership. However, European Commission and ECJ action has worked to undermine national protectionism, including a direct challenge to 'strategic sector' legislation. For example, the ECJ (2007) overruled a German law that protected Volkswagen from acquisition. Some member states – notably the UK and the Netherlands – maintain a more *laissez-faire* position and support the rigorous enforcement of EU rules.

Since the launch of the SM project in 1986, the Commission has sought to challenge public procurement by national governments that discriminate in favour of national firms and against foreign competitors. An evaluation of the public procurement market demonstrates persistent differentiation. Those