

The Single Market: A vision for the 21st century

January 2007



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EXECUTIVE SUMMARY

PAST, PRESENT AND FUTURE – AN ASSESSMENT OF THE SINGLE MARKET

The Single Market has been one of Europe's defining achievements and has delivered jobs, growth and greater choice and prosperity for Europe's citizens and businesses. By removing cross-border barriers to the free movement of goods, services, capital and people, and strengthening competition, the Single Market has created an additional 2.75 million jobs across the European Union and boosted prosperity by €225 billion in 2006. Europe is now the largest market in the world, with a population of over 490 million and it accounts for 20 per cent of world trade.

However, twenty years after the initial launch of the Single Market, progress is slowing. Rapid technological and structural change is shifting the balance of the global economy, while enlargement, ageing populations and climate change bring new challenges for Europe, not foreseen at the start of the Single Market project. For Europe to rise to these new challenges and benefit from the opportunities of globalisation, it needs to adopt a new, modern and more flexible approach to Single Market policies.

At heart this means the European Union must adopt a much more outward-looking, global perspective. It also means that the traditional model for the Single Market – one that seeks to achieve integration through legislation and the harmonisation of rules – needs to be rethought. In an era of such dramatic global change, the Single Market will never be “complete” – boundaries will be continually redrawn, new challenges will emerge and we need an approach that is as flexible as the global markets in which we now operate.

A new strategy for a 21st Century Single Market

This paper sets out a new strategy for the Single Market that calls for a renewed focus on its core purpose – to provide jobs, growth and prosperity for Europe's citizens. It argues that we need to move beyond the old approach – one based on legislation and gap-filling – and prioritise action in those areas where the economic benefits are greatest. As well as greater prioritisation, the changing context of the Single Market also argues for policy that is more tailored, proportionate and flexible. And finally, because the Single Market represents a joint endeavour across the EU and its institutions, successful Single Market policies will also require a greater emphasis on cooperation, but this must be matched by greater clarity about where action is for Member States and where more targeted Community-level action can deliver benefits.

The Single Market strategy should be built around a clear set of principles that are consistently applied in the development, implementation and assessment of Single Market policies:

- be clear about the purpose – **focusing policy on outcomes of promoting jobs, growth and prosperity**, by creating a dynamic and competitive Single Market;
- be focussed on priorities – **adopting a more systematic approach with policy priorities set according to sound analysis of where the economic benefits are greatest**. For example, a priority for action should be key markets that impact on the wider European economy, such as energy and financial services;

- take action at the right level – **emphasising cooperation and applying the principle** of subsidiarity, recognising a need for greater clarity about the respective roles of the EU and Member States in contributing to Single Market objectives; and
- deliver a modern and flexible framework – **policy makers should embrace a wider range of policy tools**, including more pro-active use of competition policy, which is central to achieving a well-functioning Single Market.

Modern Single Market policies – converting the strategy into action

Globalisation and increased diversity following enlargement put a greater premium on flexibility and a greater onus on policymakers, particularly at EU-level, where the speed at which proposals can be amended as circumstances change, is slower than for national policies.

With much of the legislation required to establish the Single Market in place, increasing the use of pro-active competition policy instead of relying simply on regulation can become a key feature of Single Market policy at a Community-level. The analytical, evidence-based approach adopted for sector inquiries can inform policy making across the Commission, while further work is needed on horizon scanning to highlight sectors where consumers and businesses are suffering through weak competition and to prioritise future market investigations.

Where there is a need for further targeted EU regulation, adherence to better regulation principles is essential. The design and enforcement of regulation should be risk-based and there should be greater use of more flexible forms of regulation and lighter-touch alternatives. Improvements in the quality of impact assessments and the process of consultation, and consistent post-implementation reviews will also make for better policy.

Effective implementation and enforcement are also essential to realising the benefits of the Single Market and building awareness and credibility amongst citizens and businesses. While the Government welcomes the practical way in which the Commission is addressing this issue, we believe that a thorough review of implementation and enforcement is required. Greater prioritisation of investigations into breaches of EU law, improved access to courts and the wider use of informal problem solving techniques such as SOLVIT can all play a role.

New economic research commissioned for this paper argues for the prioritisation of further reforms in key sectors, notably in Europe's network industries, such as energy, communications and post. Not only are these important sectors in their own right, but also they provide inputs to a large number of other economic activities so their performance has implications for the competitiveness of the economy as a whole. Further market opening in the network industries could increase Europe's GDP by 1.7 per cent and create up to 360,000 additional jobs.

Finally, if the EU is to achieve a truly dynamic and competitive Single Market, improved Community level policy must be matched by necessary structural reform undertaken at a national level, as well as a commitment to external openness to trade. A greater alignment of structural reform and Single Market priorities and the conclusion of full negotiations in the Doha Round of trade talks will be a crucial counter-part to the strengthening of Single Market policy.

PAST, PRESENT AND FUTURE - AN ASSESSMENT OF THE SINGLE MARKET

INTRODUCTION

1.1 The Single Market has delivered significant benefits for EU consumers and businesses alike. By removing cross-border barriers to trade, it has helped strengthen competition in Europe, driving up levels of innovation, enterprise and growth and delivering lower prices and more choice for consumers. However, twenty years after the launch of the Single Market project, the process of economic integration has slowed and although some Member States are performing relatively well, Europe as a whole continues to lag behind its main competitors. At the same time, the wider economic and social environment has been changing dramatically bringing new challenges for Europe's economy that were not foreseen at the start of the Single Market project.

PROGRESS TO DATE

1.2 European economic integration¹ has been in constant evolution, from the creation of the European Coal and Steel Community in 1951, to the Common Market in 1957, the Customs Union in 1968, and the Single Market Programme in the 1980s and early 1990s. The Single Market Programme was launched in 1986 to overcome profound economic challenges at the time, manifest in prolonged low GDP growth, high and volatile inflation, escalating unemployment and deteriorating public finances. Spurred by a feeling that Europe was falling behind major competitors, European leaders recognised the need to respond and set out to create “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”. By removing regulatory barriers the Single Market aspired to open up “opportunities for growth, for job creation, for economies of scale, for improved productivity and profitability, for healthier competition, for professional and business mobility, for stable prices and for consumer choice”.² The creation of the Single Market has been followed by further reform, including significant liberalisation of markets such as telecommunications and transport, and complemented by structural reforms under the Lisbon Strategy.

Benefits of the Single Market

1.3 Twenty years on from the launch of the Single Market Programme, Europe can be proud of its achievements. By removing cross-border barriers to market entry, the Single Market has helped to increase competition in Europe, putting downward pressure on prices, promoting productivity and growth, creating incentives for innovation, and ensuring that resources are allocated swiftly towards more productive uses. The EU is now the largest multi-member single market in the world and has delivered considerable economic benefits:

- an increase in EU GDP of 1.8 per cent or €225 billion in 2006³;
- 2.75 million extra jobs⁴;
- a quadrupling of foreign direct investment in the first ten years;

¹ “Integration” refers to the removal of barriers to trade in this report

² 1988 Cecchini Report - Lord Cockfield's Foreword

³ European Commission (2007): 'Step towards a deeper economic integration: The Internal Market of the 21st Century'

⁴ *ibid*

- an improved export performance, with EU external trade increasing from 6.9 per cent to 12.3 per cent of EU GDP between 1992 and 2005;⁵ and
- an enhanced productivity performance, with evidence that productivity in some sectors of the EU economy has increased by up to 2 per cent.⁶

Consumers have benefited

1.4 The Single Market programme, combined with domestic reforms to replace state-owned monopolies with private-sector companies, has done much to enhance competition in European product markets and, to a lesser extent, in services. The impact of greater competition is evident in converging prices across the EU, particularly in the 1990s.⁷ This has reduced prices for consumers and increased the choice and quality of goods and services on offer. It has also boosted growth and employment and improved living standards.

1.5 In telecommunications, for example, average prices have fallen by 50 per cent for national calls and 40 per cent for international calls following liberalisation, while the existence of a common GSM standard has enabled manufacturers to benefit from economies of scale by supplying products Europe-wide. In the European car market, cross-country price differentials fell throughout the 1990s and the speed of price convergence following price shocks has increased, implying greater flexibility in prices.⁸

...as have businesses

1.6 Businesses have also benefited in many ways from the deeper integration brought about by the Single Market programme. Aside from benefits arising from greater competition, lower input prices and greater productivity, the Single Market Programme has delivered the following benefits to businesses:

- trade within the EU has become much easier with the absence of border bureaucracy, cutting delivery times and reducing costs;
- the principle of mutual recognition ensures that in many cases companies can do business across the EU by complying with the rules in their home Member State;
- small and medium-sized enterprises (SMEs), for whom previously export costs were prohibitive, have gained access to new exports markets; and
- companies across Europe are now able to bid for contracts from public authorities in other Member States due to the opening up of public procurement.

⁵ Source: Eurostat; world export figures exclude intra-EU exports.

⁶ Notaro (2002): 'European Integration and Productivity – Exploring the Gains of the Single Market';

European Commission (2003): 'The macroeconomic effects of the Single Market Programme after ten years', mimeo

⁷ European Commission (2005): Internal Market Scoreboard no. 14, July 2005

⁸ Goldberg and Verboven (2003): Market Integration and Convergence to the Law of One Price

THE SINGLE MARKET TODAY – SLOWER PROGRESS?

1.7 There is growing evidence that the rate of progress – in terms of strengthening and deepening the Single Market – has slowed down in recent years. Despite political agreement to liberalise energy markets, Member States have been slow to translate this into action on the ground and recent experience with the Services Directive suggests that it may be getting harder to secure agreement to ambitious reform. At the same time, with many of the one-off gains associated with earlier Single Market measures already realised, the economic evidence suggests that the dynamic gains associated with greater competition and productivity are proving harder to come by. Measures of price convergence, trade integration and investment flows all point to some slowdown in progress in the past few years.

Price convergence slowing

1.8 Price levels were still converging across the EU in 2005, but at only half the pace achieved in the mid-1990s. Moreover, price convergence in the EU still falls well short of what has been achieved in the US. Surveys conducted by the European Central Bank and European Commission show that prices adjust relatively slowly when compared with the US, while the prices of services are particularly inflexible.⁹ According to the European Commission only 20 per cent of price changes in services in the Euro area are price falls, compared with 40 per cent in other product markets.

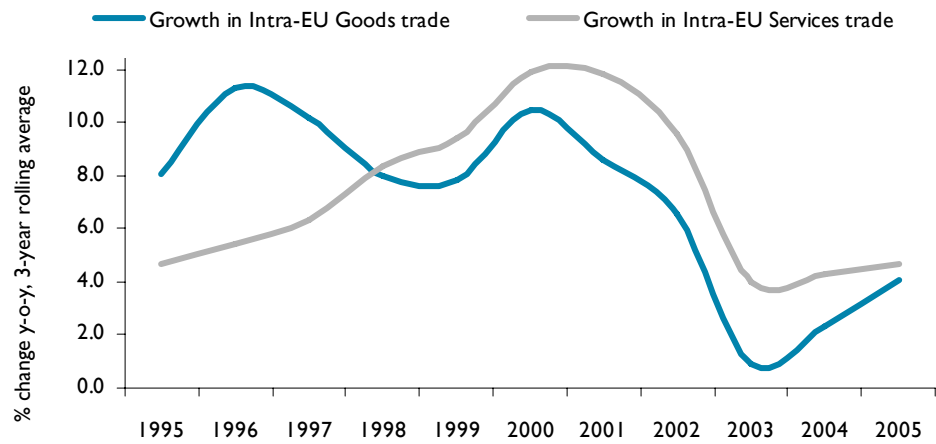
A weaker record on trade

1.9 Similarly with trade, following a strong performance in the 1990s, trade growth within the EU15 in both goods and services has fallen significantly since 2000 and this is only partly explained by cyclical factors. Growth in services trade in particular shows signs of only limited recovery. Moreover, evidence suggests that national markets continue to display persistent “home bias”, in other words, consumers tend to buy domestically produced goods and services, whilst buying relatively few – potentially cheaper or better – goods and services produced abroad. Home bias in EU goods markets decreased between the mid-90s and 2000, but has since levelled off¹⁰, which suggests that Europe is failing to reap the full benefits from trade among Member States.

⁹ European Commission (2006): “The EU Economy 2006 Review, Adjustment Dynamics in the Euro Area”

¹⁰ ‘Single Market Trails Home Bias’ – Bruegel Policy Brief, October 2006.

Chart 1.1 Europe's performance has weakened



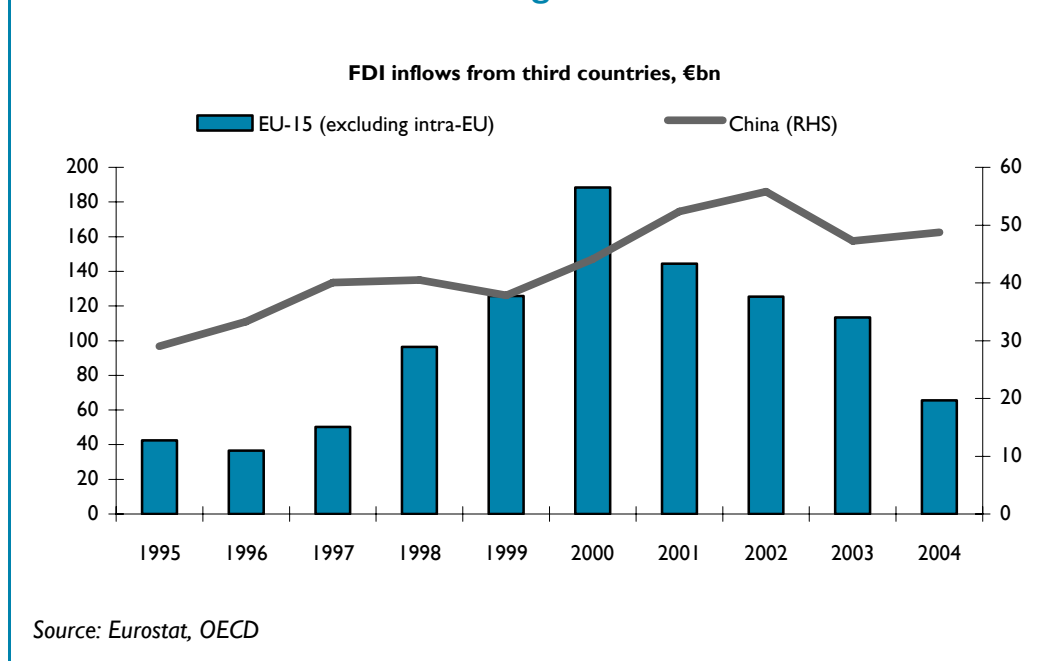
Source: Eurostat

The Single Market has become less attractive to investors

1.10 Cross-border investment amongst EU15 countries in 2000 was fourteen times larger than in 1992, but by 2004 had fallen to four times the 1992 level.¹¹ This is partly explained by cyclical factors, notably a wave of mergers and acquisitions (M&A) activity in the late 1990s, but also reflects an underlying weakening of non-M&A FDI flows in the EU. Over the same period, the pronounced fall in FDI flows from third countries into the EU15 suggests that foreign companies may judge the benefits of increased participation in the Single Market to be diminishing, though FDI flows can be expected to recover from current levels. FDI flows into emerging markets such as China have not suffered a similar decline.

¹¹ Source: Eurostat

Chart 1.2 FDI inflows falling



Europe lags behind its competitors

1.11 In addition to these signs of some slowdown in progress, it is clear that Europe still lags behind its main competitors – notably the US – in certain key respects. The long-standing challenge identified by Europe’s leaders at Lisbon European Council in March 2000 to “make the European Union the most competitive and dynamic knowledge-based economy in the world”¹² remains a far-off aspiration. At the same time, competition can be expected to become more intense, with the rapidly emerging industrialising economies of India and China catching up fast.

Living standards remain well below US

1.12 After some narrowing of the gap between EU and US living standards in the early-80s, the gap has widened again. Since the mid-90s average annual growth in EU GDP per capita has been around 0.3 per cent lower than that of the US, and EU living standards in the EU15 are now around 30 per cent lower than in the US, 35 per cent for the EU25. Trend growth for the EU is only two thirds of US trend growth, with little prospect in the short-run of a significant narrowing of this gap.

Poor labour market performance

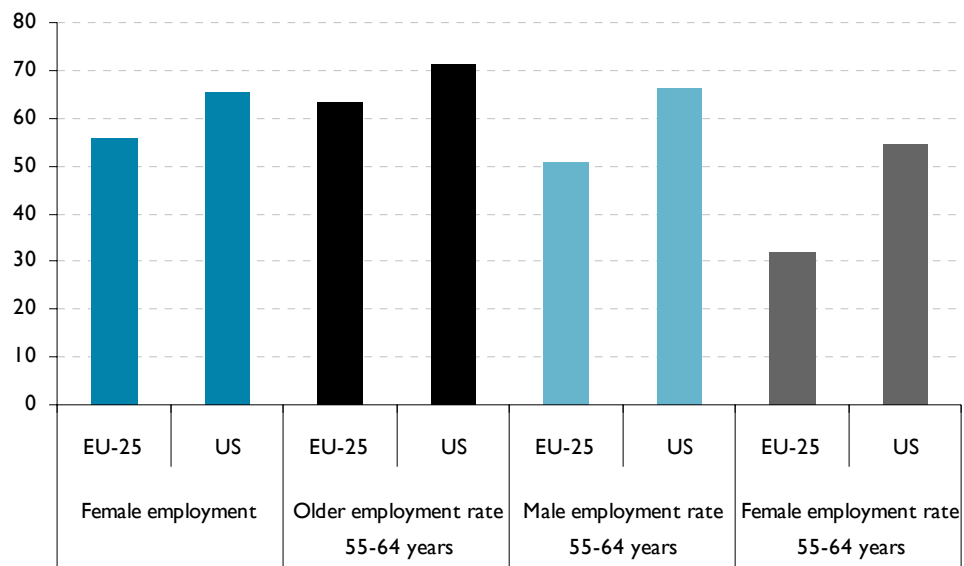
1.13 The EU’s comparatively poor labour market performance explains a large part of the gap in living standards with the US. European unemployment stands at some 20 million, of which almost half is long-term unemployment, and there are over 95 million inactive people of working age.¹³ While some Member States have made good progress in recent years in reducing unemployment rates, Europe as a whole would need to create at least 12 million jobs to meet its Lisbon targets and an additional 18 million jobs to match US employment rates.¹⁴ Stubbornly high unemployment levels, particularly amongst young and older workers, and differences in unemployment across regions and countries persist.

¹² Presidency conclusions of Lisbon European Council, 23 & 24 March 2000

¹³ Source: Eurostat; EU-27 Figures

¹⁴ Source: Eurostat; HM treasury calculations

Chart 1.3 Relatively poor labour market performance



Source: Eurostat

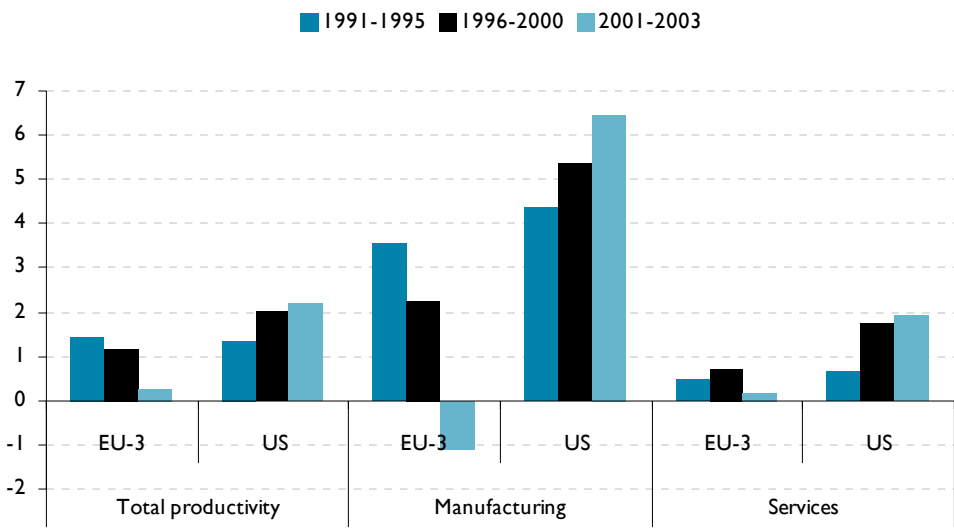
Note: This graph purposely focuses on certain labour market groups in which progress is needed, and does not attempt to give a complete comparison with the US.

A mixed record on innovation

1.14 A weak record on innovation, compared to its major competitors, is reflected in Europe’s lower Research and Development (R&D) expenditure, patenting activity and shares of high-tech exports, and ultimately, in Europe’s weaker productivity performance. Private investment in R&D is only half that of the US and less than half of Japanese levels, and China, India and other emerging economies are rapidly stepping up their innovation activity. China’s gross R&D expenditure as a share of GDP has grown by almost 250 per cent over the past ten years and is now higher than the EU average.¹⁵ This helps explain persistently lower rates of productivity growth in EU manufacturing and services, when compared with the US. Service sector productivity growth has been relatively stagnant since the 1980s and remains well below US levels.

¹⁵ In addition, Europe seems to be losing attractiveness for R&D investment, which is strongly associated with knowledge creation. This seems to be driven by a strategic shift from demand-driven considerations to a more supply-side, innovation-seeking motivation, and is to the advantage of countries such as US, which has unrivalled research and teaching institutions and a highly integrated innovation system, with a proven track record of developing cutting-edge technology clusters, and China and India which can combine human capital with lower labour costs.

Chart 1.4 Europe's trailing productivity growth



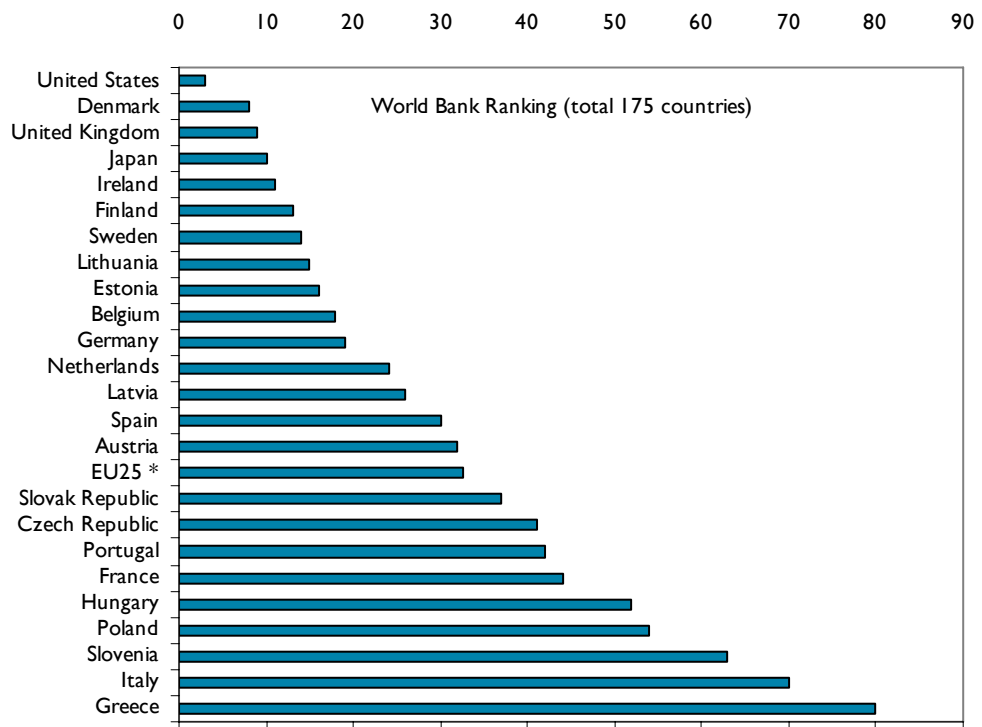
Source: OECD

Less favourable business environment

1.15 Despite some notable progress in reforming labour markets and more recently in promoting better regulation, the European business environment continues to be characterised by excessive regulation and market segmentation, which are stifling competition. The World Bank's 'Doing Business in 2007 Indicators' show that most European countries rank relatively poorly in terms of their business environment and framework conditions for enterprise and remain considerably behind top performers such as the US and Japan. The OECD estimates that restricted competition could be reducing productivity by double-digit percentages in some EU markets¹⁶.

¹⁶ OECD (2002) Product market competition and economic performance

Chart 1.5 Unease of doing business



*EU25: Simple average excluding CY, LU, MT

Note: A higher ranking signifies a less benign business environment. The original World Bank indicator is labelled Ease of Doing Business.

Source: World Bank, *Doing Business in 2007*

1.16 Persistently high levels of regulation and weaker competition are particular concerns in Europe’s network industries and in services. Insufficient liberalisation of EU gas markets will cost Europe’s energy consumers an estimated £40 billion this year alone while the European Central Bank (ECB) estimates that further reform to encourage competition in Europe’s network industries could yield price falls of up to 36 per cent¹⁷. ECB studies also show that services are the most rigid sector of the Euro area economy in terms of price setting, a phenomenon that is put down to limited competition.¹⁸

¹⁷ ECB (2005) Regulatory Reforms in Selected Network industries

¹⁸ ECB (2006): ‘Competition, Productivity and prices in the Services Sector’, Occasional paper No. 44, ECB July 2006.

Table 1.1 Regulations in services sectors

	Telecom	Post	Airlines	Rail	Road	Retail trade	Professional services
Euro Area	1.5	2.8	1.1	4.1	2.3	2.9	2.7
US	0.2	3.7	0	3	0.5	2.6	1.8
Japan	1.7	2.9	1.7	3.8	0.5	2.4	2.3

Note: The indicators range from 0 to 6 for the least and most restrictive regulation level, respectively

Source: Eurostat, OECD Regulatory Indicators Database and European Commission

THE CHALLENGES FOR EUROPE IN THE 21ST CENTURY

Dramatic global change

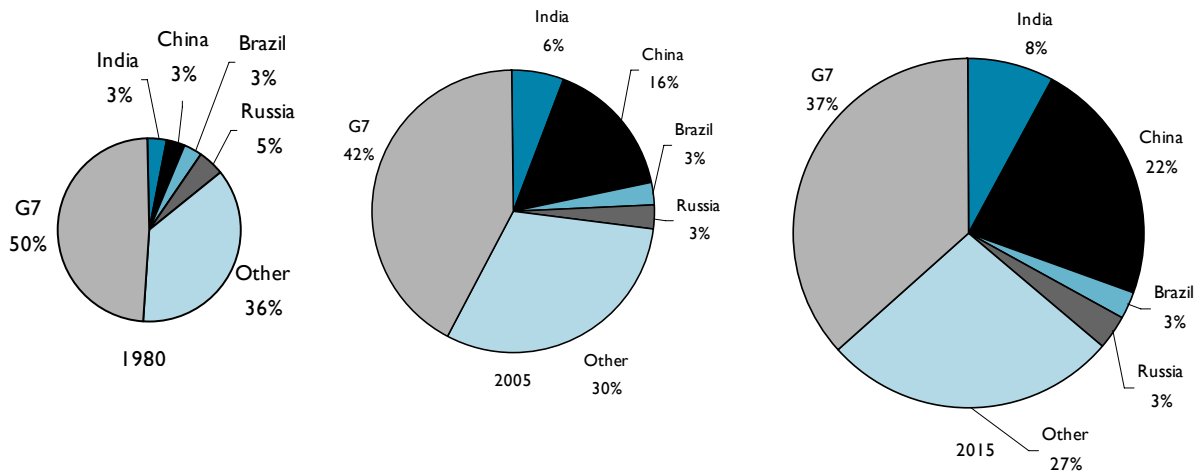
1.17 The economic context within which the Single Market operates has changed fundamentally since the process of economic integration began. Today's more interconnected world has brought new economic and social challenges not envisaged at the outset of the Single Market project. In particular, the location of global economic activity has shifted dramatically, with Asian economies and other rapidly developing markets producing an increasing proportion of world output. Underpinned by advances in technology, which are increasing the tradability of goods and services, business is becoming ever more integrated across national borders, changing patterns of trade and investment, and the location of production. Global sourcing of goods and services has replaced national sourcing:

- China and India's rapid growth means that they are now respectively the second and fourth largest economies in purchasing power parity terms;
- twenty years ago just 10 per cent of manufactured goods came from developing and emerging countries. By 2020 the figure could be as high as 50 per cent;
- developing economies are also increasingly trading in higher value added industries and in services – nine out of the 25 leading importers and exporters of commercial services are developing countries;¹⁹
- rising global capital flows mean that economic activity is increasingly integrated across borders, increasing the sources and destinations for FDI. As well as China and India, other emerging economies such as Brazil and Russia are attracting massive inward investment, over half a trillion dollars from 2000-2004; and

¹⁹ Emerging economies such as China are already raising their game and competing in goods across the value chain. The proportion of manufacturing output in China that is high-tech is already similar to that in the EU – around 20 per cent; but both lag far behind the US where 30 per cent of manufacturing output is high-tech.

- growing inter-dependence between economies and businesses means that countries all share a stake in each other's problems and prosperity. Accessing the gains from globalisation relies on achieving a long-term vision of a world-trading system that is fair as well as free.

Chart 1.6 Shifting shares in global output 1980-2015



Source: IMF, Consensus Forecasts, EIU September 2005 and HMT estimates

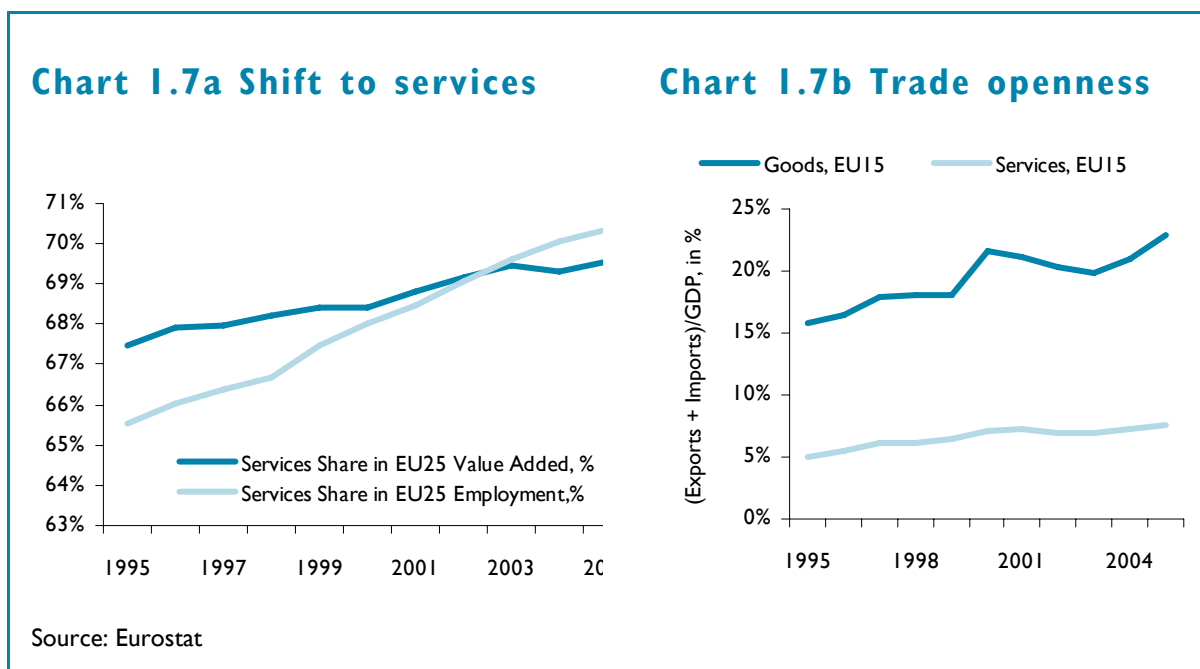
Structural change in Europe's economy

1.18 The structure of Europe's economy has gradually shifted from one based heavily on traditional manufacturing industries, to one in which the service sector constitutes the main driver of economic growth and employment. This long-term shift in output and employment has continued over the past ten years so that services now account for around 70 per cent of value added and employment in the EU. Rapid advances in technology, particularly ICT in the more recent past, and changes to the way in which production is organised, mean that cross-border flows are increasingly composed of services, R&D, financial capital and human capital, and not just physical goods²⁰. As a result, innovation is becoming much more important as a driver for economic growth.

²⁰ For more detail see EC (Unpublished): 'Factor Mobility in the Global Economy: Policies for Growth in an interconnected World', EPC, December 2006.

The shift to services

1.19 Despite this shift towards services, the level of trade in services with countries outside the EU has remained largely constant. Equally, while the low share of services in intra-EU trade may partly be explained by their lower tradability (as services tend to be produced and consumed locally), it also reflects the continued existence of barriers to trade in services. The opening of service markets is crucial to Europe’s future prosperity. According to one study by the ECB, increasing competition in services within the Euro area to US levels could augment output by 12 per cent.²¹ If trade integration in business services sectors were to reach the levels currently seen in manufacturing, relative producer prices for services would, on average, decline by almost 20 percent. Agreement on the Services Directive has the potential to bring new opportunities for Europe’s businesses and consumers who can benefit greatly from the liberalisation of the services sector, without affecting workers’ rights. However, a concerted effort to strengthen and deepen the Single Market in services will be required.



The growing importance of SMEs

1.20 Against the background of a structural shift towards services, small and medium-sized enterprises (SMEs) have emerged as the key engine of innovation, growth and employment in Europe’s economy. In 2003, non-financial SMEs accounted for two-thirds of EU25 employment and 57 per cent of value added. Furthermore, advances in technology have enabled SMEs to become increasingly international, with almost 40 per cent of European SMEs relying on international markets for their business. This process of internationalisation can help improve the competitiveness of SMEs, for instance by enabling better sourcing of intermediate inputs or by providing access to a wider customer base and better technologies.²² The way in which the Single Market operates for SMEs will be crucial to the competitiveness and success of Europe’s economy in future years.

²¹ ECB (2004): ‘Benefits and Spillovers of Greater Competition in Europe’, Working Paper No. 341

²² European Commission (2003): ‘Observatory of SMEs: Internationalisation of SMEs’, Report No. 4

A changing European landscape

1.21 Alongside globalisation and structural change, Europe is facing a number of other important social and economic challenges not foreseen at the start of the Single Market project. Enlargement, ageing populations and climate change bring with them new challenges for Europe's economy and permanently alter the European landscape:

- **Enlargement** – each successive wave of enlargement has broadened and extended the Single Market and in turn the scope for gains from trade, investment and competition. The Single Market has become much more diverse in terms of levels of development and administrative capacity, as well as culturally and linguistically, meaning that a “one size fits all” approach becomes increasingly unrealistic and inappropriate.
- **Ageing** – the proportion of Europe's population over 65 is set to rise sharply. According to the United Nations, the average old-age dependency ratio in the EU will rise from 24 per cent in 2000 to 36 per cent by 2025 and 50 per cent by 2050, a steeper rise than in the US. Among the EU Member States, Spain and Italy are predicted to experience the most dramatic population ageing, with the UK among the least.²³ An ageing European population will put upward pressure on age-related spending such as health care and pensions.
- **Climate change** – the evidence for human-induced climate change is growing ever stronger. The Stern Report set out the economic challenges involved in managing the transition to a low-carbon economy and emphasised the importance of coordinated international action. The EU is already leading the world in carbon trading with the EU Emissions Trading Scheme, which will help to reduce carbon emissions at least cost, but new policies to promote the adoption of clean technologies and drive energy efficiency will also be required. Looking ahead, the challenge of climate change will be indivisible from the economic challenge of promoting an effective Single Market.

Growing dissatisfaction amongst Europe's citizens

1.22 Rising to the challenges of globalisation, climate change and an ageing population, and adapting to enlargement and structural change represents a challenge for Europe's citizens and its policymakers. Around one third of people in the EU continue to feel that their country has not benefited from EU membership and the proportion that feel the European Union is travelling in the right direction fell by 6 percentage points in 2006 (from 39 to 33 per cent).²⁴ A recent Commission survey shows that while the majority of EU citizens consider increased competition to be positive and remain satisfied with the impact of the Single Market on the range of products and services available to them, attitudes towards the Single Market have become less positive in the past four years.

²³ United Nations Population Division (2002) 'World Population Prospects: The 2002 Revision', New York, 2003.

²⁴ Eurobarometer No. 66

1.23 Just as the economic context has changed as a result of globalisation and structural change, so too has the social context. Changes to Europe's labour markets mean that the "job for life", which even at the outset of the Single Market project had already become far less common, is now a thing of the past. At the same time, successive waves of enlargement have transformed Europe from a union of just 12 members to one of 27 Member States, with much more diverse social protection and industrial relations systems. Europe's citizens are more affluent, more highly educated and are living longer than ever before. However, they are also more diverse, and the new opportunities of globalisation have been accompanied by new challenges and, in some cases, new insecurities. Despite recent improvements in labour market performance, the EU27 still has about 20 million unemployed, of which almost half (46.5 per cent) have been unemployed for over 12 months.

OPPORTUNITIES FOR AN OPEN AND COMPETITIVE EUROPE

1.24 The Single Market has delivered immense benefits to European citizens and firms, but its full potential has not been fully realised. Europe's economy continues to lag behind its major competitors, and with the emerging economies of China and India catching up fast, there is evidence that progress on the Single Market has slowed and stalled in some areas. The Single Market remains the bedrock on which Europe can build greater prosperity for its citizens, but the programme of twenty years ago does not reflect the new challenges presented by globalisation and by the changing landscape of Europe in the 21st century – older, larger and more diverse.

1.25 The Single Market Review provides an important opportunity – an opportunity to modernise and revitalise our approach to Single Market policy to enable Europe to respond to these new challenges. Embracing globalisation could bring material gains of up to 8 per cent in the level of per capita income in coming decades – the equivalent of €800 billion.²⁵ However, critically, the size of the benefits will depend on the degree to which restructuring takes place. The full benefits – including dynamic gains through increased competition and efficiency – will only be realised if Europe embraces reform and greater openness.

²⁵ EC (2006): Globalisation: Trends, Issues and Macro Implications for the EU', C. Denis, C. Mc Morrow and W. Roeger, DG ECFIN, July 2006.

INTRODUCTION

2.1 The Government believes that a new approach to Single Market policy is necessary to equip Europe for the challenges of the 21st Century and to respond to concerns expressed by citizens and businesses. Moving beyond the goal of “completing” the Single Market, Europe should adopt a new strategy that is more outcome-focused, more effectively prioritised and which uses a wider range of more flexible policy tools. It should be built around a clear set of principles that are consistently applied in the development, implementation and assessment of Single Market policies.

A MODERN SINGLE MARKET POLICY

More than just legislation

2.2 To date the Single Market project has been largely driven by an ambitious programme of legislative reform. The aim of this programme has been to create an integrated and homogenous legal framework of standards and rules to enable citizens and businesses to live, work and trade across borders. The enduring legacy of the Single Market’s legislative programme is a comprehensive package of over 1500 pieces of EU-level legislation²⁶ that provides the core of today’s Single Market.

2.3 When the Single Market was conceived, large-scale legislative reform was necessary to open up national markets to international competition and this approach has yielded substantial economic benefits, especially in the initial years of the programme. However, the early success of this approach has led to a tendency amongst policy makers to use periodic reviews simply to update the legislative programme and extend it to those areas where further regulation is considered necessary to “complete” the Single Market. Recent experience combined with economic evidence pointing to a slowdown in progress towards a deeper Single Market suggests that this approach may now be suffering from diminishing returns.

2.4 While further legislative measures may be required in some areas where they can be supported by robust evidence, with much of the legislation required for an effective, well-functioning Single Market now in place, moving towards a single set of harmonised rules for all activities is neither desirable nor – in an enlarged Europe of 27 Member States – is it achievable. In the past excessive focus on the coherence and consistency of internal rules has meant that Europe has failed to exploit fully the opportunities of greater openness and trade with the rest of the world. Even today, expensive subsidies still remain in some sectors and it is estimated that barriers to external trade and investment – such as tariffs, quotas and unjustifiably restrictive standards – could cost Europe’s consumers up to 7 per cent of EU GDP or around 600-700 billion euros a year.²⁷

²⁶ http://ec.europa.eu/internal_market/score/docs/relateddocs/list-dir/im-directives_en.pdf

²⁷ Messerlin (2001) ‘The real cost of European Protectionism’, Institut d’Etudes Politiques

2.5 The Government believes that Single Market policy must be modernised to take account of the new challenges that Europe is now facing, in particular, increased competition from the newly emerging economic powers of China and India. As the pace of global change intensifies, there will be an even greater premium on ensuring that policy and policy makers can adapt to take account of changing circumstances. To rely on EU legislation that takes years to negotiate, years to implement and years to take effect is no longer appropriate.

Responding to Europe's citizens

2.6 To build a consensus around this new approach, Europe needs to demonstrate how it is responding to the concerns raised by its citizens, consumers and businesses. Survey evidence highlighting growing dissatisfaction among Europe's citizens points to the need to reconnect Single Market policies with the citizens they serve, by delivering clear benefits through effective, outcome-focused and prioritised action and by engaging with people more effectively through better consultation and communication. The Government believes that this objective is best achieved by ensuring open and competitive markets that deliver choice and value for consumers, higher levels of employment and greater business opportunities. In addition, it will be vital to address people's legitimate concerns as they themselves seek to meet the challenges and exploit the opportunities of globalisation. That will involve both empowering consumers and businesses, by providing more information and choice, and an effective means of redress where Single Market rights are impeded, and supporting citizens at a national level through modern and flexible social policies.

A PRINCIPLED APPROACH

2.7 The Single Market strategy should be built upon a clear set of principles that should guide the development, implementation and assessment of Single Market policies:

- be clear about the purpose – **focusing policy on outcomes of promoting jobs, growth and prosperity**, by creating a dynamic and competitive Single Market;
- be focussed on priorities – **adopting a more systematic approach with policy priorities set according to sound analysis of where the economic benefits are greatest**. For example, a priority for action should be key markets that impact on the wider European economy, such as energy and financial services;
- take action at the right level – **emphasising cooperation and applying the principle of subsidiarity**, recognising a need for greater clarity about the respective roles of the EU and Member States in contributing to Single Market objectives; and
- deliver a modern and flexible framework – **policy makers should embrace a wider range of policy tools**, including more pro-active use of competition policy, which is central to achieving a well-functioning Single Market.

CLEAR ABOUT PURPOSE

Promoting jobs, growth and prosperity

2.8 The Single Market should not be seen as an end in itself, but instead as the principal means of achieving prosperity and higher levels of social welfare for Europe's citizens. Policies should focus on outcomes – enhancing competition and promoting enterprise and innovation – to deliver jobs and growth. This crucial role of the Single Market was highlighted in the Kok report²⁸, which underlined its importance in enhancing competitiveness and creating the wealth necessary to allow living standards to rise and to maintain Europe's social values. Chapter 1 sets out how globalisation and structural change has changed the social – as well as the economic – context of the Single Market. That is why the Government believes that an effective and well-functioning Single Market requires an effective and well-functioning social dimension and a more modern approach to social policy (See Box 2.1).

Box 2.1: The Social Dimension

Globalisation can be managed well or badly, fairly or unfairly, but by pursuing modern social policies that combine flexibility and fairness, Europe's long-standing social values can be advanced alongside economic prosperity. Europe's founders rightly recognised that markets are social structures and work best when there is an explicit social dimension. An effective and well-functioning Single Market therefore requires an effective and well-functioning social dimension. Indeed, the uncertainties which accompany globalisation mean that a social policy, which helps people prepare for these uncertainties and adapt to change, is more important than ever.

The existing set of rights and standards have helped build a common framework that reflects core European social values, but increasingly, the old European social model – with high levels of worker protection and social security costs – is coming under pressure. A more subtle and tailored approach is now required. Legislation is a relatively blunt tool for dealing with social policy. Moreover, social policies should not be passive, but active, helping individuals adapt to change. By protecting employability rather than specific jobs, governments can support people to move into and progress in work. However, given the diversity between Member States, these policies are best delivered at a national or regional level, closer to where changes are impacting. This is partly because it allows policies to be tailored to reflect the demography, labour market conditions and institutions of each individual Member State and partly because national governments are better placed to react to changing circumstances. It is also a matter of democratic accountability.

Equally, there is an important role for EU-level action to address issues of a cross-border nature. For example, the free movement of labour must be supported by the mutual recognition of qualifications, and where appropriate the portability of benefits. Similarly, the free movement of capital across national borders supports the case for European action to ensure that employees across Europe have rights to information and consultation. In addition, there are other areas where greater cooperation at a European level can add significant value, for example through the exchange of best practice or analysis that can inform reform programmes in Member States.

²⁸ High Level Group chaired by Wim Kok: Facing the challenge: the Lisbon Strategy for growth and employment, 3 November 2004.

FOCUSSED ON PRIORITIES

Prioritise action according to economic impact

2.9 A more systematic and rigorous approach to prioritise policy measures is required to ensure action is focussed on those areas where evidence suggests the potential economic benefits are greatest. This requires an assessment of the importance of particular sectors to the wider economy and a deeper understanding of the nature of the market and the barriers that exist. In the UK, the Office of Fair Trading (OFT) is undertaking work to develop methods for effective horizon scanning, including analysing productivity data to highlight sectors that may be suffering from a lack of competition. A prioritisation committee has been established along with a dedicated unit to conduct preliminary analysis in order to ensure better prioritisation of investigations and earlier action where it is deemed necessary. The Commission's sectoral competition inquiries²⁹ provide a good example of how a more systematic, evidence-based and analytical approach can pay dividends. This kind of approach must be extended to inform all aspects of Single Market policy.

2.10 Further liberalisation of the network industries is one area where action should be prioritised since not only are they important sectors in their own right, representing 7 per cent of EU GDP and 5 per cent of total EU employment, but also because they provide inputs to a large number of other economic activities and their performance has implications for the competitiveness of the economy as a whole. Box 2.2 summarises analysis of the potential gains from further liberalisation that shows why reform of these important sectors should be prioritised.

TAKE ACTION AT THE RIGHT LEVEL

Greater cooperation while applying subsidiarity

2.11 An effective, well-functioning Single Market is dependent on policies and actions agreed at a Community-level and the policies and actions of individual Member States. Action coordinated at an EU-level should be focussed on those areas where there are significant cross-border externalities or spillovers, or where there are common barriers across Member States that cannot be tackled through unilateral action and cooperation alone. Member States' prime responsibility is to act on their commitments to carry out necessary structural reforms (coordinated under the Lisbon Strategy), to ensure that EU level legislation is swiftly and correctly introduced into domestic law, and to abide by agreed Single Market rules. Alongside Member State actions, the Commission can complement national efforts by encouraging best practice through benchmarking and through the publication of research that identifies common features of successful structural reforms.

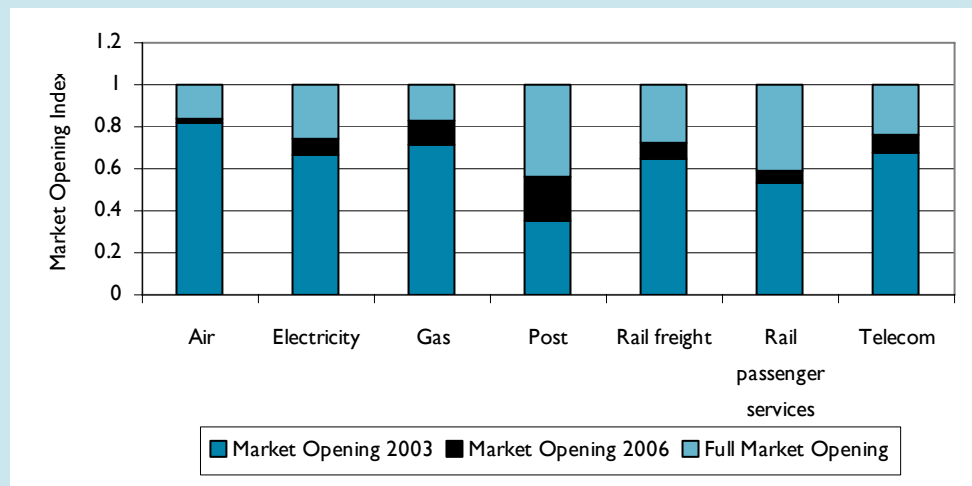
2.12 Clearly the scope and form of European cooperation will need to vary according to the particular circumstances, but at each stage EU-level action and coordination must be applied in line with the principles of subsidiarity and justified by clear additional benefits. The informal summit of the European Council held at Hampton Court during the UK Presidency of the EU in 2005 was useful in focusing EU policy on those areas where Member States can benefit from a greater degree of coordination, in areas such as energy and climate change and in innovation.

²⁹ The European Commission launched inquiries into European Financial Services and Gas and Electricity markets on 13 June 2005, pursuant to Article 17 of Regulation (EC) No 1/2003

Box 2.2: Prioritising the Network Industries

Since 1990, it is estimated that liberalisation in the network industries has resulted in welfare gains of 1.9 per cent or €98 billion across the EU, as well as creating an additional 500,000 jobs. Reform has helped to increase choice for consumers and deliver lower prices. For example, telecoms prices across the EU have fallen by nearly 7.5 per cent a year since 1998 and over 95 per cent of EU citizens in the EU15 can choose between 5 or more operators for international telephone calls. However, as figure 1 makes clear, there is significant scope for further market opening across all sectors.

Figure 1: Market Opening in six network industries, EU15



Note: The figure shows the market opening index as a weighted average over the EU15 Member States using shares of total output. For example Italy generates ten per cent of the total electricity in EU15 and therefore, the Italian Market Opening Index for electricity has a ten per cent weight in the overall EU15-index for electricity.

Source: Copenhagen Economics

New research commissioned by the Government demonstrates that further liberalisation of the network industries could deliver significant benefits to the wider economy. Full market opening could increase welfare by a further 1.3-1.7 per cent – an extra €75 to €95 billion of benefits for the EU economy on top of what has already been achieved – and employment by between 140,000 and 360,000 jobs. The spillover effects to the wider economy would be felt particularly in the service sector, where industries rely especially heavily on inputs from, for example, telecoms and postal services.

With much of the legislation necessary to deliver market liberalisation in Europe’s network industries already in place, further benefits will depend on more effective implementation and enforcement of existing commitments. Further legislation may be necessary, but should be justified on the basis of robust impact assessments to ensure the most effective and least burdensome approach. The Government believes that this approach will be necessary to deliver more effective unbundling in gas and electricity markets, as the Commission have indicated. Alternatives to legislation can be used to good effect, notably the greater use of proactive competition policy and sector inquiries. In the Energy sector, for example, the Commission’s sector inquiry has resulted in targeted infractions against those Member States who have not implemented Single Market legislation and a renewed focus on companies breaching Single Market rules.

2.13 In many areas of policy, particularly employment, social and tax policy, Member States will wish to implement policies that reflect their particular national institutions, economic and political systems and the preferences and expectations of their citizens. In the field of taxation, for example, the EU has already agreed and implemented the necessary tax measures to help create an effective and robust Single Market. And increasingly, rather than seeking to further standardise or harmonise policies at an EU level, the EU should recognise that the challenges of globalisation can best be met by delivering open, flexible and competitive tax systems across the EU. The key is to preserve flexibility while strengthening the effective cooperation between Member States.

A MODERN AND FLEXIBLE POLICY FRAMEWORK

Using the full range of policy tools

2.14 Globalisation and rapid technological change put a greater premium on flexibility, while enlargement raises questions about the feasibility and desirability of further significant expansion of harmonising legislation. This puts a greater onus on policymakers, particularly at EU-level, where the speed at which proposals can be amended as circumstances change is usually slower than for national policies.

2.15 Further progress on better regulation in the EU is essential. Proposals for new legislation must be justified by a more thorough assessment of their economic impact and should follow more active consultation with stakeholders. Flexible approaches and alternatives to regulation – including the use of co- and self-regulation, mutual recognition and New Approach Directives – should be carefully considered and Single Market policies should be routinely reviewed to inform best practice. The scope for using secondary legislation so that rules can change more flexibly in faster-moving sectors has already proved useful in Financial Services.

Competition policy – a key policy tool

2.16 With much of the legislation required to establish the Single Market in place, increasing the use of pro-active competition policy, instead of relying simply on regulation, should be a key priority of Single Market policy at a Community-level, clearly aligned with the core purpose of the Single Market, which depends on the promotion of efficient and dynamic markets. The analytical, evidence-based approach adopted for sector inquiries can inform policy making across the Commission, while further work is needed on horizon scanning to highlight sectors where consumers and businesses are suffering through weak competition and the prioritisation of future market investigations.

2.17 The approach of prioritising action according to economic impact can be replicated in the area of implementation and enforcement, by focusing infraction and sanctions on the most significant distortions to competition and by strengthening procedures that enable market participants – EU consumers and businesses – to exercise their Single Market rights. More detailed proposals on each of these areas are set out in Chapter 3.

INTRODUCTION

3.1 A modern and flexible approach to Single Market policy is necessary to enable the EU's citizens and businesses to benefit from the opportunities and adapt to the pressures of globalisation. This chapter considers how the principled approach set out in Chapter 2 can be applied in practice, by making concrete recommendations for improving Community policy on regulation and competition and setting out ideas for improving the conduct of policy more generally, for example, by improving implementation. It also sets out the crucial role of individual Member States in undertaking structural reforms and highlights the potential benefits from greater cooperation between Member States.

BETTER REGULATION

3.2 Effective regulation can play a vital role in correcting market failures, promoting fairness, increasing competition and empowering consumers. In the Single Market context, EU-level regulation can also provide a useful tool to ensure that different regulatory standards in different Member States do not inhibit cross-border trade and consumer protection measures can help promote market integration by providing consumers with the confidence to make cross-border purchases. However, inefficient and over-burdensome regulation can impose significant costs on business, reducing Europe's competitiveness without improving regulatory outcomes, and can also act against the interests of consumers by reducing choice. A regulatory framework that inhibits firm entry and growth will limit allocative efficiency and slow down the uptake of innovation and productivity growth.

Embedding better regulation **3.3** A key aspect of better regulation is the principle that regulation should be used only where necessary and should be proportionate, ensuring the desired policy result while minimising costs and burdens on business. A robust analysis of the market failure should be the starting point for all regulatory proposals and the full range of policy responses should be actively considered. In many cases, it will be neither desirable nor feasible to adopt harmonised rules to ensure the effective operation of the Single Market. The use of more flexible regulatory approaches and alternatives to regulation may deliver an equivalent policy outcome, while allowing for greater flexibility and avoiding unnecessary burdens (see Box 3.1).

A risk-based approach **3.4** Where a legislative approach is deemed necessary, the legislation needs to be fit for purpose and the enforcement proportionate so that resources are focused on areas where the risks to society are greatest, while enabling Europe's businesses to compete effectively in the global economy. The decision to regulate and its design and enforcement should be risk-based to ensure an efficient use of resources, decreased costs for compliant businesses and improved protection for consumers by targeting areas of highest risk. Low risk areas should be subject to fewer inspections, lower data requirements and better advice, so that resources can be devoted to areas of highest risk.

Box 3.1: More flexible regulation and alternatives

It is not true that most businesses, if unregulated, will act irresponsibly. Well-informed consumers, corporate social responsibility, organised labour, pressure and interest groups have all encouraged businesses to take measures to reduce risk to society, who are increasingly aware of the damage that can be done to their reputations by poor business practice. Today's consumers also tend to be much better informed and more discerning than consumers in the past and are much more likely to take their business elsewhere if they can find a better deal or if the goods or services are substandard.

Research carried out in the UK by the National Consumer Council shows that across six markets – including gas, electricity, telephones and financial services – levels of consumer switching in 2005 were up 52 per cent on five years before. Similarly, where consumers can make informed choices, the service that business provides will often extend well beyond their statutory obligations. For example, in the retail clothing market, shops often allow customers to return goods even where there is no legal requirement to provide a refund. In these circumstances, there is scope to employ a range of lighter-touch, non-legislative alternatives to regulation, while maintaining policy outcomes:

- **information and guidance.** In markets where there is a problem of insufficient or asymmetric information, rather than regulate, the best answer may be to tackle the problem head on. The provision of information can be effective in changing behaviour without recourse to regulation or combined with light-touch co- or self-regulation. Empowering consumers by providing greater access to the appropriate information should be a central consideration in all EU measures; and
- **co-or self-regulation** can offer a light-touch means of protecting consumers while minimising burdens on business, for example, in the form of EU-wide codes of practice. This approach is well suited to established industries or markets where there is a reasonable level of consumer awareness and stakeholder representation at EU level. The advertising sector operates well with this model in many EU Member States and at EU level, providing flexibility to social and technological change and reflecting the cultural, legal and commercial diversity of the EU.

There will still be a need for targeted, focussed legislation and regulation in some sectors to promote further market opening, particularly in the network industries. However, globalisation, rapid technological change and an enlarged EU put a greater premium on flexibility, and a need for greater understanding about how the EU regulatory regime interacts with the rest of the world. The UK therefore believes a wider range of additional regulatory approaches should be also employed, for example:

- **mutual recognition** enables businesses to produce goods and services in accordance with the standards that apply in their own country and have the right to sell those goods and services in other Member States. It covers around a quarter of goods traded within the EU. While respecting the right of Member States to remove products where there is a genuine threat to public safety, the Government would like to see the operation of mutual recognition strengthened to make it harder for Member States to restrict trade by imposing additional requirements that go beyond those necessary under EU law and to give businesses a greater right of redress;

- the **New Approach** for goods trade was designed to address the problem of increasing EU diversity, which complicates the process of agreeing complex directives and common standards. New Approach directives set out essential requirements for products to be marketed in the EU, but give companies flexibility in the way they meet them, allowing compliance to be demonstrated through adherence to voluntary standards; and
- under the Lamfalussy arrangements, a series of so-called “Level-II Committees” have delegated powers to establish and amend secondary EU financial services legislation, to take account of changing market developments. Overall the Government believes that the introduction of these arrangements, first to securities, and subsequently to banking and insurance and pensions has been successful. They have improved the quality of European financial services legislation by increasing the transparency of the legislative process – through more open and earlier consultation with market participants – and are helping to drive more effective co-operation between national supervisors and the convergence of supervisory practices.

Substantial progress already 3.5 Following committed action by the Commission significant progress has been made in recent years in embedding better regulation principles into EU policy-making:

- this year the Commission will finish its screening of all pending legislative proposals. It has already withdrawn over 60 and plans to withdraw a further 10 proposals in 2007;
- a commitment was made in 2003 to produce impact assessments for all new significant legislative proposals. This commitment was extended in 2006 to also include simplification proposals. More than 160 assessments have already been produced and a new Impact Assessment Board has been proposed to systematically review their quality;
- the Commission has begun to focus on consolidating and simplifying the acquis rather than producing new legislation and has begun reviewing overlapping and complex legislation; and
- the Commission has announced its intention to measure administrative costs across the EU and proposed that the Spring European Council endorse a 25 per cent target reduction of administrative burdens by 2012, which the UK strongly supports.

Scope for further reform 3.6 The Government believes that the process of embedding better regulation principles must continue. While progress has been made, there is still more to be done in order to make better regulation a reality within the EU. The Government would like to see:

- **greater use of a risk-based approach to regulation** with greater consideration given to the use of alternatives to regulation. Where regulation is deemed necessary, the Commission should formulate proposals to enable risk-based enforcement by Member States;

- **improvement in the quality of impact assessments** to ensure they reflect the full impact of proposals on businesses and consumers, as far as possible in quantitative terms (for example by using the EU Standard Cost Model to determine administrative burdens); ensuring all options are actively considered before a decision is taken, enabling stakeholders to contribute from the earliest possible stage. To this end, Green Papers should contain an initial assessment of the market failure to be addressed; and explore the potential for negative impacts on the Single Market and competitiveness, in line with current guidelines;
- **the use of impact assessments for all proposals, across all EU institutions and at all levels.** This should include explicit assessment of the impact of any substantive amendments to Commission proposals by Parliament or Council;
- **improvements to the process of consultation by aiming for a typical consultation period to be at least twelve weeks** to reflect the greater reach and broader group of stakeholders affected by EU-level measures. In addition, consultation should involve more active and targeted engagement of a wider range of stakeholders to ensure the views of hard-to-reach groups, such as SMEs, are properly considered; and
- **greater use of the Competitiveness Group of Commissioners to send back poorly designed Single Market legislation** to the Commission Services if better regulation principles have not been fully applied or the case for action is not clearly analysed. In time, this body could be strengthened and given a clearer remit similar to the Panel for Regulatory Accountability in the UK.³⁰

**Ex-post
assessment to
inform best
practice**

3.7 The Government would like to see the Commission set out a framework for the consistent post-implementation review of the effectiveness of legislation. Using the impact assessment as the starting point, the review should establish a baseline and include success criteria against which the policy will be assessed. Lessons can be learned from Member States' experience in undertaking post-implementation reviews. For example, the UK's approach is to:

- review a policy change after specified number of years, depending on the policy;
- think about criteria for modifying the policy if it does not meet its initial objectives;
- consider the scope for simplification or deregulation;
- consult stakeholders for their views on the implementation of policy and whether there have been any unintended consequences; and
- consider the use of sunset clauses to ensure legislation is reviewed and remains fit for purpose.

³⁰ In the UK, all regulatory proposals likely to impose a major new burden on business require clearance from the Panel for Regulatory Accountability, chaired by the Prime Minister. The Panel's consideration is based on a thorough impact assessment on the proposal. PRA must approve every proposal costing at least £20 million.

COMPETITION POLICY

Competition works for business and consumers

3.8 Effective competition policy must be placed at the heart of the new Single Market strategy. By encouraging market entry and rewarding efficiency, competition is key to stimulating the higher levels of market dynamism and productivity the EU needs in order to remain competitive, while at the same time delivering choice and value for consumers.

3.9 In recent years the Commission has been making significant progress in adopting a more proactive approach to exercising its competition powers. The modernisation of EU competition policy³¹ has allowed the Commission to focus attention on more important mergers and anti-competitive cartel cases with clear Single Market impacts. Faced with a number of challenges over the past 12 months the Commission has led a robust defence of Single Market rules, taking tough action where they have been breached. The first two sector inquiries into the energy and financial services sectors have been an important step towards a better understanding of the functioning of those markets.

A further strengthening of the EU competition regime

3.10 The Government believes that the Commission must continue to take a robust stance in pushing forward a pro-active competition policy to improve the Single Market. In addition, the Single Market review offers an opportunity to reinforce the central role of competition policy in strengthening the Single Market, by promoting:

- **greater use of market investigations** – as part of its fundamental review of the Single Market, the Commission should commit to embedding sector inquiries into the EU competition regime and to undertaking further inquiries into priority sectors, where competition is lacking;
- **a greater role for private actions** against anti-competitive behaviour. Private actions have an important role to play in the competition framework by providing real redress for those affected by anti-competitive behaviour and dissuading future infringements. The Commission, working with Member States should continue to examine how private damages actions for breaches of EU anti-trust rules could play a complementary role to public sector enforcement. In doing so the Commission should continue with the aim set out in its Green Paper of fostering a ‘competition culture, not a litigation culture’, empowering individual citizens and business and thereby strengthening the Single Market; and
- **an “economic approach” to tackling state aid.** The Government believes that further reform to state aid rules and their enforcement should be pursued within an overall framework in which aid which has a minimal impact on competition can be swiftly agreed, whilst tough action is taken against subsidies that seriously harm competition.

Reform in Member States

3.11 Alongside effective EU level enforcement of competition law, Member States have a key role to play in supervising national markets. The Government believes that Member States should commit themselves to:

³¹ Council Regulation 1/2003 of 14 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty

- **greater independence for national competition authorities.** Experience over the past year, suggests that all too often, decisions taken at a national level are subject to undue political interference. In order to promote greater independence, Member States should agree to regular independent evaluation, which could be undertaken by the Commission, to benchmark national competition regimes.

Improved decision making

3.12 More generally, a targeted and prioritised approach to the Single Market must also be supported by greater efficiency and coordination in decision-making:

- **sharing across the Commission the expertise gained from the sector inquiries** to promote a more analytical, evidence-based approach. The close working relationships established between DGs Competition, Transport and Energy and Internal Market and Services in the recent sector inquiries should be used as a model for other areas; and
- **there is a need for better coordination across the whole decision-making process**, through improved efficiency and cooperation across the Commission, Council and European Parliament, in order to support a more focused, prioritised and coherent approach to Single Market policy.

IMPROVING IMPLEMENTATION AND ENFORCEMENT

Ensuring a level playing field

3.13 Recently there has been greater recognition of the importance of ensuring that existing rules and regulations are transposed correctly into national laws and that these rules are systematically enforced. Effective implementation and enforcement are essential to realising the benefits of the Single Market and building awareness and credibility amongst citizens and businesses.

3.14 Transposition and implementation of Single Market legislation continues to be slow. The Commission “scoreboard”³² of July 2006 shows that across the EU25, there are over 1,650 instances where a Member State has not fully transposed a Directive into national law. Although improvement is expected in the latest edition of the scoreboard, Member States must continue to make concerted efforts to transpose Directives in time. In addition, the Commission are pursuing 1,163 infraction cases against Member States to investigate potential breaches of Single Market legislation³³.

3.15 Working with Member States, the Commission is already examining the application and enforcement of Community law across the Union. The aim is to identify what works, what does not, and to understand why problems arise, with a view to spreading best practice. Member States face common problems, and by working together they will be able to share ideas and best practice, and so raise the standard of implementation and enforcement across the EU. For example, the establishment of a group to discuss common implementation of the Unfair Commercial Practices Directive proved to be a valuable forum for sharing understanding of the complexities and ambiguities in the Directive. It is reinforcing awareness of the need to implement the Directive, which the UK will be doing, consistently and on time. Similarly, the Commission has already begun to put in place arrangements to coordinate implementation of the Services Directive. The wider use of implementation groups could prove useful in tying down practical issues around implementation and enforcement of other EU rules.

³² Internal market scoreboard, Edition 15, July 2006.

³³ Figures taken from July 2006 Internal Market scoreboard.

3.16 The EU Consumer Protection Co-operation Regulation is another example of an important step forward in protecting European citizens by enforcing consumer protection laws. It establishes a network of public authorities with powers to cooperate more effectively in order to tackle cross-border scams and practices that are detrimental to the collective interests of consumers. The Government has supported this initiative and would like to see the Commission ensuring that all Member States are using this enforcement network to crack down on rogue traders who operate in their own country.

3.17 The Government welcomes the practical way in which the Commission is addressing this issue and looks forward to working with it and other Member States to achieve progress. However, it believes that a thorough review of implementation and enforcement is required and that this should consider the following:

- **a new system for prioritising investigations into breaches of EU law** based on economic impact, concentrating resources where there are major impediments to competition. The Commission should consult on proposals for a new infringement policy that sets out transparent criteria for prioritising cases. Evidence gathered from sector inquiries, SOLVIT centres, impact assessments and competition cases will all be an important part of this process;
- **options for improving access to courts.** Ultimately, those who believe their Single Market rights have been infringed have the right to take action in the courts. However, court action can be time-consuming and costly and so is less accessible for SMEs and private individuals. Consideration should be given to how the system of legal redress can be opened up to these groups as part of the Commission's work on private actions; and
- **improving and expanding informal problem solving techniques such as SOLVIT** which provide a low-cost, accessible means of redress that is well-suited to the needs of citizens, consumers and small businesses. The UK would welcome the extension and development of such techniques, drawing on SOLVIT as an example of good practice (see Box 3.2 for more details).

Box 3.2: Improving the operation of SOLVIT

SOLVIT is a network of problem-solving bodies, with a centre in every Member State, which aims to resolve disputes that arise for individual citizens and businesses from the misapplication of Single Market law. Anyone who encounters such a problem – for example, a business that is wrongly told that it cannot sell its products in another EU country – may present a complaint to the SOLVIT centre in his or her own country. That SOLVIT centre will then work with its counterpart in the relevant country to try to resolve the issue. The service is free and quick – SOLVIT Centres have a ten-week deadline for proposing solutions to complaints.

SOLVIT is widely recognised as a very effective tool for tackling Single Market problems, and its service is proving popular. In 2005, the SOLVIT network handled 469 official cases and a much larger number of cases were dealt with outside of formal procedures. Of these, 78 per cent were resolved successfully and the average length of time taken to deal with a case was 65 days.

The Commission plays an active role in facilitating cooperation between SOLVIT centres, and the Government supports the Commission in trying to drive forward improvements in these areas. In particular, the UK calls for:

- greater sharing of best practice between Member States, including in efforts to promote the use of SOLVIT;
- improvements to the interface between SOLVIT and other enforcement mechanisms, for example the Citizens Signpost Service;
- the Commission to consider whether information acquired in SOLVIT cases can be more easily transferred to the Commission in order to make it easier for individuals to turn SOLVIT complaints into formal complaints; and
- in cases where there is disagreement between countries over the application of EU law, the Commission to consider the potential for unresolved cases to be transferred directly for resolution as formal complaints.

THE ROLE OF MEMBER STATES

3.18 This Chapter has focused on Community level policies, in particular regulation and competition policy, which provide the framework that underpins the Single Market programme. However, if the EU is to achieve a truly dynamic and competitive Single Market, improved Community level policy must be accompanied by necessary structural reform undertaken at a national level. Single Market policies such as the Services Directive, will ultimately deliver greater economic benefits if they are accompanied by national measures, for example to improve the functioning of labour markets.

Box 3.3: The Lisbon Strategy for Jobs and Growth

At the Lisbon European Council in March 2000 Europe's leaders committed themselves to a ten-year programme of economic reform designed to make the Union the most competitive and dynamic knowledge-based economy in the world, with more and better jobs and greater social cohesion. In March 2005, following a comprehensive mid-term review, the European Council agreed to relaunch the Lisbon Strategy to focus more sharply on the key priorities of jobs and growth. A new package of Integrated Guidelines was subsequently endorsed in June 2005 for the period 2005-08, which identified the key challenges facing the EU as a whole. These new arrangements for governance of the Lisbon Strategy also gave Member States the opportunity to identify their own reform priorities and share best practice through the publication of National Reform Programmes (NRPs).

The Lisbon Strategy covers a wide range of product, labour and capital market reforms, all of which can contribute to the effective functioning of the Single Market. Following publication of the first set of NRPs, the Spring 2006 European Council concluded that reform should focus on four specific priority areas: investing more in knowledge and innovation; unlocking business potential; increasing employment opportunities; and defining an energy policy for Europe.

Greater cooperation **3.19** Although the challenges set out in Chapter 1 represent common challenges for Europe's economies, distinct national preferences and institutional arrangements in different countries argue against uniform solutions in the area of structural reform. Supply side policies, for example those relating to labour markets, taxation and planning, quite rightly are designed and implemented at a national level. That said, successful policies often share common features, providing scope for sharing national experience and best practice to the benefit of all Member States. In line with the principle of subsidiarity, greater cooperation on structural reform under the Lisbon Agenda should therefore be encouraged, but as with Community level policy, this must be prioritised.

3.20 In the field of taxation, for example, the EU has already agreed and implemented the necessary tax measures to help create an effective and robust Single Market. Looking ahead, in an increasingly global economy, no country will be able to set its tax policy in isolation from other countries and so cooperation between countries in the EU and elsewhere will be important in ensuring that national tax systems can coexist effectively. This will involve continuously working together to drive down costs to business, improve transparency, exchange information and tackle fraud. The key is to preserve national flexibility, while strengthening the effective cooperation between Member States, rather than creating rigid structures incapable of adapting to the evolving demands of globalisation.

3.21 In this context, Member States could be invited to report more explicitly on the actions they have taken in support of Single Market priorities in their Lisbon National Reform Programmes, including on action to:

- improve the framework conditions for innovation and entrepreneurship including, through increasing competition, stimulating private R&D, education and training and improving the access to capital, especially for SMEs;
- take forward the better regulation agenda, for example by screening new regulatory proposals and simplifying existing regulations; and

- reform labour markets by introducing active labour market policies which protect employability rather than specific jobs.

AN OUTWARD LOOKING EUROPE

3.22 In light of the increasingly global nature of economic activity a more outward-looking relationship with the rest of the world is a vital aspect of Europe's internal reform agenda. Where the EU takes forward regulatory measures such as the development of new standards, it is important to ensure that those standards are designed so that they are consistent with the aim of promoting international competitiveness and do not erect new barriers to global trade. The goal should be to create a Single Market which is flexible enough to take advantage of regulatory developments across the globe.

Box 3.3: Intellectual Property Rights.

As the Lisbon Agenda makes clear, the EU must focus on research and innovation in order to meet the challenge of globalisation. Yet based on 16 indicators drawn up by the Commission, the EU lags far behind the US and Japan in terms of innovation. A more efficient patent regime would help the EU turn more intellectual capital into business capital and help drive innovation, and to compete more effectively with the rest of the world. The cost of applying for and maintaining a patent in seven European countries is between three and five times higher than the comparable costs of patenting in Japan and the US, mainly due to translation costs. A more modern system could save SMEs in particular hundreds of millions of euros.

The UK believes that to allow the EU to develop its patent regime there is a need for targeted action at the Community level, either by taking forward a Community instrument, or by ensuring that any non-EC instrument is fully compatible with EU law and that it should be compatible with any future Community instrument in this area, such as a possible Community patent. All options for improving European patents should be considered, whether Community proposals or non-EC proposals which are compatible with EU law, according to whichever is most likely to deliver benefits both in the short and long term, including:

- **push ahead with the Community Patent.** This would enable the granting of single patents covering the whole EU, to be enforced before a single court. Centralisation, and reduced translation requirements would result in cost savings;
- **ratify the London Agreement.** This would mean that only certain parts of a patent (i.e. the patent claims) would have to be translated into the languages of the countries for which the patent was being applied, which would almost halve translation costs and save patent applicants across the EU an estimated €200 million; and
- **approve the European Patent Litigation Agreement (EPLA).** This would result in a single patent court system and provide increased certainty for businesses owning or using patented technology and could result in a reduction of litigation costs of up to 60 per cent.

External openness to trade **3.23** In this context the EU has a clear role to play externally to improve the conditions for global trade. Gains from trade liberalisation will be greatest if trade barriers are reduced in a multilateral context. This is why the Government is emphasizing the importance of concluding negotiations in the Doha Round of world trade talks. This will require bold leadership and a new willingness from WTO members, and the EU has a key role to play in delivering a world trading system that is fair as well as free.

3.24 In addition to tackling trade barriers such as tariffs, quotas and restrictive standards, behind-the-border barriers, which arise from differences in regulatory approaches and standards, should also be dismantled. The EU and the US support working closely together to overcome these barriers and to ensure new barriers are not being created. The transatlantic economic relationship is the largest bilateral trade and investment relationship in the world, accounting for 14 million jobs on both sides of the Atlantic. Removing remaining barriers could, according to the OECD, bring permanent increases in per capita GDP of up to 3.5 per cent. The Government believes that identifying further priority areas for regulatory cooperation with the US and other partners is an important part of maximizing the gains from the Single Market.

4

PUTTING THE STRATEGY INTO ACTION

INTRODUCTION

4.1 The Government is calling for a new approach to the Single Market that is more tailored, proportionate and flexible and deploys a wider range of policy tools. This final chapter provides an illustration of sectors where the Government believes that these principles can be translated into practical and concrete action on the ground and provides recommendations for action by the European Institutions and Member States.

4.2 Three of the four sectors that we have highlighted here - Telecommunications, Energy and Postal Services - are part of Europe's under-reformed network industries. With over €75 billion of potential extra economic benefits possible from further market-opening, it is clear that action in these areas is crucial to deliver a more effective Single Market. However the structure of these industries, often dominated by former state-owned monopolies, highlights the need for a flexible Single Market policy with a wide range of policy tools. Where the dominance of vertically-integrated companies, such as in the Energy sector, can not be tackled by competition policy and other non-legislative measures alone, there is a case for additional Community-level regulatory action. However, in the financial services Sector, where further reform is necessary to improve access to capital and lower prices for business and consumers, but where the markets are more integrated, a more subtle approach based on greater supervisory cooperation, the use of non-legislative policy tools and consistent implementation and enforcement of EU legislation is required.

FINANCIAL SERVICES

Clear about purpose **4.3** An efficient and competitive market in financial services across the EU brings considerable benefits for the wider economy as a whole, particularly for small businesses and start-ups in new and high growth industries in need of capital financing. Developing a Single Market in financial services therefore lies at the heart of EU Member States' commitment to economic reform in Europe.

Focus on priorities **4.4** The benefits of an efficient, integrated financial services market are significant. It would:

- provide a framework that underpins the competitiveness of EU-based firms and markets, in the face of increasing global consolidation;
- reduce the cost of accessing capital and improve the allocation of capital across the EU, thereby acting as a driver for innovation; and
- give firms increased opportunities to access markets in other Member States and to carry out business effectively on a cross-border basis, thereby providing consumers with access to a wider range of more competitively priced products.

Act at the right level **4.5** For the last seven years, the EU Financial Services Action Plan (FSAP) has been the legislative framework for developing the Single Market in financial services. With the key FSAP measures still to be implemented, it is too early to judge the success of the FSAP. Nevertheless, the Government welcomes the ex-post economic evaluation of the FSAP that the European Commission has announced.

4.6 With the publication of “the EU Financial Services Action Plan: A new strategic approach”³⁴ the UK authorities argued that EU legislation should not be seen as the default tool of policy makers, and that the Commission needed to become more cautious about bringing forward legislation on financial services. Member States have a responsibility to implement legislation in a timely and proportionate manner, and the Commission must ensure this is carried out effectively and consistently across the European Union. Supervisors must continue to cooperate under the Lamfalussy arrangements to bring about a convergence of supervisory practices.

Use the right tools

4.7 Going forward, the UK Authorities (HM Treasury, Bank of England and FSA) have set out five priorities that they believe represent a modern and flexible approach and should guide further attempts to integrate the EU’s financial markets. They are:

- **better implementation and enforcement of EU measures affecting the financial services sector.** At the EU level that means ensuring legislation is implemented consistently, proportionately and on a timely basis throughout the European Union. This is essential if the benefits of the FSAP are to be realised. 2007 will be a major year for implementation with deadlines for key directives like the Capital Requirements Directive and Markets in Financial Instruments Directive being reached;
- **greater use of alternatives to EU regulation.** In general, EU legislation should be a last resort. Alternative approaches to policy-making, such as market initiatives or more use of EU competition policy, should always be considered first. The Government welcomes the financial services sectoral competition investigations, and the market-led codes of practice, for example as agreed by the Commission and industry on Clearing and Settlement;
- **better regulation.** In specific cases, EU legislation could be the most appropriate option to correct for a specific market or regulatory failure. Where new EU legislation is being considered, a proper assessment of the problem and costs and benefits should be undertaken, competitiveness testing carried out, and financial market participants should be fully consulted;
- **enhancing the operation of the Lamfalussy arrangements.** These new regulatory arrangements are now in place to supervise financial services across the EU. They have been shown to work for securities markets and been successfully extended to banking and insurance and pensions. The Government believes that further practical developments like the streamlining of reporting requirements, the delegation of tasks between supervisors and establishing dispute resolution mechanisms will further enhance the practical working of these supervisory arrangements; and
- **recognising the global nature of financial services.** A global perspective is needed when considering the impact of EU financial services regulation on the competitiveness of EU-based firms and financial centres, and international action will sometimes be needed to tackle global issues. The Government welcomes plans to deepen the already successful EU-US dialogue, and to further co-operation with other third countries including Japan, China and Russia.

³⁴ After the EU Financial Services Action Plan: a new strategic approach, HM Treasury, FSA and Bank of England, May 2004.

TELECOMMUNICATIONS

Clear about purpose 4.8 Becoming the leading knowledge-based economy in the world, as the EU aspired to at Lisbon, is a considerable task and one in which the communications industry will play a pivotal role. Further liberalisation of telecommunications would lead to significant price savings and greater choice for consumers and businesses as well as stimulating investment and innovation.

Focus on priorities 4.9 Progressive liberalisation in the telecoms sector throughout the 1990s has led to cheaper prices and more choice for EU consumers, whilst early EU action in the field of mobile telephony has resulted in high take-up across the EU. Despite this success, there are still further gains to be achieved and further liberalisation could lead to even greater price savings and choice for consumers and businesses. A recent estimate suggests that further liberalisation could reduce prices by around 11 per cent across the EU15³⁵ and increase the overall size of the market by 4 per cent and cross-border trade by 29 per cent.

Act at the right level 4.10 In the telecommunications sector, a substantial amount of Community legislation forming the framework for a Single Market is already in place, and ensuring the full implementation of existing measures must therefore be a priority. However, a combination of national and Community approaches will be necessary to deliver the remaining benefits of greater integration. Strong national regulatory authorities are essential to ensure that Member States can react quickly to local problems and reflect local market conditions. However, in certain circumstances, for example in the case of spectrum allocation in certain services to allow network access to competitors, there is a case for EU-level action to ensure a coherent regime.

Use the right tools 4.11 The Government believes there are a number of steps that should be taken to ensure a better functioning European telecoms market and the Commission should consider these in developing its new Electronic Communications Markets Regulatory Framework for 2007:

- action to encourage greater independence of national regulatory authorities, giving them greater responsibilities for ensuring competition;
- systematic monitoring of the application of remedies by national regulatory authorities to ensure they act in support of the Single Market;
- the implementation and enforcement of the obligation on Member States to ensure there are no barriers to cross-border provision of services through constraints such as standards, physical presence or partnership with local entities; and
- a flexible, market-led community approach to spectrum allocation as the preferred means of achieving innovative pan-EU services.

³⁵ Copenhagen Economics, The Potential Gains from full market opening across in Network Industries, November 2006

ENERGY – GAS AND ELECTRICITY

Clear about purpose 4.12 A fully liberalised European gas and electricity market will lead to a more efficient use of energy and enable Europe to respond more effectively to the challenges of climate change and energy security, whilst providing consumers with more competitive pricing and greater choice. Not only is energy an important sector in its own right, its efficient operation is also essential to the wider economy, and further liberalisation could help deliver significant economic benefits, including contributing to the effectiveness of the EU Emissions Trading Scheme and delivering cost-effective reductions to Europe's carbon emissions.

Focus on priorities 4.13 In the EU, the energy industry (gas and electricity) accounts for 2.1 per cent of total value added.³⁶ Full market opening could increase cross-border trade in electricity by 31 per cent³⁷ and reduce prices in the EU15 by up to 13 per cent³⁸. Total savings in the EU25 could be of the order of tens of billions of euros.³⁹

4.14 Despite the clear gains that have been achieved as a result of liberalisation of the energy sector since the first Electricity and Gas Directives in 1996 and 1998, there is still work to be done to achieve a more effective Single Market in energy. The Commission's energy sector inquiry into competition in the electricity and gas markets has found evidence of persistent problems in Europe's energy markets including a high degree of market concentration, lack of transparency, opaque mechanisms for setting prices, a prevalence of grandfathering rights, lack of market integration and ineffective unbundling.⁴⁰ This is a good example of the use of competition policy as tool for setting priorities for further action.

Act at the right level 4.15 There are roles for the Commission, Member States and their national regulators. The Commission should build on the excellent work that has been undertaken in its sector inquiry, exercising its competition powers where appropriate to combat structural obstacles to market integration. Enforcement action against those Member States that fail to meet their obligations under the terms of the liberalisation package will be crucial.

4.16 National regulators can also play a key role. Regulatory cooperation requires action to level up regulators' powers and make them truly independent, while a common approach on regulatory issues that affect cross-border trade is a priority.

Use the right tools 4.17 The Government supports the proposals in the Commission's Strategic Energy Review to strengthen the development of the Single Market in energy, using a variety of policy tools. Key areas for action supported by the Government are:

³⁶ Copenhagen Economics, The Potential Gains from full market opening across in Network Industries, December 2006

³⁷ *ibid*

³⁸ *ibid*

³⁹ Total EU electricity consumption in 2005 was 2,936.5TWh according to Eurostat (table 3.1)

<http://epp.eurostat.ec.europa.eu/cache/ITYOFFUB/KS-BX-06-010/EN/KS-BX-06-010-3A.PDF>

⁴⁰ Commission, Energy Sector Inquiry, Draft Preliminary Report, March 2006 and Euractiv, Liberalisation of EU Electricity and Gas Markets, October 2006

- a common approach to regulatory issues through greater cooperation. This will depend crucially on stronger and more independent national regulatory authorities. A flexible regulatory framework that provides investors in cross-border infrastructure projects with sufficient regulatory certainty and coherence will require greater regulatory coordination and consistency coupled with a robust process for reaching agreement on cross-border issues;
- greater transparency, through the provision of information, to inform investment decisions by market participants; and
- the effective unbundling of network operators. The Commission has found that unbundling requirements of the liberalisation package have not been fully implemented in all Member States in a manner which guarantees independent network operation. The Government therefore welcomes the Commission's proposals for more effective unbundling through ownership unbundling.

POSTAL SERVICES

Clear about purpose

4.18 The postal sector is a key part of the EU's economic infrastructure and as with other network industries, efficiency savings achieved in this sector can be passed directly on to businesses elsewhere in the economy, helping to maintain the competitiveness of EU firms. Developments in technology have led to a rise in the importance of business-driven mail, which now accounts for 87.5 per cent of letters sent in the EU. In many areas, technology has enhanced the importance of a strong postal infrastructure, especially for industries such as e-commerce, publishing, and mail order. Further market opening in the postal sector would help improve services, widen choice and reduce costs.

Focus on priorities

4.19 The postal industry has a turnover of some €90 billion a year, contributing approximately 1 per cent of EU25 GDP⁴¹ and employing some 1.71 million, while some 5 million people are employed in directly dependent professions. In the wider economy, postal services are of particular importance to the service sector, which accounts for around two thirds of postal services consumed.⁴²

4.20 Despite the adoption of the 2002 Postal Directive, there are a limited number of market entrants and the sector continues to be dominated by large national incumbents. In Sweden, postal liberalisation has led to a 30 per cent price fall since the beginning of the 1990s,⁴³ and it is estimated that full market opening could lead to a 21 per cent reduction in prices across the EU15.⁴⁴

Act at the right level

4.21 For a genuine EU-wide market in postal services, Member States must fulfil their commitments to open domestic markets to competition by the 2009. This must be matched by effective enforcement by the Commission.

Use the right tools

4.22 The current Postal Directive is due to expire in 2008 and the Commission has put forward a proposal to open EU postal markets fully to competition by 2009. Agreement of this new postal Directive should be the top priority for the EU in this sector to achieve full market opening.

⁴¹ Commission, FAQs on EU Postal Policy ; Copenhagen Economics, The Potential Gains from full market opening across in Network Industries, November 2006

⁴² Copenhagen Economics, Market Opening in Network Industries, September 2005

⁴³ Swedish Industry Ministry, 'Swedish Experience of a liberalised postal market', June 2006

⁴⁴ Copenhagen Economics, The Potential Gains from full market opening across in Network Industries, November 2006

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