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THREE YEARS TO THE COMPLETION OF THE INTERNAL MARKET : A FIRST ASSESSMENT OF ITS IMPACT

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ENCOURAGING PROGRESS HAS BEEN MADE

The European Council in Strasbourg stated that "the internal market is beginning to assume its final shape, and its positive effects are being felt in all sectors of economic life in general, the timetable which was set is being adhered to".

The encouraging picture painted by this statement is prompted by the fact that some 60% of the decisions required to ensure completion of the internal market have been adopted; and by the economic and political progress made in the Community since 1984 as highlighted in the address to Parliament on the Commission's programme. Production has risen by 20% and 8.5 million new jobs have been created with industry rediscovering its drive and vigour both at home and abroad.

The Community is now showing a regained capacity for decision-making and greater determination to attain the objectives it has set itself. We cannot, however, claim that problems do not remain - both institutional and political - to be overcome.

I. A RENEWED DYNAMISM IN ANTICIPATION OF 1992

A frontier-free area is part of the Community's long-term political objectives, but it is also intended to provide industry with an environment in which it can become more competitive and meet the global competition of an economy which is becoming more international. The success of the 1992 Programme will be determined by the response from industry.

1. Corporate dynamism

One of the cornerstones of the Internal Market Programme is its credibility with industry since the potential benefits expected to arise from it will depend largely on a change in company strategies. The battle for credibility has been won with the private sector now beginning to gear up for the new environment expected after 1992. The nature of the changes being made is confirmed by the surveys undertaken by the Commission in mid-1989:

(i) Companies expect increased competition on their home markets and an expansion in exports to other Member States. These expectations amplify the trend already observed towards a significant rise in intra-Community trade. Its share of Community exports rose from 55% in 1982 to 62% in 1988 in a period of economic growth, compared with a downward trend in 1980 and

1981 and a constant share of 61% from 1973 to 1979.

(ii) Companies are planning to invest more at home, in other Member States and even outside the Community in order to meet this increase in demand in an enlarged market. This additional investment will be channelled towards Portugal and Spain among the Community's less developed Member States, helping them to catch up and furthering the process of convergence. Recent data show that with an annual GFCF growth rate of over 10%, Portugal and Spain are well above the Community average of 8.3% in 1988 and 6.9% in 1989.

(iii) Companies have taken decisions on internal resource allocation and adopted strategies of external acquisition and cooperation agreements in response to the Directives introduced. The total number of mergers or takeovers undertaken by the top 1 000 Community companies has risen from 227 in 1985/86 to 383 in 1987/88 and 492 in 1988/89. The number of transfrontier acquisitions by Community companies stood at 1 300 in 1989 amounting to ECU 45 000 million of which 60% was disbursed by Community companies. The number of inter-company joint ventures and cooperation agreements on R&D has also increased. These should promote more rapid dissemination of technology.

(iv) Firms in the United States, Japan and the EFTA countries are showing greater interest in the Community market with a marked increase in direct investment by these countries. By way of example, total United States investment in the Community has grown from USD 83.9 Billion in 1985 to USD 126.5 in 1988, which represents an increase of over 50% over this period; while the flow of Japanese direct investment has risen from USD 2 000 million in 1985 to USD 8 300 million in 1988 and over 500 Japanese companies have set up in the Community. What is even more interesting is the fact that Community investment abroad, particularly in the United States, exceeds foreign investment in the Community, a clear sign of Community industry's desire to operate more internationally.

2. More benefits than expected?

2.1 A large number of analyses have been made of the potential benefits of the internal market. The first of these was the report which the Commission had carried out into the cost of non-Europe - which estimates the medium-term macroeconomic effect of market integration to be an increase in GDP of 4.5% to 7%, a drop in consumer prices of 4.5% to 6.1% and an extra 1.8 to 5 million new jobs - which provoked reactions in various circles (industry, trade union and academics) both inside and outside the Community.

This was followed by a flow of commentaries and more detailed analyses, at times critical, owing to the complex nature of the analyses made and the underlying political issues at stake.

In this, the third phase, there have been a number of lengthier works published, often by research institutes. They have sought to refine the quantification methodology used by the Commission with the aid of their own macroeconomic models and have looked at new aspects such as the regional and sectoral impact of 1992. For its part, the Commission has undertaken a more detailed analysis of national and sectoral aspects to learn more about the structural changes which will be prompted by 1992.

2.2 Generally speaking, the Commission's macroeconomic assessment holds true, even though alternative estimates are sometimes lower, and also higher, than those of the Commission. Studies which point to more modest benefits cast doubt on the whole political feasibility of the 1992 Programme. Obviously this is not an assumption made by the Commission which was concerned with assessing the potential impact of <u>all</u> the White Paper's measures. Differences in interpretation, e.g. on the role played by economies of scale or the benefits of mergers, also lie at the root of such studies.

There are, on the other hand, other studies which consider the Commission's estimates to be too cautious as they do not take account of some of the dynamic effects arising from completion of the internal market. The greater efficiency which will come from the abolition of non-tariff barriers and increased competition should stimulate investment and thereby lead to an increase in capital, all of which will promote economic growth. It is feasible to assume that the improvement in supply will have a lasting effect on growth.

2.3 The internal market will undoubtedly serve as a catalyst for growth by improving the conditions of Community supply, and the market's response has so far been positive. The introduction of major innovations (microprocessors, biotechnology, computer-assisted design) heralds a new technological revolution which may well stimulate economic growth. The dynamic effects of 1992 cannot be over-estimated. Economic recovery in the Community is due partly to the present favourable economic climate and the redirection of economic policy in the early 1980s, which have helped to make investment cost-effective, and to the investment drive following the low level of investment of the 1970s.

The catalytic effect produced by the positive expectations of companies is a clear sign that the credibility of the 1992 Programme must be maintained. Incorporation into national legislation and implementation of Council Decisions are crucial and it is up to the Commission to oversee this incorporation.

II. NECESSARY ADJUSTMENTS

1. The present situation

(a) At national level

The reaction and attitude of the 12 Member States to the changes which will be required to complete the internal market are largely positive. The public authorities are taking steps to ensure the internal market will be completed in areas ranging from budget to regional planning and taxation. In addition, a number of countries have already introduced measures into their national legislation which are still under discussion at Community level.

The structural pattern in the less developed Member States is far from uniform. Trade between Greece and, to a lesser extent, Portugal and their Community partners is interindustrial based mainly on traditional industries. Spain's industrial fabric, on the other hand, has developed in sectoral areas with a higher technological content.

This phenomenon is even more marked in Ireland which, owing to the presence of multinationals, is well placed in high technology areas such as information technology and telecommunications.

Studies undertaken by the Commission show that industry and, in some cases, the public authorities of these countries are anticipating the impact of 1992. Dynamic changes have also been observed in some of these countries. Investment has been particularly marked in Spain and Portugal with the flow of foreign investment to these two countries increasing substantially over the last few years. The process of restructuring and modernization of Portuguese and Spanish industry has been helped along not only by this foreign investment but also by the cooperation agreements concluded between national and foreign companies. This has not been the case in Greece where investment in manufacturing industry has tended to decline and flows of foreign investment have remained around the same level.

(b) At regional level

The impact of 1992 on regions is unlikely to be spread evenly over the regions of the Community. The result of studies available suggest that considerable restructuring is taking place and will continue in the medium term. This will probably be particularly true for some of the weakest regions of the Community where protection from competition was more widespread and seems to have delayed modernisation in some sectors (Greece, Spain and Portugal). However, the potential benefit for these regions of 1992 is also considerable. Consumers in these regions will benefit in terms of prices, quality and range of goods and services available.

(c) At sectoral level

The most obvious impact of the internal market is at sectoral level. The White Paper's legislative programme more directly concerns certain industrial sectors - e.g. through the opening up of public procurement and the elimination of technical barriers - and services, in particular transport, banks and insurance companies. Hence the reasons why the changes prompted by 1992 are so evident.

The Commission, and subsequently the Member States, have identified the industrial sectors most directly affected by the internal market. There are 40 out of 120 sectors, accounting for some 50% of value added by industry which will probably be most directly concerned. However, although the internal market has a major impact on sectors which depend traditionally on public aid (telecommunications, electrical equipment, energy and railway equipment, pharmaceutical products), some sectors may also be affected by the opening up of the Community market and increased competition from non-Community countries (e.g. textiles, footwear, consumer electronic products, toys, shipbuilding and the car industry). Corporate strategies within these sectors will determine how successfully they can cope with changes in the competitive environment.

(d) At individual company level

Community industry must become more competitive again if it is to be successful in the internal market.

It is at this level that changes are most needed to face the increased competition generated by the growth in intra-Community trade which the abolition of barriers and a general internationalization of the economy will bring.

The corporate strategies adopted can be seen at all levels in the value added chain:

(i) the search for an optimum size which may lead to a reduction in the number of production sites, an increase in production per site and mergers and acquisitions within the same sector both inside and outside the Community. It is essential to avoid reduced competition on the Community market;

(ii) at the production level where investment is being made in new products, product ranges are being extended and production processes improved. Participation in Community research and development programmes and investment financing should be promoted;

(iii) at the level of trade where cooperation agreements are being concluded to penetrate new markets and distribution networks are being bolstered; improved logistics (efficient transport, reduced storage, punctual delivery, administration of formalities) are essential here but depend largely on effective removal of frontiers and optimum use of infrastructures;

(iv) investment in human resources through better training and pan-European recruitment.

These strategies are today being followed by numerous large companies, as well as by a still too limited number of small and medium-sized operators. In this context, the particular attention which the Community has already paid to assist SMES in their adaptation to this new environment will have to be reinforced. Other forms of enterprise, (such as co-operatives and the-like), also call for increased effort, given their specific organisational structures which pose problems for their inclusion in a single market without frontiers.

2. The outlook

Economic and Monetary Union will help bolster the impact of the internal market by encouraging greater integration of European economies and fostering the competitive environment needed to instill dynamism into industry. It will also be of direct benefit to European industry because it will reduce exchange rate uncertainty and make intra-Community transactions cheaper. It is, however, also essential if the potential benefits of 1992 are to be translated into reality, particularly those deriving from the liberalization of movements of capital and the integration of the financial services market in the Community. Finally, European Monetary Union and the 1992 Programme share a common purpose in that they impose discipline and additional constraints on Member States by making them more interdependent. Such constraints may, however, also help to make economic policy more efficient.