



# OECD Economic Surveys EUROPEAN UNION

APRIL 2014





# **OECD Economic Surveys: European Union 2014**

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**Please cite this publication as:**

OECD (2014), *OECD Economic Surveys: European Union 2014*, OECD Publishing.  
[http://dx.doi.org/10.1787/eco\\_surveys-eur-2014-en](http://dx.doi.org/10.1787/eco_surveys-eur-2014-en)

ISBN 978-92-64-20680-9 (print)  
ISBN 978-92-64-20681-6 (PDF)

Series: OECD Economic Surveys  
ISSN 0376-6438 (print)  
ISSN 1609-7513 (online)

OECD Economic Surveys: European Union  
ISSN 2072-5078 (print)  
ISSN 2072-506X (online)

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## Table of contents

|   |    |
|---|----|
| <b>Basic statistics of the European Union, 2012</b> .....               | 7  |
| <b>Executive summary</b> .....  | 9  |
| Main findings .....   | 10 |
| Key recommendations .....   | 11 |
| <b>Assessment and recommendations</b> .....                             | 13 |
| Fostering economic recovery .....                                       | 15 |
| <i>Recommendations to boost growth, employment and innovation</i> ..... | 33 |
| Reinvigorating the Single Market to boost growth and employment .....   | 33 |
| <i>Recommendations to reinvigorate the Single Market</i> .....          | 39 |
| Towards a low carbon economy .....                                      | 39 |
| <i>Recommendations on climate change</i> .....                          | 45 |
| Bibliography .....  | 45 |

### Thematic chapter

|  |    |
|--|----|
| <b>Chapter 1. Reinvigorating the EU Single Market</b> .....                            | 51 |
| The potential for growth gains from a deeper Single Market are large .....             | 52 |
| Unnecessary barriers to trade and resource allocation reduce potential gains ...       | 56 |
| <i>Main recommendations to reduce implicit barriers within the Single Market</i> ..... | 66 |
| Enhancing labour market mobility within the Single Market adds to gains .....          | 66 |
| <i>Main recommendation to enhance labour mobility</i> .....                            | 69 |
| Better network interconnections across borders would enhance integration gains ..      | 69 |
| <i>Main recommendations for network sectors</i> .....                                  | 75 |
| Free trade agreements (FTAs) can boost integration gains from the Single Market ...    | 76 |
| <i>Main recommendation to promote trade</i> .....                                      | 78 |
| Bibliography .....   | 78 |

|                       |    |
|-----------------------|----|
| <b>Glossary</b> ..... | 83 |
|-----------------------|----|

#### Box

|   |    |
|---|----|
| 1.1. FDI patterns within the EU: The role of policies ..... | 58 |
|---|----|

#### Tables

|  |    |
|--|----|
| 1. Macroeconomic indicators and projections .....                          | 19 |
| 2. Long-term growth scenario .....   | 22 |
| 3. EU 2020 targets .....   | 23 |
| 4. <i>Going for Growth</i> priorities for euro area countries – 2013 ..... | 24 |
| 5. The effect of “ten per cent” reform on GDP per capita .....             | 26 |

## Figures

|  |    |
|--|----|
| 1. EuroBarometer . . . . .   | 14 |
| 2. Banking and government risk measures . . . . .  | 16 |
| 3. Bank deposits have bottomed out . . . . .   | 17 |
| 4. Current account balances . . . . .  | 17 |
| 5. Evolution of price competitiveness . . . . .  | 18 |
| 6. Net international investment position and sovereign risk spread . . . . .                                 | 19 |
| 7. Low and uneven productivity growth . . . . .  | 20 |
| 8. Structural unemployment in the EU is high and growing . . . . .   | 21 |
| 9. Inequality is increasing in some EU countries . . . . .   | 21 |
| 10. Rising old-age dependency ratio in EU27 . . . . .  | 22 |
| 11. Change in responsiveness to <i>Going for Growth</i> recommendations<br>from 2009-10 to 2011-12 . . . . . | 23 |
| 12. Higher tax wedge on labour is correlated with less working activity . . . . .                            | 25 |
| 13. Well-being outcomes . . . . .  | 27 |
| 14. Generation of legal acts . . . . .   | 29 |
| 15. Graduation rates in tertiary education . . . . .   | 30 |
| 16. Business outlays for research and development (R&D) and patents per capita                               | 31 |
| 17. Investment in knowledge-based capital (KBC) and selected public policies . . .                           | 32 |
| 18. Trade between EU member states . . . . .   | 33 |
| 19. Productivity is higher in large firms . . . . .  | 34 |
| 20. Employment protection is relatively high in the EU . . . . .   | 34 |
| 21. Restrictiveness of economy-wide product market regulation . . . . .                                      | 36 |
| 22. Barriers in services show little change between 2008 and 2013 in the EU . . . .                          | 36 |
| 23. The EU emission allowances price has collapsed . . . . .   | 40 |
| 24. Expected demand and supply of emission allowances . . . . .  | 41 |
| 25. Effective carbon prices in selected countries . . . . .  | 42 |
| 26. Diesel and petrol prices adjusted for externalities . . . . .  | 42 |
| 27. Electricity prices for industry . . . . .  | 43 |
| 28. The agricultural sector efficiency is low in several EU countries . . . . .                              | 44 |
| 1.1. Trade between EU member states . . . . .  | 53 |
| 1.2. Productivity is higher in large firms . . . . .   | 53 |
| 1.3. Do resources flow to more innovative firms? . . . . .   | 54 |
| 1.4. The distribution of firm employment growth . . . . .  | 55 |
| 1.5. EU countries differ in their ability to allocate labour to the most<br>productive firms . . . . .       | 55 |
| 1.6. Restrictiveness of economy-wide product market regulation . . . . .                                     | 56 |
| 1.7. Selected indicators of product market regulation . . . . .  | 57 |
| 1.8. FDI restrictiveness index . . . . .   | 59 |
| 1.9. Indicators of differences in regulations . . . . .  | 60 |
| 1.10. Heterogeneity in countries diminishes more the farther they are<br>from common practices . . . . .     | 60 |
| 1.11. Cross-border procurement . . . . .   | 62 |
| 1.12. Barriers in services show little change between 2008 and 2013 in the EU . . . .                        | 63 |
| 1.13. Long trial length is associated with a lower share of FDI . . . . .                                    | 64 |
| 1.14. The number of infringement cases is decreasing . . . . .   | 65 |
| 1.15. Stock of migrated population within the EU . . . . .   | 67 |

|  |    |
|--|----|
| 1.16. Immigration flows into western EU countries . . . . .  | 67 |
| 1.17. Share of EU25 non-national teachers . . . . .          | 69 |
| 1.18. Mobile phone prices are widely dispersed . . . . .     | 70 |
| 1.19. Individual purchases over the Internet. . . . .        | 71 |
| 1.20. Electricity prices for industry . . . . .              | 74 |
| 1.21. Effective carbon prices in selected countries. . . . . | 75 |
| 1.22. Foreign value added content of gross exports . . . . . | 76 |
| 1.23. Exports to dynamic Asian economies . . . . .           | 78 |

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of the European Union were reviewed by the Committee on 19 February 2014. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 20 March 2014.

The Secretariat's draft report was prepared for the Committee by Jean-Marc Fournier and Eckhard Wurzel under the supervision of Piritta Sorsa. Research assistance was provided by Isabelle Duong, Annamaria Tuske and Valery Dugain.

The previous Survey of the European Union was issued in March 2012.

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**BASIC STATISTICS OF THE EUROPEAN UNION,<sup>a</sup> 2012**  
(Numbers in parentheses refer to the OECD average)<sup>b</sup>

| LAND, PEOPLE AND ELECTORAL CYCLE  |          |         |  |              |
|---|----------|---------|--|--------------|
| Population (million)  | 506.1    |         | Population density per km <sup>2</sup>                                   | 116.0 (34.6) |
| Under 15 (%)  | 15.6     | (18.4)  | Life expectancy (years, 2011)  | 80.4 (80.0)  |
| Over 65 (%)   | 17.9     | (15.3)  | Males  | 77.4 (77.3)  |
| Foreign-born (% , 2011)   | 6.5      |         | Females  | 83.2 (82.8)  |
| Latest 5-year average growth (%)  | 0.3      | (0.7)   | Last general election  | June 2009    |
| ECONOMY   |          |         |  |              |
| Gross domestic product (GDP)  |          |         | Value added shares (%)   |              |
| In current prices (billion USD)   | 16 665.3 |         | Primary  | 1.7 (2.5)    |
| In current prices (billion EUR)   | 12 971.1 |         | Industry including construction  | 24.9 (27.3)  |
| Latest 5-year average real growth (%)   | -0.2     | (0.6)   | Services   | 73.4 (69.8)  |
| Per capita, PPP (thousand USD)  | 25.8     | (37.0)  |  |              |
| GENERAL GOVERNMENT  |          |         |  |              |
| Per cent of GDP   |          |         |  |              |
| Expenditure <sup>c</sup>  | 49.3     | (42.8)  | Gross financial debt   | 85.1         |
| Revenue <sup>c</sup>  | 45.4     | (36.5)  |  |              |
| EXTERNAL ACCOUNTS   |          |         |  |              |
|   |          |         | Main exports (% of total merchandise exports)                            |              |
|   |          |         | Machinery and transport equipment  | 41.9         |
|   |          |         | Other manufactured goods   | 22.7         |
| In per cent of GDP  |          |         | Chemicals and related products, n.e.s.                                   | 16.4         |
| Exports of goods and services   | 44.9     | (53.8)  | Main imports (% of total merchandise imports)                            |              |
| Imports of goods and services   | 42.9     | (50.4)  | Mineral fuels, lubricants and related materials                          | 30.4         |
| Current account balance   | 0.5      | (-0.5)  | Machinery and transport equipment  | 25.2         |
|   |          |         | Chemicals and related products, n.e.s.                                   | 21.6         |
| LABOUR MARKET, SKILLS AND INNOVATION  |          |         |  |              |
| Employment rate (%) for 15-64 year olds                                       | 64.1     | (65.0)  | Unemployment rate (%)  | 10.5 (7.9)   |
| Males   | 69.6     | (73.1)  | Youth (%)  | 23.0 (16.2)  |
| Females   | 58.5     | (57.0)  | Long-term unemployed (%)   | 4.7 (2.7)    |
| Participation rate (%) for 15-64 year olds                                    | 71.7     | (70.9)  | Tertiary educational attainment 25-64 year-olds (%) <sup>c</sup>         | 27.6 (31.5)  |
| Average worked hours per year <sup>d</sup>                                    | 1679     | (1765)  | Gross domestic expenditure on R&D (% of GDP)                             | 2.1 (2.4)    |
| ENVIRONMENT   |          |         |  |              |
| Total primary energy supply per capita (toe, 2011)                            | 3.3      | (4.3)   | CO <sub>2</sub> emissions from fuel combustion per capita (tonnes, 2011) | 7.0 (9.9)    |
| Renewables (% , 2011)   | 10.2     | (8.1)   | Municipal waste per capita (tonnes, 2011) <sup>e</sup>                   | 0.5 (0.5)    |
| Fine particulate matter concentration (urban, PM10, µg/m <sup>3</sup> , 2010) | 19.1     | (20.1)  |  |              |
| SOCIETY   |          |         |  |              |
| Income inequality (Gini coefficient) <sup>f</sup>                             | 0.306    | (0.305) | Education outcomes (PISA score)  |              |
| Relative poverty rate (%) <sup>f</sup>  | 23.5     | (22.3)  | Reading  | 489 (496)    |
| Public and private spending (% of GDP)  |          |         | Mathematics  | 489 (494)    |
| Health care (2011)  | 8.2      | (9.5)   | Science  | 497 (501)    |
| Pensions (2011)   | 12.7     | (8.7)   | Share of women in parliament (% , January 2014)                          | 26.8 (26.5)  |
| Education (2010)  | 5.7      | (4.0)   | Net official development assistance (% of GNI)                           | 0.4 (0.4)    |

Better life index: [www.oecdbetterlifeindex.org](http://www.oecdbetterlifeindex.org)

- a) Average of EU27/28 countries, depending on data availability, unless otherwise indicated.  
b) Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exists for at least 29 member countries.  
c) 2011 for the OECD.  
d) Average of the EU21 countries also members of the OECD.  
e) 2010 for the OECD.  
f) 2009 for the OECD.

Source: Calculations based on data extracted from the databases of the following organisations: Eurostat, OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.



## Executive summary

- *Main findings*
- *Key recommendations*

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

## Main findings

**Raising inclusive long-term growth.** The EU economies, including those most heavily hit by the crisis, appear to be turning the corner after many years of low and uneven growth. However, low productivity growth, while partly due to the recession, has deep structural causes: high tax burdens, rigid labour laws, barriers to competition, and slow innovation dynamics. Inequality has grown since the 1980s, and high unemployment is hurting the most vulnerable, weakening public support for the EU project. Significant structural reforms have been implemented in some European countries in response to the crisis, but deeper reforms in more countries would raise growth on a sustainable basis. EU institutional and regulatory reforms, complemented by national policies, can enhance inclusive and sustainable growth. The EU 2020 strategy, the European Semester and the Horizon 2020 initiative have been designed to support growth and innovation, but have not succeeded noticeably so far. National ownership has been weak, significant hurdles remain for innovative firms, and regulatory costs of both EU and national origin are large. Social, employment and environmental impacts of reforms are not systematically assessed and spill-overs are not fully incorporated in the European Semester process and in adjustment programmes.

**Reinvigorating the Single Market.** Implicit barriers between EU countries restrict the circulation of goods, services, people and capital. The heterogeneity of rule settings across EU countries and high national barriers, especially in the more protected service sectors, make it hard to adapt to each national regulation. Unnecessary restrictions on foreign direct investment remain in place. Lack of portable pension rights and of national recognition of professional qualifications weakens labour mobility. Physical networks between countries are hampered by deficient infrastructure, and lack of harmonised regulations. Finally, there is room to lower external barriers to trade, which would enhance competitive forces, boost productivity and encourage innovation.

**Towards a low carbon economy.** Progress towards a low-carbon economy in Europe should remain a priority going forward. The European Union Emission Trading System (ETS), a pioneering market to curb greenhouse gas emissions, has in the crisis been characterised by depressed carbon prices which fail to provide the financial incentives for adaptation and innovation to reduce carbon emissions. Lack of legally binding longer-term targets, narrow coverage of the ETS and some expensive subsidy programmes have undermined the economic effectiveness of climate change policy. Finally, the electricity infrastructure is not well adapted to support the change in energy mix needed to meet long-term carbon emissions targets.

## Key recommendations

### ***Raising inclusive long-term growth***

- Enhance the EU Semester process by focusing more on spill-over effects, strengthening the underpinning analysis, systematically assessing employment, social and environmental impacts of reforms. Continue to address structural imbalances, and better co-ordinate communication with EU member states.
- Reinforce the EU Impact Assessment system and the new EU Regulatory Fitness (REFIT) programme to improve the design of policies and reduce burdens for firms and national public administrations.
- Implement the EU Horizon 2020 framework programme for research and innovation to simplify procedures, and bridge a gap between research institutions and the private market.

### ***Reinvigorating the Single Market***

- Improve the implementation of the Services Directive, in particular by eliminating unjustified and disproportionate restrictions to the cross-border provision of services and to the establishment of businesses.
- In network sectors that require regulation, further strengthen co-operation between national regulators, with a view to moving towards cross-border regulators.
- Deepen the internal energy market through further development of energy interconnections.
- Move forward with the adoption of the proposed directives on free movement of workers and on acquisition and preservation of supplementary pension rights. Take measures to eliminate double taxation of pensions, develop automatic qualification recognition, and eliminate disproportionate national barriers related to regulated professions.
- Continue the intensive engagement in multilateral trade negotiations, move forward with a trade agreement with the United States to reduce non-tariff barriers, while continuing to negotiate trade agreements with other partners.

### ***Towards a low carbon economy***

- Strengthen the EU Emission Trading Scheme (ETS) by adopting an ambitious 2030 target accompanied by a tight ETS allowance cap. In this context, the renewable energy target and subsidy schemes should avoid creating distortions within the Single Market.
- Make sure that each sector is either subject to CO<sub>2</sub> taxation (for example, under the planned Energy Taxation Directive) or participates in the ETS, as appropriate.
- Encourage ownership unbundling of generation, supply and network activities within vertically-integrated electricity utilities, and streamline permit procedures to support electricity grids investment.



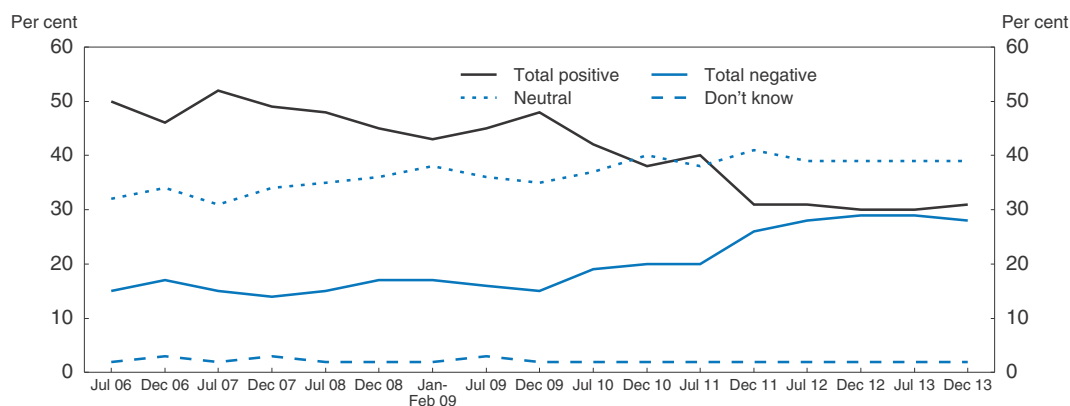
## Assessment and recommendations

- *Fostering economic recovery*
- *Reinvigorating the Single Market to boost growth and employment*
- *Towards a low carbon economy*

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More than five years after the onset of the global economic and financial crisis, growth is beginning to pick up in EU economies. Systemic risks have been reduced, large external and internal imbalances have receded, and most of the vulnerable countries are gradually regaining competitiveness via wage adjustment and significant structural reforms. Still, low confidence, weak private sector balance sheets and fiscal consolidation, necessitated by the high debt levels, weigh on demand. Unemployment rates stand at double-digits in several countries, and in most are more than twice as high for the young. Inflation is very low in many countries, and deflation risks have risen. The impact of supportive monetary policy on demand is weakened by financial fragmentation. Credit is restrained by weak bank balance sheets, high exposure to sovereign debt and, in the vulnerable countries, high interest rates driven by high perceived risks. These factors have been undermining confidence in the European project (Figure 1).

Figure 1. **EuroBarometer**  
Replies to question QA11 on the image of the EU<sup>1</sup>



1. "In general, does the EU conjure up for you a very positive, fairly positive, neutral, fairly negative or very negative image?"

Source: EC (2013), "Public Opinion in the European Union", First Results, *Standard EuroBarometer 80*, Autumn, [http://ec.europa.eu/public\\_opinion/index\\_en.htm](http://ec.europa.eu/public_opinion/index_en.htm).

StatLink  <http://dx.doi.org/10.1787/888933009805>

The challenge for policy is to reinforce the recovery, get people back to work and create a basis for sustainable growth. While the largest part of the required fiscal consolidation has been achieved, in most EU countries strong fiscal positions will need to be maintained for many years to bring debt down. Priority should be given to repairing financial sector balance sheets and recapitalising banks, where needed, in order to restore credit growth and support demand. Fragmentation can be reduced and confidence boosted by further progressing towards banking union in Europe. Expansionary monetary policy will need to support demand for some time. At the same time, higher priority needs to be given to structural reforms to boost more even adjustment and rebalancing, competitiveness, and



the growth potential. This could be facilitated by continued reinforcement and implementation of EU wide fiscal and structural governance.

The 2014 *Economic Survey of the Euro Area* and the 2014 *Economic Survey of the European Union* discuss these challenges from different perspectives: the former mainly focusses on financial sector reform and fiscal and monetary policies, and the latter on structural reform surveillance at the EU level.

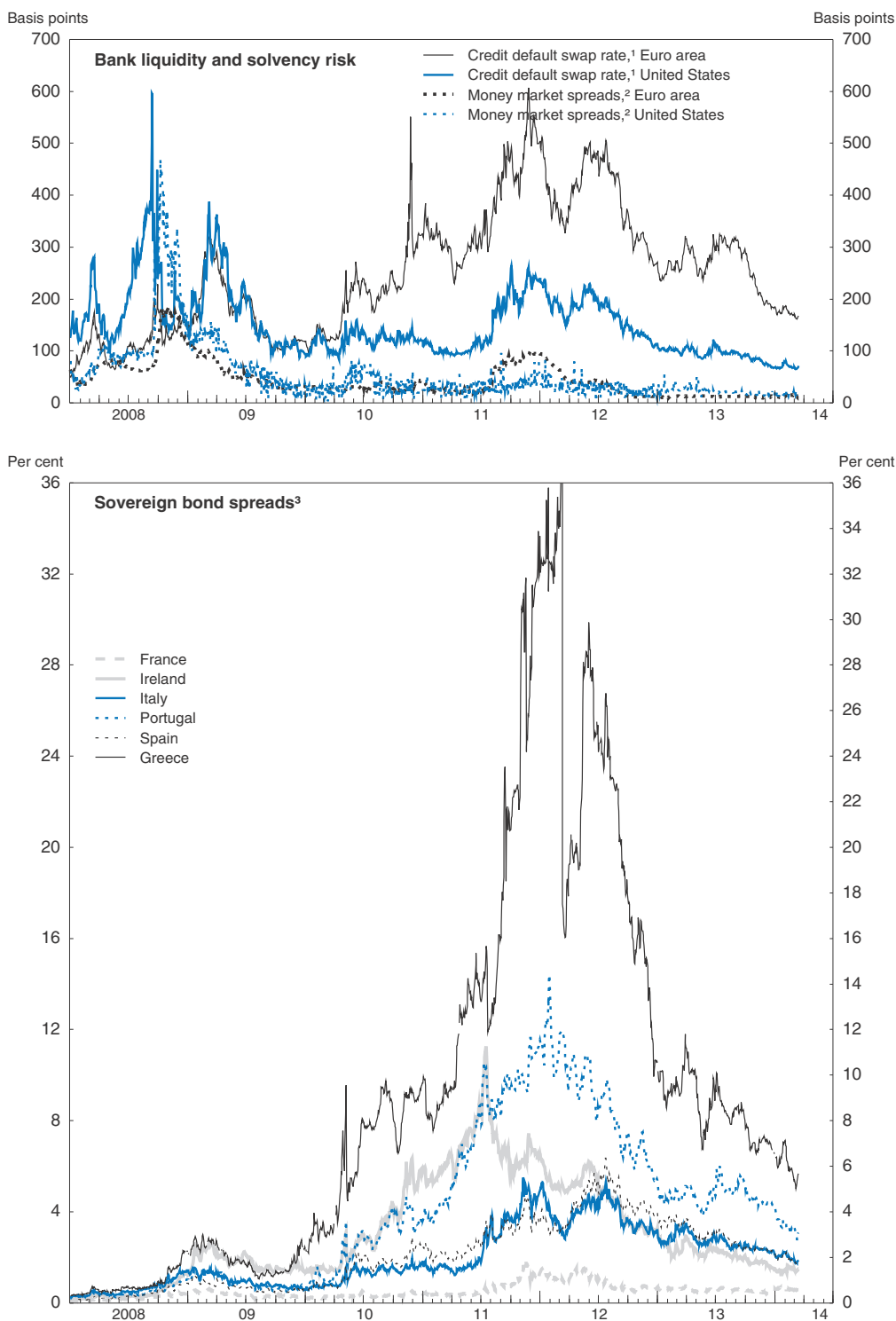
## Fostering economic recovery

The EU exited from recession in the second quarter 2013, following six quarters of declining GDP. Some central European countries (such as Latvia, Lithuania and Romania), Luxembourg, Sweden and the United Kingdom have enjoyed relatively strong growth. In the euro area, confidence has improved against the backdrop of the Outright Monetary Transactions (OMT) programme, progress in fiscal consolidation, structural reforms and external rebalancing and steps forward in reforming EU banking supervision. In vulnerable countries, both long-term government bond spreads against Germany and credit default swaps have declined from their peak levels in summer 2012 (Figure 2), and bank deposits have stopped falling or have picked up again (Figure 3). However, sizable differences remain, especially on the labour market, which usually lags behind recovery: the unemployment rate in Germany is at a record low of about 5%, but exceeds 25% in Spain and Greece. In the vast majority of countries, unemployment among the young is at least twice the overall rate. In the euro area, risks of deflation or a protracted period of very low inflation remain as the large degree of economic slack has put persistent downward pressure on inflation, which is well below the ECB's quantitative definition of price stability (HICP inflation just below 2%).

Current account imbalances in the euro area have narrowed as, in some countries, the collapse in domestic demand has compressed imports and as better competitiveness has, in some countries, boosted exports (Figures 4 and 5). While business and housing cycles account for about 2 points of GDP of the current account adjustment in deficit countries in 2012 (Ollivaud and Schwellnus, 2013), these countries have undergone significant structural adjustment, suggesting that their current account positions will not return to pre-crisis levels. The current account improvements in vulnerable countries are likely to have contributed to the fall in credit risk premia since the second half of 2012, as external funding needs have fallen. Unit labour costs in these countries have come down substantially, with the notable exception of Italy, but prices have adjusted less than wages, in part reflecting slow product market reforms, which has limited the effect of declining unit labour costs on price competitiveness (Figure 5). Much less rebalancing has occurred in economies with high surpluses, suggesting inefficient levels of saving and investment. A stronger contribution of their domestic demand to growth would smooth overall adjustment in the euro area.

Structural reforms, in part by boosting growth, can put the rebalancing process on a more sustainable footing (e.g. OECD, 2011a; OECD, 2012a). Labour market reforms can help to better align wages to productivity (e.g. reforms of wage-setting frameworks). In deficit countries, structural reforms focusing on strengthening productivity and price and non-price competitiveness, and easing regulations would boost exports. In addition, removing policy distortions that encourage consumption would increase household saving. In surplus countries, measures to create more favourable conditions for investment and

Figure 2. **Banking and government risk measures**



1. Banking-sector five-year credit default swap rates.
  2. Spread between three-month interbank rates (Euribor in the euro area, Libor in the United States) and overnight swap rates.
  3. Ten-year sovereign bond yield relative to German yield.
- Source: Datastream.


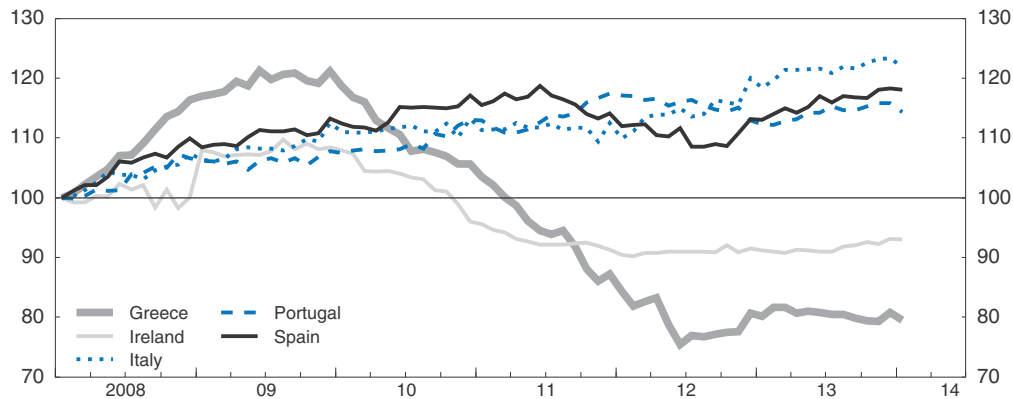
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Figure 3. **Bank deposits<sup>1</sup> have bottomed out**

Index January 2008 = 100



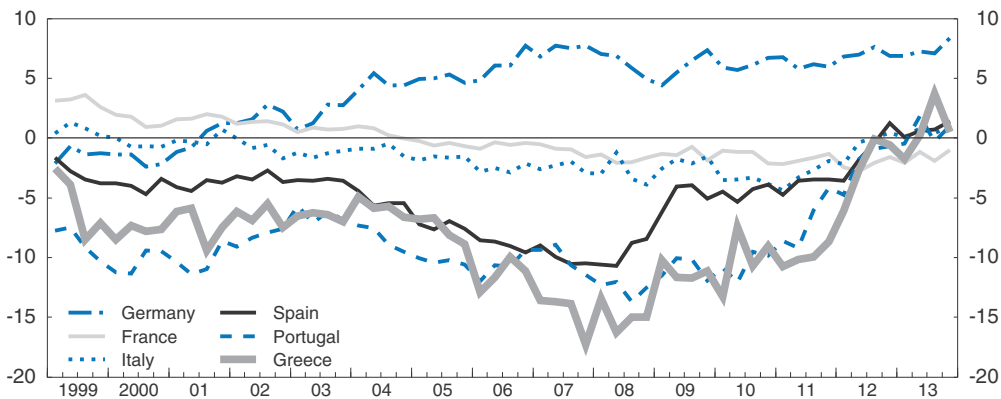
1. Non-financial corporations and household deposits in monetary financial institutions (MFIs).

Source: European Central Bank.

StatLink <http://dx.doi.org/10.1787/888933009843>

Figure 4. **Current account balances**

As a percentage of GDP



Source: OECD, OECD Economic Outlook Database.

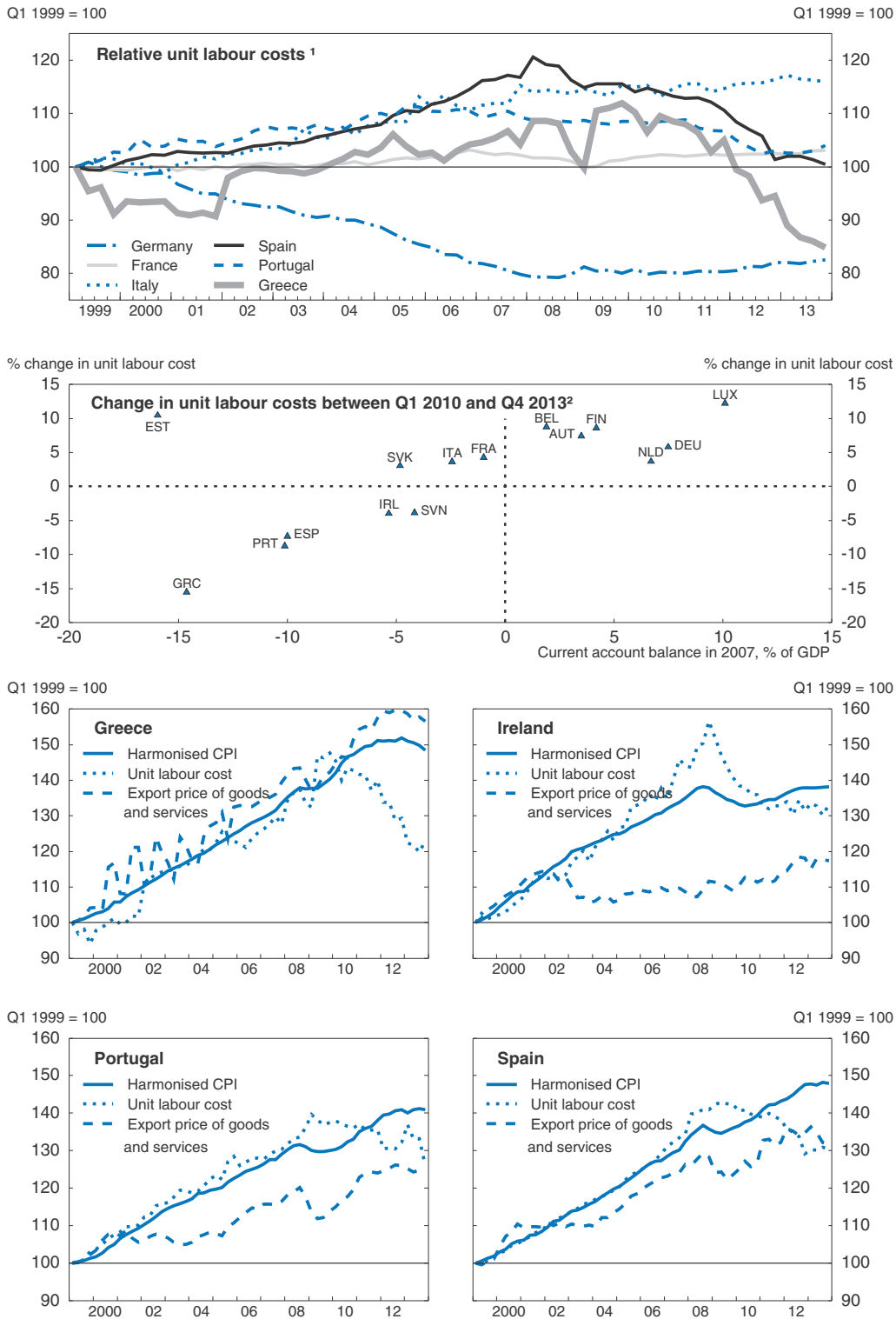
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regulatory reform in service sectors could boost domestic demand and smooth the overall adjustment.

Net international investment positions (NIIPs) of vulnerable countries remain strongly negative, and reducing them will require many years of current account surpluses or large valuation changes. This inevitably slow pace of correction, in turn, might damp further reductions in sovereign risk premia, which appear to be positively correlated with European countries' NIIPs (Figure 6), especially so for euro area countries with both high external and high government debt (Turner and Spinelli, 2013). This points to the need to implement structural reforms to improve competitiveness and current account balances, and to restore fiscal sustainability.

Economic growth is projected to rise in 2014 and 2015 as confidence improves further, financial market fragmentation declines and fiscal consolidation eases (Table 1). The pace of growth is projected to be strong in some countries outside the euro area, especially

Figure 5. Evolution of price competitiveness



1. The figures shown correspond to unit labour costs of the whole economy relative to unit labour costs in the rest of the euro area.
2. Or latest available data.

Source: OECD, OECD Economic Outlook Database and OECD calculations.


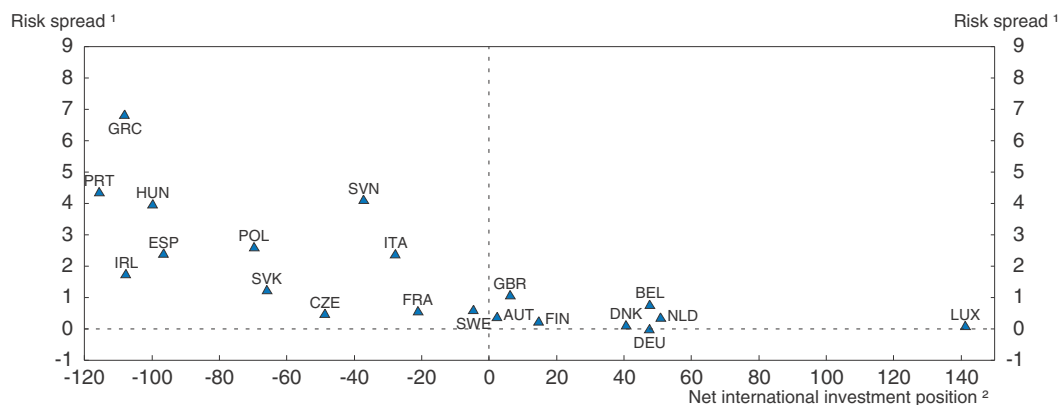
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Figure 6. **Net international investment position and sovereign risk spread**  
Q4 2013 or latest available data



1. Ten-year government bonds over Germany.

2. As a percentage of GDP.

Source: IMF, Balance of Payments Statistics Database; OECD, OECD Economic Outlook Database.


StatLink  <http://dx.doi.org/10.1787/888933009900>

Table 1. **Macroeconomic indicators and projections**  
Annual percentage change, volume (2009 prices), EU21<sup>1</sup>

|  | 2011       | 2012        | 2013       | Projections <sup>2</sup> |            |
|--|------------|-------------|------------|--------------------------|------------|
|  |            |             |            | 2014                     | 2015       |
| <b>GDP</b>   | <b>1.7</b> | <b>-0.4</b> | <b>0.1</b> | <b>1.4</b>               | <b>1.9</b> |
| Private consumption                                      | 0.2        | -0.8        | -0.1       | 0.9                      | 1.5        |
| Government consumption                                   | -0.3       | -0.3        | 0.4        | 0.2                      | 0.2        |
| Gross fixed capital formation                            | 1.5        | -3.1        | -2.2       | 2.2                      | 3.7        |
| Final domestic demand                                    | 0.4        | -1.1        | -0.4       | 1.0                      | 1.6        |
| Total domestic demand                                    | 0.7        | -1.6        | -0.4       | 1.1                      | 1.6        |
| Exports of goods and services                            | 6.7        | 2.5         | 1.5        | 3.9                      | 4.9        |
| Imports of goods and services                            | 4.3        | -0.3        | 0.4        | 3.4                      | 4.5        |
| <b>Other indicators</b> (growth rates, unless specified) |            |             |            |                          |            |
| Potential GDP <sup>3</sup>                               | 1.0        | 1.0         | 1.0        | 1.2                      | 1.4        |
| Output gap <sup>3, 4</sup>                               | -1.3       | -2.5        | -3.5       | -3.4                     | -2.9       |
| Employment   | 0.4        | -0.3        | -0.2       | 0.2                      | 0.6        |
| Unemployment rate  | 9.6        | 10.4        | 10.8       | 11.0                     | 10.7       |
| GDP deflator   | 1.4        | 1.4         | 1.4        | 1.1                      | 1.3        |
| Consumer price index                                     | 3.1        | 2.6         | 1.5        | 1.5                      | 1.5        |
| Core consumer prices                                     | 1.7        | 1.7         | 1.2        | 1.4                      | 1.4        |
| Household saving ratio, net <sup>5</sup>                 | 6.5        | 6.3         | 6.0        | 6.0                      | 5.6        |
| Current account balance <sup>6</sup>                     | 0.4        | 1.0         | 1.8        | 1.8                      | 1.9        |
| General government financial balance <sup>6</sup>        | -4.5       | -4.1        | -3.3       | -2.6                     | -2.3       |
| Underlying government primary balance <sup>4</sup>       | -1.6       | -0.5        | 0.5        | 0.9                      | 1.4        |
| Gross government debt (Maastricht) <sup>6</sup>          | 83.4       | 87.5        | 89.8       | 90.7                     | 91.0       |
| General government net debt <sup>6</sup>                 | 55.2       | 60.6        | 62.9       | 64.7                     | 65.1       |
| Three-month money market rate, average                   | 1.6        | 1.0         | 0.5        | 0.4                      | 0.7        |
| <b>Memorandum items</b>                                  |            |             |            |                          |            |
| Gross government debt <sup>6</sup>                       | 90.8       | 98.8        | 100.8      | 102.1                    | 102.1      |

1. EU21 refers to the 21 EU member states that are also members of the OECD.

2. Projections are taken from the OECD Economic Outlook 94.

3. Potential output and the output gap are taken from the OECD Economic Outlook 94.

4. As a percentage of potential GDP.

5. As a percentage of household disposable income.

6. As a percentage of GDP.

Source: OECD, OECD Economic Outlook 94 Database.

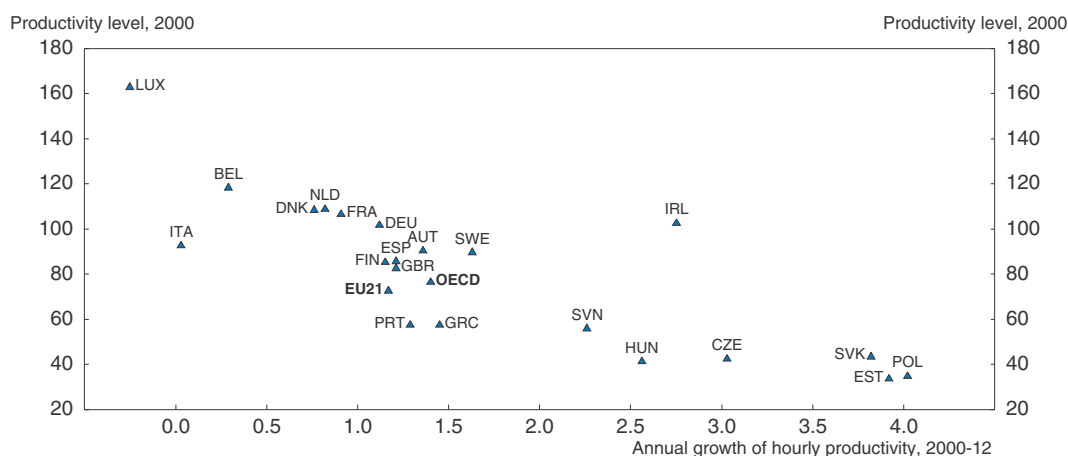
Poland and Sweden. The pace will remain moderate in the EU as a whole, however, as tight credit conditions will bear on economic activity for some time, especially in the vulnerable euro area countries. High unemployment and weak income growth are holding back private consumption and investment. Unemployment is projected to stabilise in 2014, starting to decline only in 2015. Inflation might change little in 2014 and 2015, given the large slack. The current account surpluses of Italy, Portugal and Spain are projected to rise further over the next two years.

The risks to these projections have become more balanced but are still on the downside. Downside risks include the uncertain political situation, social tensions and still challenging public finances in many countries which mean that financial market turbulence could flare up again. The vulnerabilities in this respect would be increased by: insufficient progress in establishing institutions and rules to ensure that European banks function effectively; failure to achieve adequate asset quality reviews and stress tests in 2014 and, then, to clean up bank balance sheets; and insufficient progress on structural reforms in both debtor and creditor countries. Deflation risks may intensify if activity continues to be weak. External risks include a still sharper slowdown in emerging market economies, and a tightening of the US monetary stance (the prospect of which already upset markets in May 2013). The upside risk, that the recovery could be stronger than envisaged, could occur if further bold structural reforms are implemented. This could underpin positive feedbacks between confidence, economic growth – in particular investment – and the ability of the banking sector to extend loans.


### **Growth in the European Union (EU) remains weak and non-inclusive**

Seen from a longer-term perspective, growth and productivity performance in the EU has been disappointing, despite the potential gains from a unified European market. Since 2000, total labour productivity per worker grew, in trend, by 0.8% a year, as against 1.2% in the OECD on average. Differences within the EU are also large (Figure 7). In countries with high productivity levels, unlocking new sources of productivity growth is getting harder. Southern European countries that were lagging behind in 2000 have failed to catch up. The recession has also set back EU economies. The structural unemployment

Figure 7. **Low and uneven productivity growth**

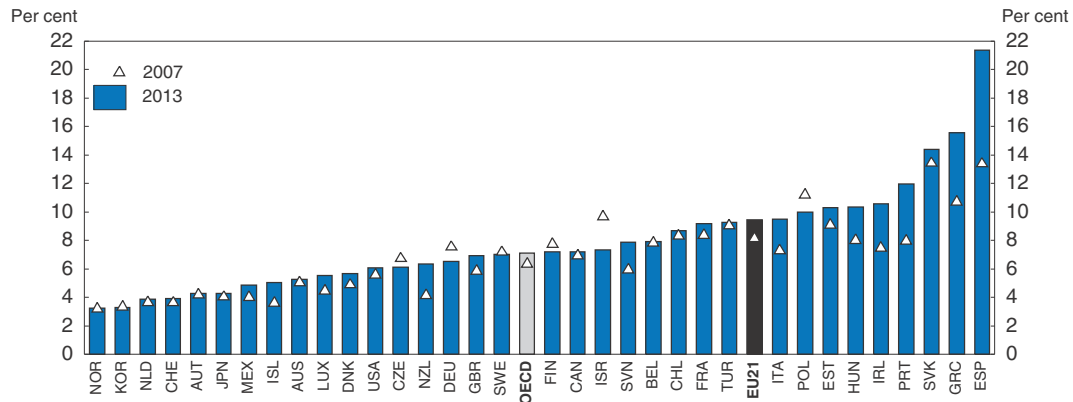


Source: OECD, Productivity Database.

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rate rose by more than 1 per cent in the EU between 2007 and 2013 (Figure 8), and convergence also appears to have stalled in some Central European EU countries. Growth has failed to reduce income inequalities in the EU since the 1990s. Much of this reflects inequality within countries (Figure 9), but the situation has been worsened recently by falling incomes in some low-income countries (Bonesmo Fredriksen, 2012). All these factors have contributed to weakening support for the European Union as citizens perceive fewer benefits from it.

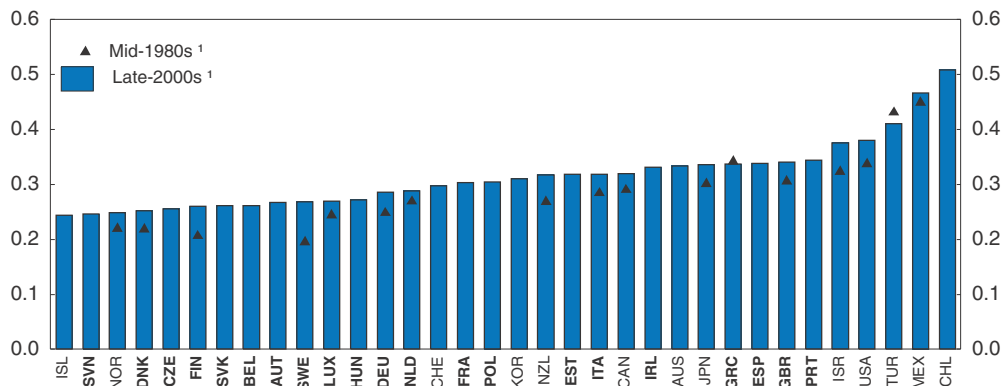
**Figure 8. Structural unemployment in the EU is high and growing**  
Non-accelerating inflation rate of unemployment



Source: OECD, OECD Economic Outlook 94 Database.

StatLink <http://dx.doi.org/10.1787/888933009938>

**Figure 9. Inequality is increasing in some EU countries**  
Gini coefficient of household disposable income, total population



1. The reference year differs across countries. For mid-1980s, it refers to 1985 or nearest available year. As for late 2000s, it refers to 2010 or 2009.

Source: OECD, Income Distribution Database, via [www.oecd.org/social/inequality.htm](http://www.oecd.org/social/inequality.htm).

StatLink <http://dx.doi.org/10.1787/888933009957>

If structural reforms do not proceed further, growth is expected to remain modest over the longer term (Table 2). Because of ageing, employment growth, which had been roughly 1% per year before the crisis, will fall towards zero, and dependency ratios will rise steadily (Figure 10). Migration flows and regular increases in the effective retirement age, as countries complete substantial pension reforms, will most likely do little more than

**Table 2. Long-term growth scenario**

Average growth rate, per cent, EU21

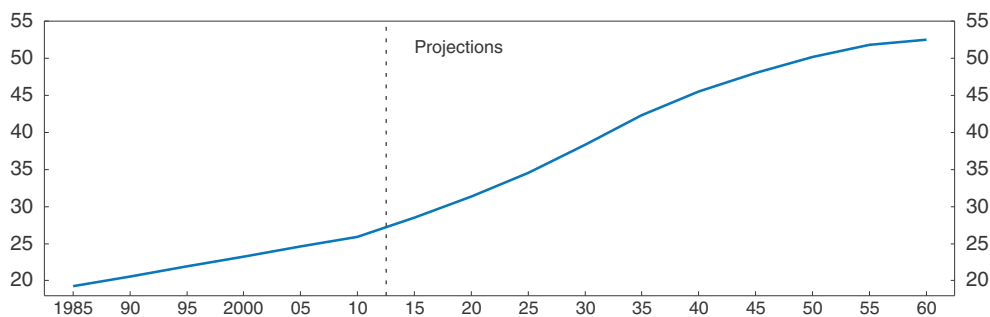
|   | 2001-07 | 2008-12 | 2013-17 | 2018-30 | 2031-60 |
|---|---------|---------|---------|---------|---------|
| Real GDP  | 2.4     | -0.1    | 1.7     | 2.2     | 1.4     |
| Real potential GDP  | 2.0     | 1.2     | 1.4     | 2.1     | 1.4     |
| Investment rate <sup>1,2</sup>                                    | 22.0    | 17.9    | 18.7    | 18.7    | 13.1    |
| Labour efficiency   | 0.2     | -0.2    | 0.7     | 1.5     | 1.5     |
| Potential employment  | 0.9     | 0.4     | 0.3     | 0.2     | -0.1    |
| Non accelerating inflation rate of unemployment <sup>3</sup>      | 8.2     | 9.0     | 9.5     | 8.2     | 7.8     |
| General government net lending <sup>1,2</sup>                     | -0.9    | -4.1    | -0.2    | -0.1    | -0.8    |
| Cyclically-adjusted general government net lending <sup>1,2</sup> | -2.5    | -2.9    | 0.2     | -0.1    | -0.8    |
| General government debt <sup>1,2</sup>                            | 65.7    | 98.8    | 98.1    | 66.2    | 59.3    |
| Current balance <sup>1,2</sup>                                    | -0.2    | 1.1     | 1.8     | -1.0    | 1.8     |

1. End of period.


2. Per cent of GDP.

3. Per cent of labour force.

Source: OECD, OECD Economic Outlook 93 Long-Term Database.

**Figure 10. Rising old-age dependency ratio in EU27**

Source: Eurostat.

StatLink  <http://dx.doi.org/10.1787/888933009976>

stabilise employment in the coming years (OECD, 2013a and b). Against the background of weak innovation, labour productivity growth may prove only moderate. Achieving the 60% target of government debt with such low growth prospects will require maintaining fiscal surpluses for an extended period of time, which will be a major policy challenge, as discussed in the 2014 *Economic Survey of the Euro Area*.

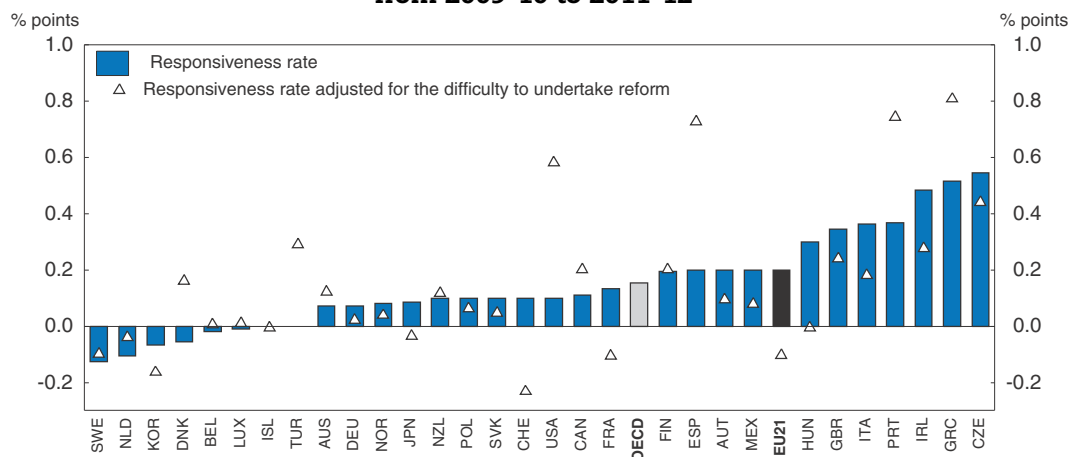
Risks to the long-term growth scenario may be mostly on the downside. Financial disruptions are still likely unless fragilities within the euro area are permanently fixed. Over time, the structure of European economies will be challenged by the rising Asian economies and other emerging markets, technological change and environmental problems. Flexibility to adapt to change will be fundamental in facing these challenges, but so far Europe has been slow to tackle structural rigidities with bold policies at the national or the EU level (Figure 11). This would also help to boost competitiveness and improve structural current account balances.

### **The Europe 2020 strategy to boost growth**

The long-term inclusive growth challenge has been recognised by EU countries and the Commission. The Europe 2020 Strategy aims at delivering “smart”, “sustainable” and “inclusive” growth. It contains ambitious targets in key policy areas: employment, education,




Figure 11. **Change in responsiveness to Going for Growth recommendations from 2009-10 to 2011-12<sup>1</sup>**



1. OECD and EU aggregates do not include Chile, Estonia, Israel and Slovenia. The reform responsiveness rate indicator is based on a scoring system in which recommendations set in the previous edition of *Going for Growth* take a value of 1 if “significant” action is taken and 0 if not. The “adjusted” responsiveness rate weighs responsiveness on each individual priority according to the difficulty of undertaking the relevant reform, as measured by the inverse of average responsiveness to priorities in this area in non-crisis circumstances across the OECD or the BRIICS.

Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris, Figure 1.2.

StatLink  <http://dx.doi.org/10.1787/888933009995>

research and development (R&D) spending, greenhouse gas (GHG) emissions and poverty reduction (Table 3). Seven flagship initiatives have been set up to reach them in the following areas: the digital agenda, innovation, youth mobility, resource efficiency, industrial policy, new skills and jobs, and a European platform against poverty. The Europe 2020 Strategy is better focused and more binding than the Lisbon strategy, for which major targets were missed (EC, 2010a).

Table 3. **EU 2020 targets**

|   | 2012 actual        | 2020 target | Unit                             |
|---|--------------------|-------------|----------------------------------|
| Employment rate   | 68.5               | 75          | % of population aged 20-64       |
| Gross domestic expenditure on R&D                           | 2.06               | 3           | % of GDP                         |
| Greenhouse gas emissions                                    | 83.0 <sup>1</sup>  | 80          | Index 1990 = 100                 |
| Share of renewable energy in gross final energy consumption | 13.0 <sup>1</sup>  | 20          | Per cent                         |
| Primary energy consumption                                  | 1 583 <sup>1</sup> | 1 474       | Million tonnes of oil equivalent |
| Early leavers from education and training                   | 12.8               | 10          | % of population aged 18-24       |
| Tertiary educational attainment                             | 35.8               | 40          | % of population aged 30-34       |
| People at risk of poverty                                   | 123                | 96          | Million                          |

1. 2011.

Source: Eurostat.

Implementation of the strategy is monitored by the yearly European Semester process, in which country-specific recommendations are endorsed by the European Council, based on the Commission’s analysis and recommendations. The specific reforms identified in the European Semester are welcome and are broadly similar to the OECD’s *Going for Growth* recommendations (OECD 2013b, Table 4). The reforms cover a broad range of policies on productivity and growth: product and labour market reforms, taxation, openness, research, innovation and education, improving business conditions, competition, enhancing flexibility, and raising the quality and use of factors of production.

Table 4. **Going for Growth** priorities for euro area countries – 2013

| Policy areas   | 2013 policy priorities <sup>1</sup>   |
|--|---|
| Product market regulations                                       |   |
| Strengthen competition in network industries                     | Austria, Belgium, European Union, Ireland, Slovak Republic, Slovenia            |
| Reform/simplify product market regulations                       | Belgium, Luxembourg, Portugal, Spain  |
| Reduce barriers to competition in the services sector            | Austria, Belgium, Finland, Germany, Ireland, Luxembourg, (priority at EU level) |
| Reduce barriers to foreign ownership/investment/trade            |   |
| Reduce regulatory barriers to competition                        | Austria, France, Greece, Italy, Spain   |
| Strengthen private-sector participation in economic activity     | Greece, Italy, Portugal, Slovenia   |
| Reform planning regulations                                      | Luxembourg  |
| Labour market regulations  |   |
| Reform (disability) benefit schemes                              | Austria, Luxembourg, Netherlands  |
| Reform the unemployment insurance scheme                         | Belgium, Finland, Greece, Netherlands, Portugal, Spain                          |
| Reduce restrictions on labour mobility                           | European Union, Slovak Republic   |
| Reduce/moderate the minimum cost of labour                       | France  |
| Reduce/ease job protection                                       | France, Germany, Italy, Luxembourg, Netherlands, Portugal, Slovenia, Spain      |
| Reform the wage bargaining system                                | Belgium, Italy, Slovenia, Spain   |
| Strengthen policies to support female labour force participation | Ireland, Slovak Republic  |
| Improve incentives for (formal) labour force participation       | Ireland   |
| Taxation   |   |
| Reform/strengthen the structure of taxation                      | Austria, Germany, Greece, Italy   |
| Reduce implicit taxes on continued work at older ages            | Belgium, Finland, Luxembourg, Slovenia  |
| Reduce the (average) tax wedge on labour income                  | Austria, Belgium, Finland, France, Greece, Germany, Italy, Netherlands          |
| Shift towards indirect taxes                                     | Austria, Belgium, Italy   |
| Reduce impediments to full-time female participation             | Germany   |
| Human capital  |   |
| Improve educational efficiency/outcomes/achievement              | Austria, France, Portugal, Slovak Republic                                      |
| Strengthen primary education                                     | Greece  |
| Strengthen secondary education                                   | Greece, Italy, Portugal, Spain  |
| Reform tertiary education  | Austria, Germany, France, Italy, Portugal, Slovenia                             |
| Financial regulation   |   |
| Improve/streamline financial regulation                          | Spain (priority at EU level)  |
| Other areas  |   |
| Reduce producer support to agriculture                           | (Priority at EU level)  |
| Improve public sector efficiency                                 | Finland, Greece, Portugal   |
| Strengthen R&D and innovation incentives                         | Ireland, Slovak Republic  |
| Reform bankruptcy procedures                                     | Ireland   |

1. These reform priorities were set in 2012 and reported in the 2013 edition of *Going for Growth*.  
Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris.

Although it is still early in the process and significant progress has been made, reform has been too slow so far in several countries and most countries are lagging behind many of the 2020 targets, in part because of the strains imposed by the crisis. The employment rate of the 20-64 year old population is stabilising at 68.5%, well below the 75% target and poverty rates have increased recently. R&D spending is still fluctuating just above 2% of GDP, short of the 3% target. The economic crisis has helped reduce GHG emission to 83% of

the 1990 reference level, not far from the 80% target, but economic recovery could reverse some of the recent gain. Almost all country-specific recommendations (CSRs) are partially implemented, in some cases to a large extent, although there has been no implementation in a few cases (EC, 2013a).

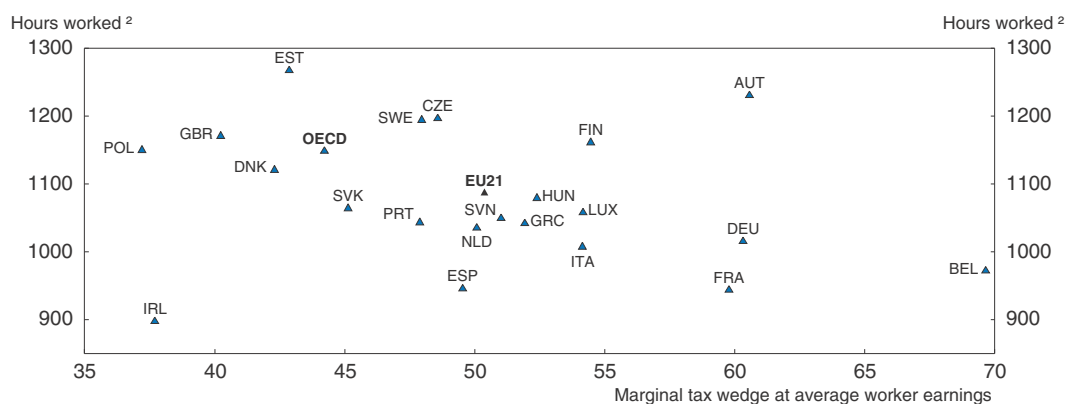
### **Stronger co-ordination, quantification of benefits and attention to inclusiveness can help implementation**

Implementation of economic reforms can be improved by strengthening the current “soft” co-ordination in the European Semester process. According to OECD analysis (OECD, 2010a), reform implementation and results require strong united leadership, an electoral mandate and effective and timely communication underpinned by solid research. Spill-over effects of policies have received little attention in the European Semester (Hallerberg et al., 2012) and each national administration tends to focus on its own country’s recommendations. Greater focus on spill-overs would strengthen peer interest and hence peer pressure. In particular, many reforms that boost domestic growth, such as easing regulations, can also benefit other EU countries, including by reducing implicit trade barriers within the Single Market.

National and EU actors can also increase national support and ownership of the European Semester’s recommendations by strengthening the underpinning analysis of the growth, employment and equity impacts of policies, deepening the dialogue with social partners, taking into account national political priorities and better co-ordinating communication with EU member states. The recent appointment of European Semester Officers by the Commission in the EU member states can help in this regard.

Estimating and disseminating the benefits of structural reforms can help improve their acceptability and implementation in EU member states. OECD research shows that structural reforms can offset permanent GDP losses from the crisis (Bouis and Duval, 2011), and a broad package of reforms could raise GDP per capita by some 20 to 25% on the long run vis-à-vis a baseline scenario with no reforms (Barnes et al., 2013; OECD, 2013a). The largest gains can be obtained by improving human capital, and by increasing work incentives by reducing the tax wedge on labour (Figure 12) and lowering replacement rates

Figure 12. **Higher tax wedge on labour<sup>1</sup> is correlated with less working activity**  
Single person without children, 2012



1. As a percentage of total labour compensation.

2. Per working-age population.

Source: OECD, Labour Force Statistics and Taxing Wages Databases.

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for unemployment insurance (Table 5). The 10 EU countries farthest away from best practice would gain even more, about 30% on average (OECD, 2013a).

**Table 5. The effect of “ten per cent” reform on GDP per capita<sup>1</sup>**  
Percentage change, average across OECD countries

|   | After 10 years | Steady state |
|---|----------------|--------------|
| <b>Labour market policies</b>             | <b>2.9</b>     | <b>4.5</b>   |
| Average replacement rate                  | 1.5            | 2.2          |
| Employment protection legislation (EPL)   | 0.3            | 0.6          |
| Maternity leave weeks                     | 0              | 0.1          |
| Childcare benefits                        | 0              | 0            |
| Childcare support                         | 0              | 0            |
| Standard retirement age                   | 0.9            | 1.7          |
| Implicit tax on continued work            | 0.1            | 0.1          |
| Average weekly normal hours and overtime  | 0.4            | 0.4          |
| <b>Taxation</b>                           | <b>2.3</b>     | <b>3.5</b>   |
| Average tax wedge                         | 1.4            | 2.1          |
| Marginal tax                              | 0.5            | 0.5          |
| Share of consumption and property taxes   | 0.4            | 0.7          |
| <b>Product market regulation</b>          | <b>2.3</b>     | <b>3.8</b>   |
| Gas                                       | 0.4            | 0.7          |
| Electricity                               | 0.3            | 0.6          |
| Road                                      | 0.2            | 0.4          |
| Rail                                      | 0.5            | 0.9          |
| Air                                       | 0.2            | 0.4          |
| Post                                      | 0.4            | 0.7          |
| Telecommunications                        | 0.2            | 0.4          |
| <b>Openness</b>                           | <b>0</b>       | <b>0</b>     |
| FDI restrictions                          | 0              | 0            |
| Tariff barriers                           | 0              | 0            |
| <b>R&amp;D incentives</b>                 | <b>0.1</b>     | <b>0.2</b>   |
| R&D tax subsidies                         | 0.1            | 0.2          |
| R&D direct subsidies                      | 0              | 0            |
| <b>Human capital</b>                      | <b>0.6</b>     | <b>11.6</b>  |
| PISA score                                | 0.3            | 5.1          |
| Average years of schooling (15-24 cohort) | 0.3            | 6.5          |

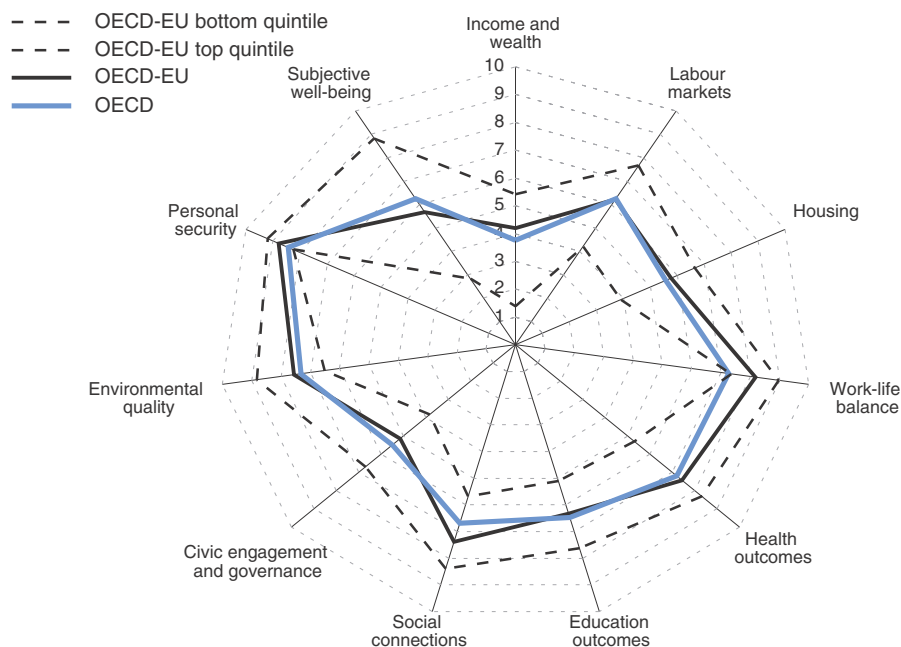
1. Policy indicators are changed by 10% of their most recent available values in each country in the direction of increasing GDP. For example, unemployment benefit replacement rates and the product market regulation indices are reduced by 10% of their most recent values. These shocks tend to be much bigger than most reforms carried out in the OECD area over the past decade (except in the area of product market regulation), though some individual OECD countries have implemented more ambitious reforms.

Source: Barnes, S. et al. (2013), “The GDP Impact of Reform: A Simple Simulation Framework”, *OECD Economics Department Working Papers*, No. 834, OECD Publishing, Paris.

Ultimately, structural policy reforms will be acceptable, and therefore sustainable, only if they address issues such as inclusiveness, environmental concerns and other aspects of well-being, as measured in *How's Life* (OECD, 2013c). These issues require country-specific analysis, as well-being outcomes are quite dispersed across EU countries (Figure 13). Also, the crisis has adversely affected well-being. For example, a recent survey reported that between 2007 and 2012, subjective life satisfaction declined by more than 20% in Greece, 12% in Spain, and 10% in Italy, although it increased moderately in Germany and Sweden (OECD, 2013c).

Figure 13. Well-being outcomes<sup>1</sup>

2013



1. Each well-being dimension is measured by one to three indicators from the OECD Better Life indicator set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between 10 (best) and 0 according to the following formula:  $(\text{indicator value} - \text{worst value}) / (\text{best value} - \text{worst value}) * 10$ .

Source: OECD Better Life Index, [www.oecdbetterlifeindex.org](http://www.oecdbetterlifeindex.org).

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Increasing human capital and bringing more people into the labour market would enhance growth inclusiveness, reduce income disparities and hence raise well-being. Win-win policies that increase growth while preserving social cohesion can be identified (OECD, 2012b) and reforms can be sequenced to minimise social impact (OECD, 2013b). Where reforms involve trade-offs, additional policies that directly aim at reducing inequalities, for example by cushioning the impact on most vulnerable groups, or ensuring long-term sustainability are needed, as policies recommended in the 2013 *OECD Economic Survey of Greece* (OECD, 2013d) for instance. Employment, social and environmental impacts of reforms should be systematically assessed in the European Semester process and in adjustment programmes, so as to favour win-win policies and to add further corrective policies when needed.

Inclusive growth and dealing with the social costs of the crisis would benefit from more attention to policies dealing with high unemployment in the European Semester process. The European Council initiatives adopted in June 2013 to address youth unemployment are welcome, but their impact is likely to be marginal in the near future. The flagship initiative, the Youth Guarantee, is a commitment to provide a good quality offer (e.g. job or training) to all young people. Its implementation will take time (EC, 2013b), and it may deliver little results unless complementary actions on the labour-demand side boost job offerings. Lowering high structural unemployment calls for comprehensive

labour market policy reforms, as recommended in *Going for Growth* (OECD, 2013b) and in the European Semester's country-specific recommendations.

Once appropriate job incentives are in place, strengthening active labour market, training and social policies is essential to raising inclusive employment, especially in the current context of depressed demand and economic change. In particular, less-skilled workers, including those hit by international competition, need training to adapt to the new economic environment. Training schemes are numerous, widely heterogeneous and complex. A comprehensive evaluation of each scheme can help to identify best practices, such as appropriate guidance to the less-educated individuals and quality controls as recommended in the *Skills Strategy* (OECD, 2012d). In countries with high long-term unemployment rates, reforms in active labour market and training policies are particularly important to avoid long-term losses in skills.

### **Reducing regulatory burdens can strengthen productivity**

Regulation of both EU and national origin may have benefits but also unnecessary costs. This *Survey* discusses how to reduce EU-origin regulatory burdens, while measures to reduce those of national origins are discussed in country specific *OECD Economic Surveys*. EU rules may align or replace national legislation, thus bringing about a reduction in the cost of doing business across the Single Market, as discussed in the Single Market Chapter.

However, Europeans perceive a rise in regulation of their societies (OECD, 2009). The complexity of institutional structures and the range of players, regulators, implementers and enforcers of regulation, all contribute to this. Estimates by national authorities suggest that EU-origin regulations account for 40-50% of the total administrative burden imposed on firms (OECD, 2009). In some cases, such as food labelling, very detailed EU-rules raise firms' costs. In addition, complex EU governance raises administrative demands on national administrations (Schout and Jordan, 2008).

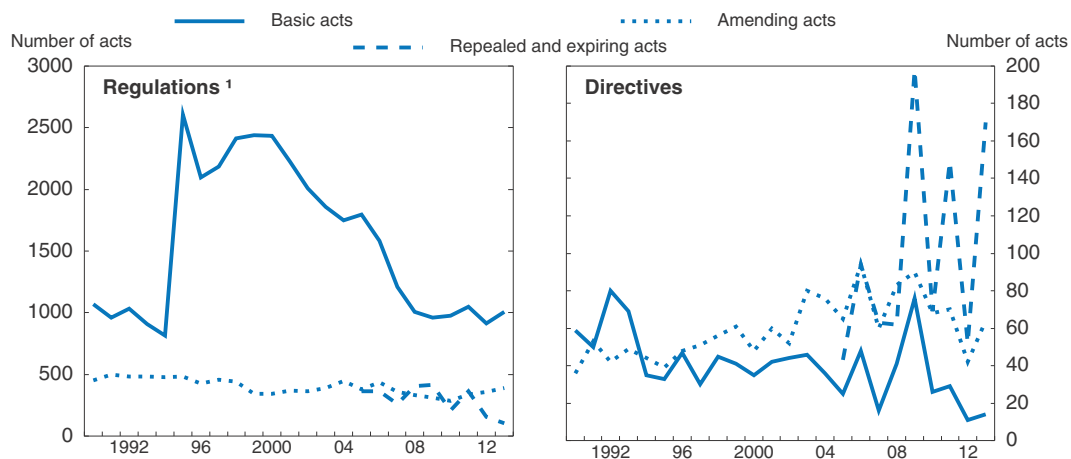
Over the last decade, the EU has launched a number of initiatives to improve the quality of legislation, such as an Impact Assessment system for new Commission proposals, the EU Administrative Burden Reduction (ABR) initiative, and the Regulatory Fitness Performance Programme (REFIT). The objective of the ABR was to cut the EU-origin administrative burden on businesses by removing unnecessary reporting requirements. According to the Commission, the proposed 25% reductions in burdens covered by the initiative have been adopted by the European Parliament and the Council, equivalent to EUR 31 billion in potential annual savings for businesses (EC, 2012a). However, many measures remain to be implemented at the national level. The Commission is in the process of extending this effort through the REFIT programme (EC, 2013d). In particular, in this programme the Commission's consultation of small and medium enterprises (SMEs) has already identified simplification measures (EC, 2013c); they should be considered by policy makers.

EU member states can further increase EU-origin regulatory burdens through the domestic legal acts needed to transpose directives into national law. These are estimated to be about a third of the burdens (EC, 2012b). The REFIT programme aims to identify these burdens and corresponding simplification measures. Consistent with subsidiarity and proportionality principles, actions can be taken at the EU level to counteract excessive practices. First, in certain policy areas a limited number of directives may be replaced by EU regulations, which do not require national transposition (EC, 2006). Second, directives can

be drafted in a more effective way to reduce room for interpretation, and undue loopholes. Third, EU level institutions need to communicate to explain to people cases where national authorities added unnecessary burdens. Democratic oversight cannot function when voters do not know at which level each decision is taken.


REFIT focuses on the burdens attached to existing legal acts through their revision and repeal. It has also led to the withdrawal of proposals and to the decision not to take forward certain initiatives. The Impact Assessment System covers the flow of new Commission proposals (Figure 14). To manage the clear risk that the overall stock of EU legislation is still getting increasingly complex, the European Parliament and Council should also systematically assess the impacts of any substantial amendments to Commission proposals. In addition, administrative burdens can be further reduced by deeper reforms that involve changes in policy design, as discussed in OECD (2010b).

Figure 14. **Generation of legal acts**



1. The rise of the number of acts in 1995 reflects a high number of international trade regulations.

Source: EUR-Lex (Official Journal of the European Union on line).

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Beyond those imposed on firms, EU procedures also generate burdens for national administrations. While it is essential that national administrations that know local specificities and implementation issues are involved in designing and implementing EU procedures, national public resources are needed, and this cost is proportionally heavier for the smaller EU countries. Care should be taken, and data made available, to ensure that these costs are assessed for both new and existing legislation. As there is a clear interaction between firm-level and national-level costs of regulation, it is appropriate that REFIT covers both.

### **EU Cohesion Policy can support EU 2020 targets and the recovery**

EU Cohesion Policy, which funds projects to diminish regional economic and social disparities, is being reformed. This reform seeks to ensure that EU funding is better targeted to attain the Europe 2020 goals for growth and employment and to streamline procedures, in line with recommendations of the last Survey (OECD, 2012c). Analysis indicates that in the past funds have not often been well targeted to growth-enhancing

investment and procedures have been administratively cumbersome (LSE Enterprise, 2011; OECD, 2012e).

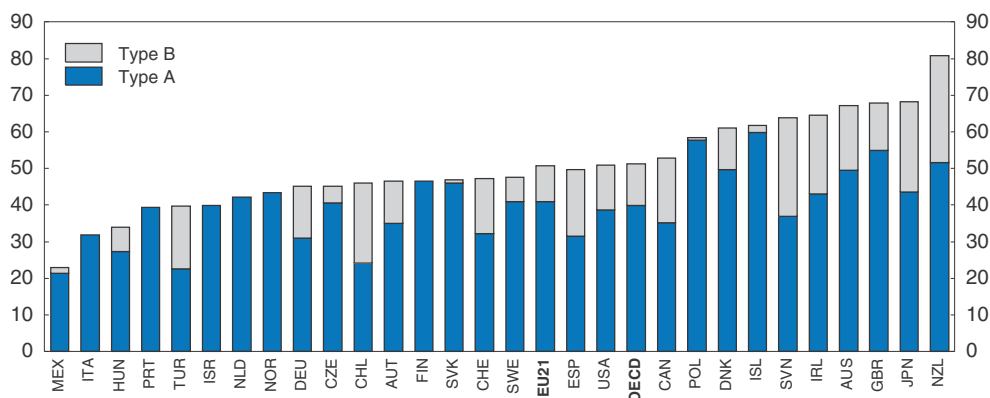
To encourage better targeting, “Partnership Agreements” are agreed between the Commission and EU member states. They specify countries’ economic objectives (out of a menu of 11, reflecting “Europe 2020” priorities), targets to be reached by the end of the programme period, performance indicators and milestones, and governments’ commitments for action. Certain conditions have to be met prior to the disbursement of funds (e.g. the proper functioning of public procurement systems), and 6% of funding conditional upon performance, to be evaluated in a mid-term review. The Commission can request Partnership Agreements to support the implementation of Council recommendations. Failing to take remedial actions may lead to suspension of funding. However, verification of compliance with commitments and associated decisions about continued funding could prove difficult and give rise to disputes. It is obviously too early to assess this wide-ranging reform, but much will depend on the transparency and clarity of the partnership contracts, as otherwise procedures risk becoming too burdensome and evaluation may be compromised.

### **Developing the knowledge-based economy can boost productivity**

Knowledge-based capital (KBC) – assets that lack physical embodiment, such as computerised information, innovative property and economic competencies – is essential to allow firms to compete in new technology sectors. It is influenced by education, R&D, ease of resource allocation, patenting, and bankruptcy law.


KBC can be boosted by better education and training policies. Graduation rates in tertiary education vary widely across countries (Figure 15), and there is scope for increasing them in some countries. While the EU 2020 target encourages raising graduation rates, the Commission should assess education quality, potentially making use of the labour market achievements of graduates and of OECD data on skills (Programme for the International Assessment of Adult Competencies).

Figure 15. **Graduation rates in tertiary education**<sup>1</sup>  
Sum of age-specific graduation rates and programme destination, 2011



1. Tertiary-type A programmes are largely theory-based. Tertiary-type B programmes are typically shorter and focus on practical, technical or occupational skills.

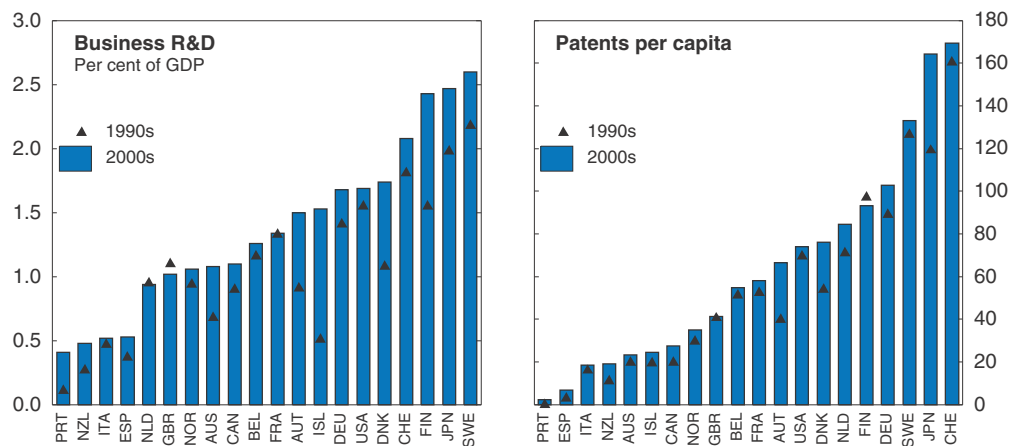
Source: OECD (2013), *Education at a Glance: OECD Indicators*, Table A3.1, OECD Publishing, Paris.

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Another lever for KBC is innovation. At 2% of GDP, EU R&D spending is below that in Japan or the United States. In Italy, Portugal and Spain, business R&D spending is particularly low (Figure 16). By contrast, in a few countries in the EU such as Sweden, Germany and Finland, businesses spend more in R&D activities and reap the benefits in terms of patents (Figure 16).

Figure 16. **Business outlays for research and development (R&D) and patents per capita<sup>1</sup>**



1. The patent measure is based on triadic patents, which refer to a series of patents for the one invention filed at the European Patent Office, the United States Patent and Trademark Office and the Japanese Patent Office.

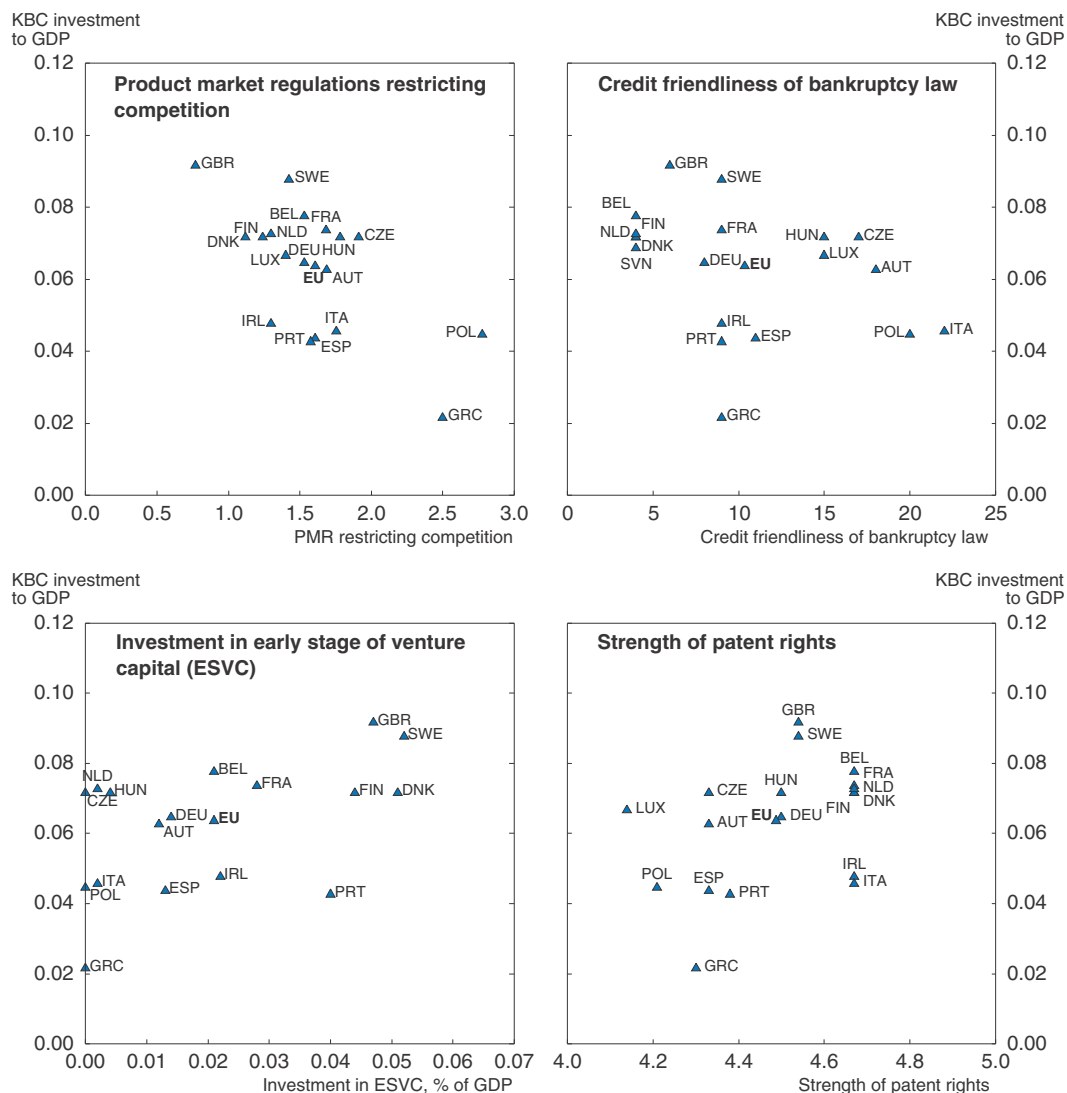
Source: Andrews, D. and C. Criscuolo (2013), "Knowledge-Based Capital, Innovation and Resource Allocation", OECD Economics Department Working Papers, No. 1046, OECD Publishing, Paris.

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At the EU level, the Horizon 2020 framework programme for research and innovation will foster EU innovation policy and simplify its implementation by setting a single set of rules and by combining all research and innovation funding in a single strategic framework. It will be co-ordinated with closely related areas such as support for SMEs. It also aims at strengthening co-operation between private firms and public research entities, which is important to generate marketable innovation (Andrews and Criscuolo, 2013). Implementation is the key to achieving genuine simplification and efficient co-operation between private and public sectors. Public support to innovation can enhance private R&D, but this is not always the case (Westmore, 2013). The public funding design has to be sensitive to market signals. For example, grants could be structured to require firms to match in some proportion the support received. Countries that lag behind could also develop refundable R&D tax incentives to meet the needs of young firms that have not yet made profits (Andrews and Criscuolo, 2013).


Apart from direct support, investment in KBC appears to be related to good bankruptcy law, flexible product market, early stage venture capital and strong patent rights (Figure 17). Bankruptcy laws vary across EU countries, pointing to possible gains from adopting best practices, which could be encouraged by the EU, perhaps through directives or guidelines. In addition, acute financing constraints for young innovative firms lacking a track record to signal their "ability or bankability" can be eased by venture capitalists.

Figure 17. **Investment in knowledge-based capital (KBC) and selected public policies<sup>1</sup>**



1. Intangible investment to GDP is measured in 2005, while the policy indicators refer to either 2003 (PMR and bankruptcy law) or 2005 (patent rights and early stage of venture capital).

Source: OECD calculations based on intangible capital estimates from Corrado et al. (2012), "Intangible Capital and Growth in Advanced Economies: Measurement Methods and Comparative Results", IZA Discussion Papers 6733, Institute for the Study of Labor; and policy indicators from the OECD (PMR, EPL), World Bank (Bankruptcy Law), and Park, W. (2008), "International Patent Protection: 1960-2005", Research Policy 37, Elsevier, [www.sciencedirect.com](http://www.sciencedirect.com).

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Lower labour market protection, taxation on corporate income and capital gains, well-functioning secondary stock market, and public co-investment funds can help attract them (Andrews and Criscuolo, 2013). The Unitary Patent in the EU, planned for 2014, is an important step to simplify patenting procedures and reduce costs.

### Recommendations to boost growth, employment and innovation

#### Key recommendations

- Enhance the EU Semester process by focusing more on spill-over effects, strengthening the underpinning analysis, systematically assessing employment, social and environmental impacts of reforms. Continue to address structural imbalances, and better co-ordinate communication with EU member states.
- Reinforce the EU Impact Assessment system and the new EU Regulatory Fitness (REFIT) programme to improve the design of policies and reduce burdens for firms and national public administrations.
- Implement the EU Horizon 2020 framework programme for research and innovation to simplify procedures, and bridge a gap between research institutions and the private market.

#### Further recommendations

- Identify best practices in active labour market and training policies to deal with the short-term costs of adjustment to reforms.
- Carefully monitor performance of cohesion policies and ensure transparency and clarity in “Partnership Contracts”.
- Ensure evaluation of education and training focuses on successful outcomes in terms of jobs.
- Consider an initiative to identify and support best bankruptcy practices, such as bankruptcy laws that do not overly penalise failure.

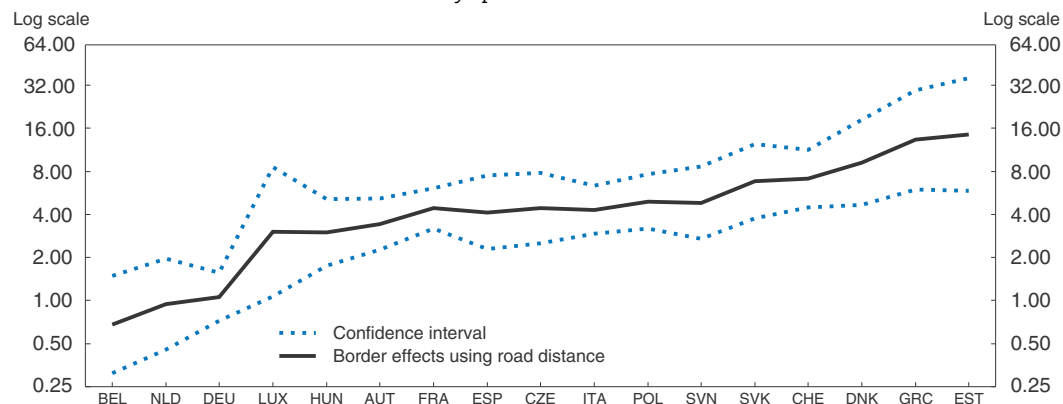
## Reinvigorating the Single Market to boost growth and employment

### Internal barriers still impede the Single Market

Completing a genuine Single Market in the EU can deliver large gains (OECD, 2011b). According to the Commission, the Single Market generated an extra 2.8 million jobs in the EU and an additional 2% in GDP from 1992 to 2008 (EC, 2012c). However, much more can be done as the EU economy is still fragmented (Braconier and Pisu, 2013; Figure 18). The small

Figure 18. Trade between EU member states

Country specific border effects<sup>1</sup>



1. The border effect is a measure of the reduction of trade due to a border. For instance, in Estonia trade within the country is almost 15 times larger than trade across the border, everything else (e.g. road distance) equal. For further detail on the estimation, see Source.

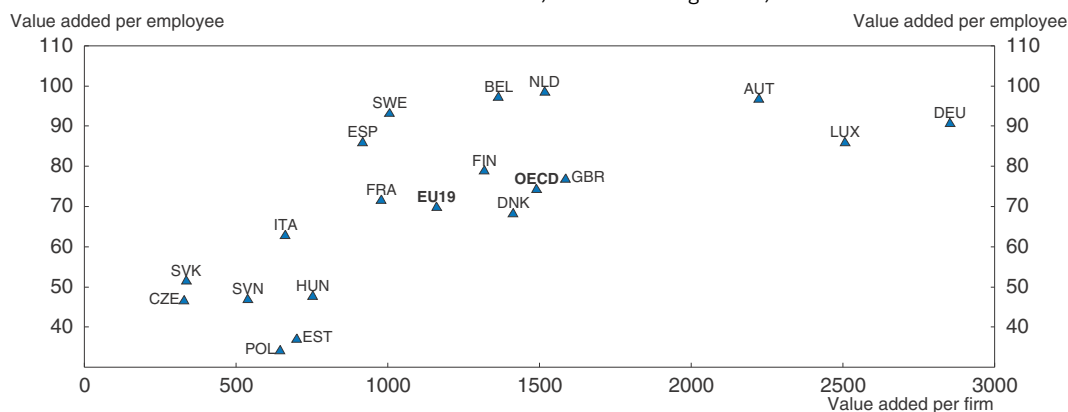
Source: Braconier, H. and M. Pisu (2013), “Road Connectivity and the Border Effect: Evidence from Europe”, OECD Economics Department Working Papers, No. 1073, OECD Publishing, Paris.

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size of firms in the EU relative to the United States, as shown in the last *Survey* (OECD, 2012c), is an indicator of the costs of fragmentation and lost opportunities in exploiting economies of scale. The positive correlation between the size of firms in terms of number of employees and their productivity in the manufacturing sector suggests that the largest firms are more productive (Figure 19).

**Figure 19. Productivity is higher in large firms**

Value added in thousand EUR; manufacturing sector; 2011<sup>1</sup>



1. Or latest available data.

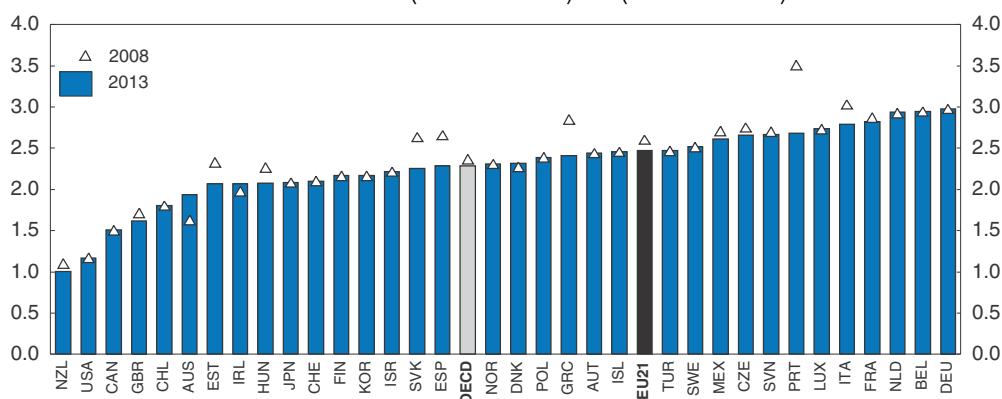
Source: US Census Bureau; OECD, *Structural and Demographic Business Statistics Database, Structural Analysis (STAN) database and OECD Economic Outlook Database*.

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Fully reaping the benefits from liberalised trade and investment requires low barriers to the re-allocation of resources and flourishing innovation. Stringent domestic regulation reduces potential productivity gains from import competition substantially (Ben Yahmed and Dougherty, 2012), which tends to favour firms close to the technology frontier. The growth and employment benefits from trade integration can be realised sooner with flexible labour markets (Kambourov, 2009), which is an issue in most EU countries (Figure 20). Retail trade regulation also affects the benefits reaped by consumers and signals for reallocation by preventing prices from adjusting fully.

**Figure 20. Employment protection<sup>1</sup> is relatively high in the EU**

Index scale from 0 (least restrictive) to 6 (most restrictive)



1. Protection of regular workers against individual and collective dismissals.

Source: OECD, *Employment Protection Legislation database*.

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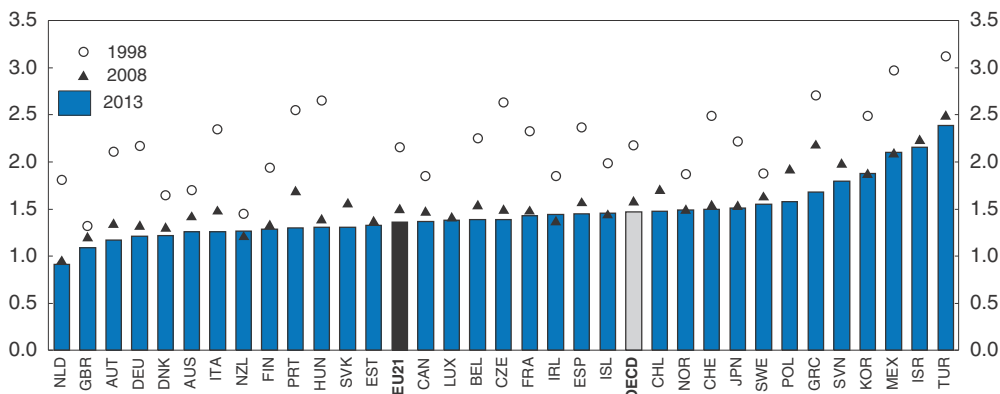
A package of policies to encourage economic integration through the Single Market has been identified in the Commission's "Single Market Act" and "Single Market Act II", and in the Monti report (Monti, 2010). These measures are a step change in the political priority of the Single Market, as discussed in the last *Survey* (OECD, 2012c), and can be further strengthened to fully tackle remaining barriers at their roots. For instance, a broad reform package that would align PMR indicators to the average of the top half of the best performers and would cut heterogeneity by one fifth, could increase trade intensity within the EU by more than 10% (Fournier et al., 2014).

Heterogeneity of rules and practices creates administrative costs and informational barriers to trade (Kox and Lejour, 2005; Fournier et al., 2014) and to investment, including FDI (Kalemli-Ozcan et al., 2014). Efficiency gains can be reaped from better harmonisation of regulations. In particular, in network sectors that are still regulated on a national basis (e.g. telecommunication, energy), efficiency gains can be achieved by making regulations more compatible and by the merger of regulators. The expertise of a unified regulator can also be stronger. The disadvantages of European wide regulation are likely to be lower than advantages, as regulators mainly handle technical issues, and as firms in network sectors are rather large and hence can better deal with language and cultural barriers. Co-operation between national regulators should be further strengthened, with a view to move towards cross-border regulators.

Tax-related administrative burdens also increase heterogeneity and costs for companies. They should also be harmonised and simplified while allowing national government to set tax rates that reflect national preferences. In addition, goods transported between EU seaports are still subject to the same custom formalities as goods from outside the EU. Concern about custom duty fraud can be addressed by new technologies (e.g. satellite observation), and formalities can be simplified, as shown by the "Blue Belt" Pilot project (EMSA, 2012). Product market regulations (PMR) in Europe remain restrictive despite recent reforms, maintaining impediments to the Single Market. The PMR indicator shows that between 2008 and 2013 gains in the EU as a whole have been very small, although they have been significant in a few countries (Figure 21). In addition, rule changes mainly reflect national policy choices, so heterogeneity hardly changed. The Commission could make more use of the link between national regulations and trade to analyse gains from regulatory reforms.

The 2013 PMR indicator also shows no improvement in the regulatory burden of services, and even deterioration in some countries despite the Services Directive (Figure 22). The Services Directive aims at removing discriminatory, unjustified and disproportionate national requirements on service providers, clarifies the requirements to ensure freedom of establishment, adopts the "silence is consent" rule and creates Points of Single Contact to streamline administrative formalities. However, firms that operate in different countries still have to comply with different sets of regulation reducing competition from foreign providers, especially from foreign SMEs. The Services Directive does not cover some sectors that are covered by other legal acts (e.g. telecommunication, energy, financial services), or public procurement. Foreigners still face implicit barriers, and the direct cross-border share of procurement is lower than 5%. The directives adopted

Figure 21. **Restrictiveness of economy-wide product market regulation**<sup>1</sup>  
Index scale from 0 (least restrictive) to 6 (most restrictive)



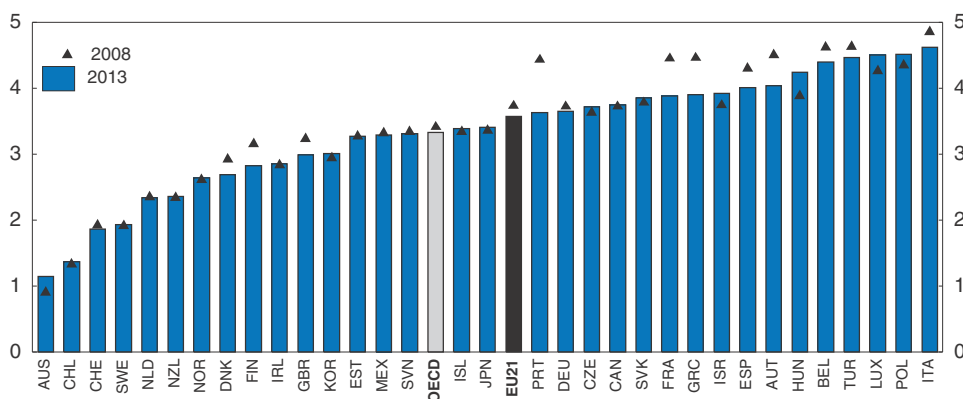
1. The set of PMR indicators is calculated with a revised methodology. For more details, see Source. Data for Luxembourg, Mexico, Poland and Turkey are preliminary.

Source: OECD, *Product Market Regulation Database*; OECD (2014), *Economic Policy Reform 2014: Going for Growth, Interim Report*, OECD Publishing, Paris; Koske, I. et al. (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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Figure 22. **Barriers in services show little change between 2008 and 2013 in the EU**<sup>1</sup>

Index scale from 0 (least restrictive) to 6 (most restrictive)



1. The set of PMR indicators is calculated with a revised methodology. For more details, see Source. Data for Luxembourg, Mexico, Poland and Turkey are preliminary.

Source: OECD, *Product Market Regulation Database*; OECD (2014), *Economic Policy Reform 2014: Going for Growth, Interim Report*, OECD Publishing, Paris; Koske, I. et al. (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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on February 2014 to reform public procurement will streamline procedures, including by establishing a European e-invoicing standard.

A more ambitious implementation of the Services Directive alone could generate an additional 0.6%-2.6% of GDP in the long run (Monteagudo et al., 2012). The Services Directive can be strengthened by eliminating unjustified or disproportionate restrictions to the cross-border provision of services and to the establishment of businesses. For example,

there are still too many restrictions on the right of establishment and on the freedom to provide services. The recent peer review on the implementation of the Services Directive (EC, 2013e) identifies in particular restrictions on the right of establishment and room for progress in the implementation of the Points of Single Contact.

FDI can be an important source of productivity gains, yet remaining FDI restrictions and product market regulations impede it (Nicoletti et al., 2003; Kalemli-Ozcan et al., 2014). In catching-up countries, lower productivity firms can achieve large productivity gains if they benefit from the expertise of foreign owners, if regulations do not impede the necessary restructuring. Stringent product market regulations have caused foreign investors to select highly productive firms (Kalemli-Ozcan et al., 2014). A few FDI restrictions remain in some sectors (e.g. media, real estates, transports). The Commission should consider an initiative to further reduce FDI barriers such as equity restrictions, approval requirements and other operational restrictions. FDI flows would also benefit from more efficient bankruptcy laws and civil justice systems. The latter is widely heterogeneous across EU member states (OECD, 2013e). Implementing minimum standards on statistics on civil justice would help.

National level enforcement of EU rules can also create heterogeneities in practice (Pelkmans and Correia de Brito, 2012). The SOLVIT network was created in 2002 to settle cross-border disputes informally. Fostering the visibility and the capacity of this network may be necessary to fully reap the benefits.

The proposed directive on free movement of workers would rightly require EU member states to take concrete action to guarantee a more effective and homogeneous application of EU law. In this context, its adoption (foreseen for April 2014) would implicate the existence of at least one body in every member state to provide assistance and information to EU workers and their family members on their EU rights. Adoption of the Directive on Acquisition and Preservation of Supplementary Pension Rights, also foreseen for April 2014, would be a substantial step forward. Reforms could be more ambitious, however, by eliminating double taxation of pensions, developing automatic qualification recognition and eliminating disproportionate national barriers related to regulated professions, as discussed in the last Survey (OECD, 2012c).

### ***The digital economy is opening up new opportunities for the Single Market***

The digital economy is expanding rapidly, opening growth and employment opportunities. However, polls indicate a lack of trust among consumers in cross-border e-commerce, calling for more effective data protection security measures, as envisaged in the Digital Agenda for Europe (EC, 2010b). Privacy protections need to be implemented in a manner that enables the benefits derivable from the use of personal data. In addition, access to markets is essential with consumers having difficulties making informed choices due to inadequate information disclosures and facing limitations in purchasing some products across borders. These obstacles, however, might be mitigated by the correct transposition of the Consumer Rights Directive, adopted in 2011. The authorities need to be able to prevent network or platform providers from abusing market power, to ensure a level playing field. This issue is addressed by the “Connected Continent” package, although the

European Data Protection Supervisor (EDPS, 2013) considers that providers would still be given large rights to manage Internet traffic. As digital activities can easily move across countries (OECD, 2008), regulation would be more effective at the EU level rather than at the country level.

According to the Commission, investment in high speed communication networks is too low (EC, 2012c). In response, the Commission helps infrastructure project funding by extending guarantees. Investment shortages also suggest a lack of competition in some markets to spur new investment. In France, for example, record levels investment reflects the introduction of increased competition particularly in the broadband market. Further deployment can also be facilitated by encouraging cross-utility reuse of infrastructure (EC, 2012c), but not from any diminution in competition. This is the main objective of the proposed regulation on measures to reduce the cost of deploying high speed electronic communication infrastructure (EC, 2013f).

### ***The Single Market can be strengthened with openness to the rest of the world***

Trade agreements would open opportunities to broaden the scope of the Single Market. Multilateral trade agreements would be the best way to reducing trade barriers, but progress has become very slow: the Doha round started in 2001 and reached a first agreement on trade facilitation only in December 2013. Plurilateral agreements, provided that they are open and cover a critical mass of world trade, are a useful tool to address trade barriers among a range of WTO members in certain sectors and can serve as building blocks for multilateralism. Examples in which the EU is involved include the negotiations on an Information Technology Agreement, Trade in Services Agreement and the recently-launched Environmental Goods initiative. Finally, free trade agreements (FTA), notably with the United States and Japan, are another key way for EU firms to realise benefits of globalisation of value chains across the world. In particular, a trade agreement with the United States would be a major step with large potential gains (OECD, 2005). Beyond the cut of remaining tariff barriers, this negotiation is an opportunity to reduce non-tariff barriers by removing unnecessary costs and delays for trade, for example by introducing mutual recognition of standards and procedures. It could become a building block for future multilateral initiatives.

Simultaneously, the EU should continue its efforts with other counterparts, with an emphasis on trade agreements with partners that have a strong political will to reach an agreement, are able to deliver high standards of trade liberalisation, have a large potential for gains, on grounds of size, different specialisations, large trade barriers, or because the partner's rapid growth creates major business opportunities. To avoid trade diversion costs, the agreements should cover substantially all trade (and investment) between the countries. While such outcomes are typically best achieved through multilateral or bilateral trade liberalisation initiatives by fostering the integration of firms in global value chains, preliminary results by Miroudot et al. (2013) indicate that further trade opening by countries to the rest of the world can under certain circumstances also yield significant productivity gains.



### Recommendations to reinvigorate the Single Market

#### Key recommendations

- Improve the implementation of the Services Directive, in particular by eliminating unjustified and disproportionate restrictions to the cross-border provision of services and to the establishment of businesses.
- In network sectors that require regulation, further strengthen co-operation between national regulators, with a view to moving towards cross-border regulators.
- Deepen the internal energy market through further development of energy interconnections.
- Move forward with the adoption of the proposed directives on free movement of workers and on acquisition and preservation of supplementary pension rights. Take measures to eliminate double taxation of pensions, develop automatic qualification recognition, and eliminate disproportionate national barriers related to regulated professions.
- Continue the intensive engagement in multilateral trade negotiations, move forward with a trade agreement with the United States to reduce non-tariff barriers, while continuing to negotiate trade agreements with other partners.

#### Further recommendations

- To encourage FDI, consider an initiative to further reduce equity restrictions, approval requirements and other operational restrictions.
- Identify areas where the heterogeneity of regulations and tax-related procedures can be further reduced and strengthen efforts to enforce the EU law at the national level.
- Build a regulatory framework for the digital economy by establishing technical and legal security and privacy standards, enabling authorities to prevent dominant providers from undertaking practices that abuse market power in the provision of Internet services.

## Towards a low carbon economy

### Combating climate change

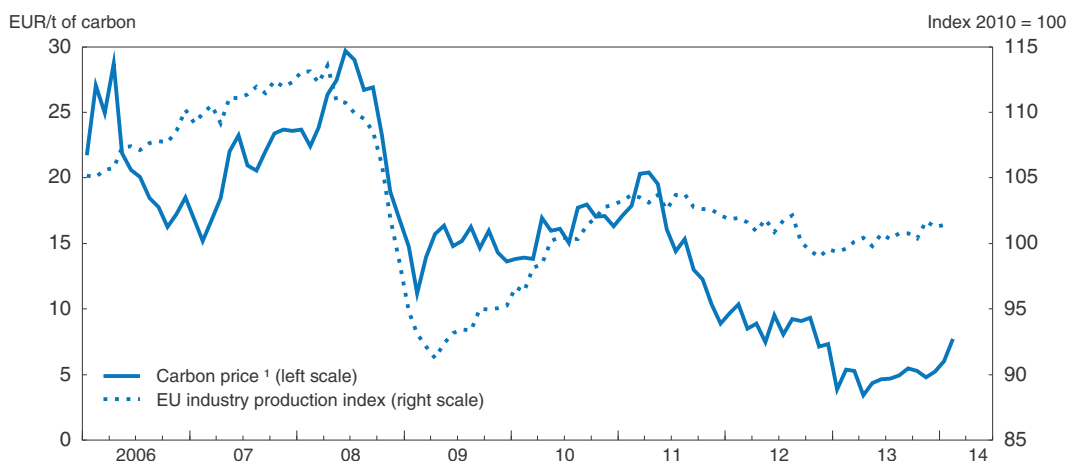
World GHG emissions are estimated to increase by another 50% by 2050, under current policy, primarily driven by energy use (OECD, 2012f). Curbing global emissions beyond 2020 would require a rapidly increasing global carbon price to an estimated EUR 250 per ton of CO<sub>2</sub> in 2050 (OECD, 2012f). The EU has pioneered a carbon market, the *European Union Emissions Trading Scheme* (hereafter, ETS) to achieve its 2020 GHG emissions target, a 20% reduction in EU greenhouse gas emissions from 1990 levels. The system covers nearly 50% of total EU emissions (EC, 2013g). The ETS tightening between the first (2005-2007) and the second (2008-2012) trading periods has reduced emissions by roughly 4% (Abrell et al., 2011). These gains are uneven across sectors, suggesting the ETS succeeded in favouring emission reduction in sectors with the lowest marginal abatement costs (Abrell et al., 2011).

Climate change mitigation would be best achieved within a multilateral treaty to ensure a level playing field, as a global carbon price would substantially reduce the cost of action (Dellink et al., 2013). The EU is taking part in the Clean Development Mechanism in

developing countries to earn certified emission reduction, and is also considering linking the ETS with similar markets.


In the EU, the emission target is not ambitious enough to address the climate change challenge. Lower economic activity than had been expected when the targets were set has opened up an opportunity to make greater progress. In the wake of the 2008 global crisis, the ETS allowance price fell to below EUR 5 per ton of carbon dioxide emitted (Figure 23). Since then, a surplus of emission allowances has developed (EC, 2012d). The recent “back-loading” initiative to postpone auctioning of allowances only partially resolves this issue, as revealed by the absence of substantial price change. This depressed price weakens the incentive to develop cleaner technologies and, along with increased coal exports from the US connected to shale gas, coal-powered electricity generation is on the rise in Germany. In addition, an unstable carbon price represents an uncertainty cost that can impede development of low-carbon technologies.

Figure 23. **The EU emission allowances price has collapsed**



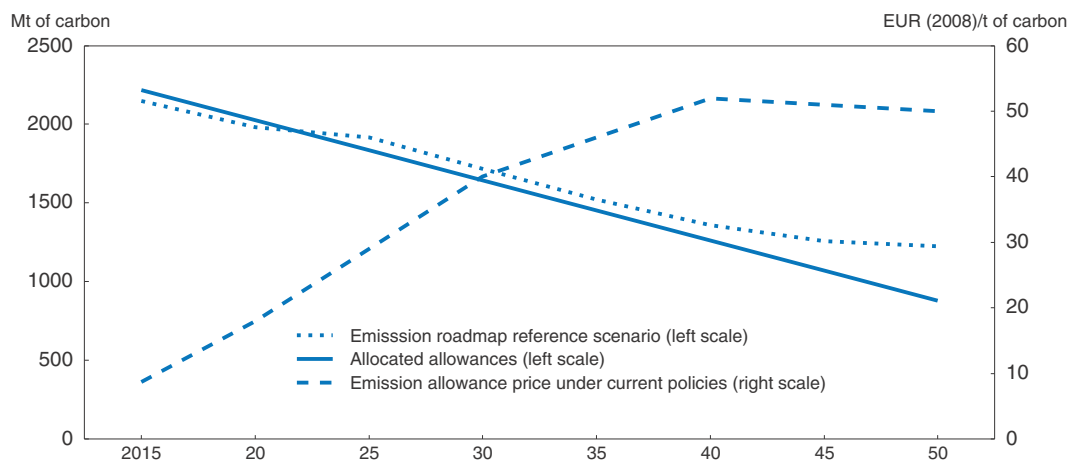
1. EUA Futures Contract, settlement price.

Source: ICE Intercontinental Exchange; Datastream; Eurostat.

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The ETS currently suffers from lack of credibility that long-term targets will be achieved, which reduces incentive to invest in abatement. This may be reflected in the currently low price of ETS allowances. The planned decline in the supply of pollution allowances under current policies is below emission expectations (Figure 24). If the long-term credibility of the system were higher, this expected mismatch between supply and demand should generate an upward pressure on prices. Credibility can be undermined by political uncertainties (Brunner et al., 2011). The current low price of the ETS makes it look ineffective, encouraging national policy makers to increase national level incentives to reduce carbon emissions. These policies, by depressing the demand for allowances, further depress allowances prices. This could develop into a vicious circle (Zachmann, 2013), in which the emission reduction process would not be efficient anymore. This lack of credibility should be decisively tackled by setting an ambitious 2030 emission target, and by adjusting the ETS emission cap accordingly.

The exclusion of several sectors (e.g. road transport, agriculture) from the ETS, as well as the different level of energy taxation applied in different sectors, raises the prospect that

Figure 24. **Expected demand and supply of emission allowances**

Source: EC, Energy Roadmap 2050.

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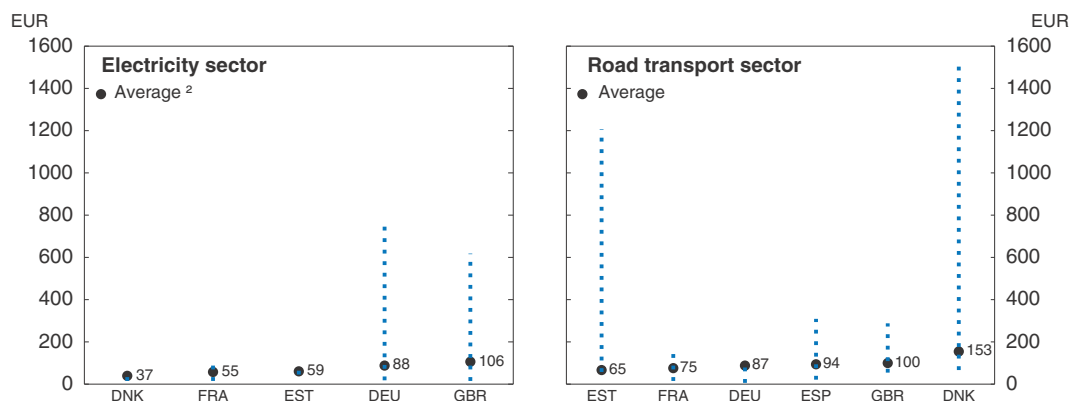
marginal emissions reduction costs will vary sharply between sectors, which would raise the overall costs of emissions reductions. Harmonisation of carbon price might be achieved by introducing a CO<sub>2</sub> component in energy taxation that would reflect as much as possible the ETS price, and by making sure that each sector and operator is either subject to CO<sub>2</sub> taxation or participates in the ETS, as appropriate. Keeping carbon prices aligned will be challenging. Road transport and fuel emission in the agriculture sector can be included in the ETS by making fuel suppliers responsible for surrendering CO<sub>2</sub> permits but would need to take into account different practices in EU member states. ETS coverage has been extended to domestic and international aviation, but with the creation of a dual market: other emitters cannot use the aviation allowance. Such sector specific arrangements are inefficient and should be suppressed.

Subsidies that favour CO<sub>2</sub> emission reduction are widely heterogeneous across countries and technologies (OECD, 2013g; Figure 25), creating distortions within the Single Market in favour of options that maximise subsidies. For instance, subsidies for solar panels in Germany are much higher than in Greece: this does not reflect solar energy potentials. Research subsidies are justified to stimulate R&D and to correct for market failures that pricing alone cannot address (Acemoglu et al., 2012). Reforms of inefficient energy subsidies can be achieved through an overhaul of the state-aid guidelines for renewable energy subsidies.

Likewise, the renewable energy target can be justified by the need to spark R&D on the issue, but the target should be set to avoid imposing sharply different marginal costs of emissions reductions, compared to the ETS. In the same vein, the systematic assessment of the environmental impact of policies to support bio fuels, including indirect land use change as proposed by the Commission (EC, 2012e), is welcome. This approach is likely to prove less costly than setting quotas on types of biofuels.

In addition, remaining inefficient fossil fuel subsidies (see OECD, 2013g, for an inventory) should be gradually suppressed, as they work directly against the carbon emissions reduction goal. However, the higher energy prices that might result could be regressive and increase energy poverty, straining existing social safety nets. The

Figure 25. **Effective carbon prices in selected countries**  
2010 EUR per tonne of CO<sub>2</sub> abated<sup>1</sup>



1. The dotted lines indicate the minimum and maximum price range.
2. Single weighted average for Denmark and average of weighted averages for the others.

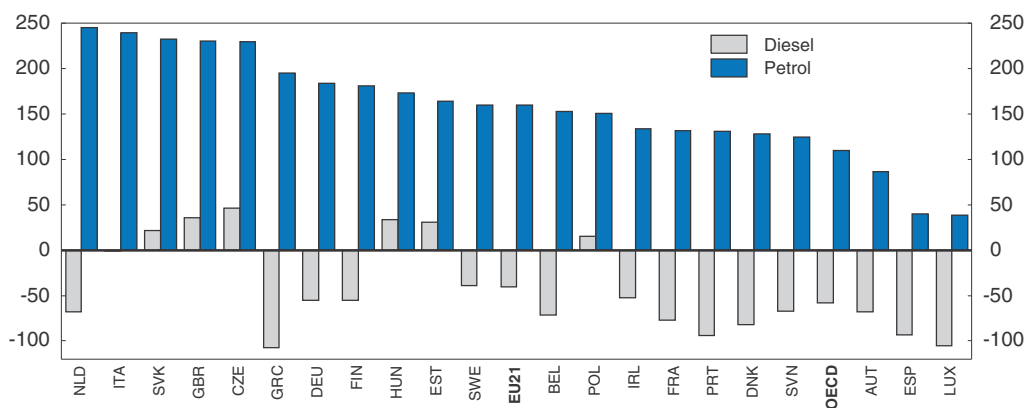
Source: OECD (2013), *Effective Carbon Prices*, OECD Publishing, Paris, Figures 3.1 and 3.9.

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authorities will need to monitor the situation carefully and strengthen their social safety nets as needed.

Improving environmental outcomes require taking into account all externalities, including not only GHG emissions, but also air pollution, noise, congestion, land use, etc. Ultimately, prices adjusted for externalities should be equalised, which is notably not the case with fuels such as diesel and petrol (Figure 26). For this purpose, a price has to be set on each externality (e.g. congestion charges). This would also be more efficient than the current use of emission standards.

Figure 26. **Diesel and petrol prices adjusted for externalities**<sup>1</sup>  
EUR/tonne of CO<sub>2</sub>, 2012 Q4



1. The implicit carbon price for diesel and gasoline in the transport sector is obtained by subtracting the external costs of negative externalities from the carbon price implied by excise tax. The external cost contains air pollution, noise, accidents and congestion. The implied carbon price is computed by converting the excise tax per litre to a tax per tonne of CO<sub>2</sub> after deducting the estimated cost of a range of externalities associated with burning fuel.

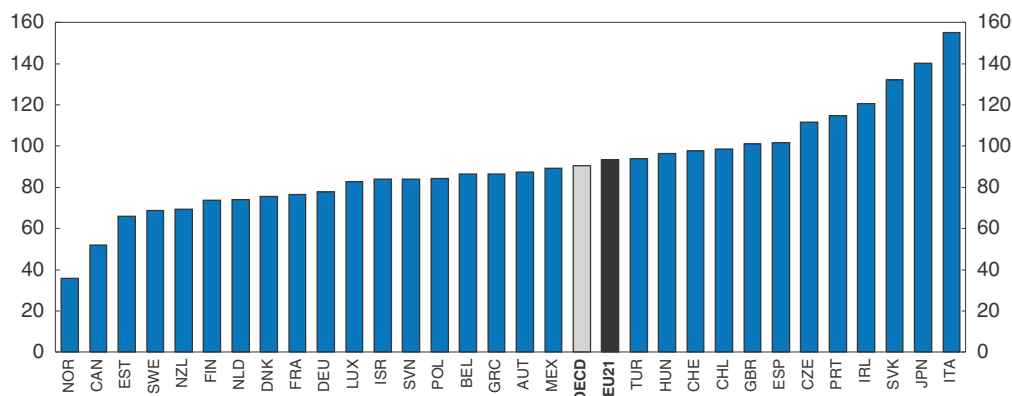
Source: OECD calculations.

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### Investing in electricity grids and interconnections

Commission estimates point to considerable investment needs for grids by 2020 (EUR 140 billion for electricity and EUR 70 billion for gas; EC, 2011). Renewable energy growth can only occur with additional electrical grid infrastructure, with a special focus on interconnection of national networks. Some areas in the EU, like the Iberian Peninsula, still have only limited connections to European electricity and gas networks. Price differences between neighbouring countries reveal important network bottlenecks (Figure 27). Vertically-integrated national incumbents with large market shares in home countries have a strong interest in stifling investment in interconnection capacity to protect their own national markets. Ownership unbundling of generation, supply and network activities within vertically-integrated electricity utilities is needed, in the states where they are not realised so far, to address conflicts of interest. Permit procedures should be streamlined where possible. In addition, the Commission should continue its efforts to promote smart grids by developing binding network codes and guidelines. The regulation on Guidelines for trans-European energy infrastructure is in force since May 2013, including Projects of Common Interest (PCI).

Figure 27. **Electricity prices for industry**  
EUR per thousand kilowatt hours before taxes, 2012<sup>1</sup>



1. Or latest available data.

Source: IEA, Energy Prices Database.

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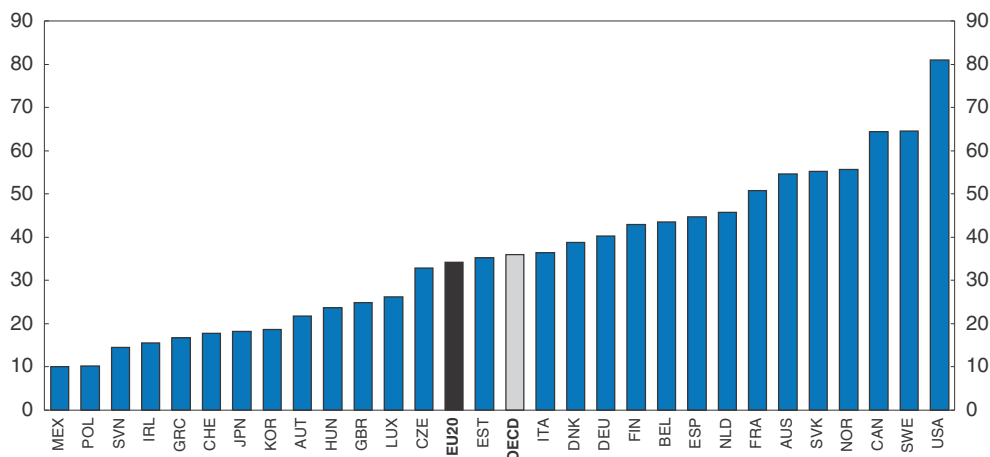
A sound assessment of energy infrastructure needs requires switching from national assessment of needs to EU-wide assessment. Unfortunately, as discussed in Black (2013), the co-ordination of national policies in the energy field is hampered by the perceived divergence of national interests. National decisions taken independently have led to over-investment in production capacities, illustrated by levels of spare production capacities. As each country is making conservative and hence low assumptions of the evolution of production capacities of its neighbours, it can overestimate capacity investment needs.

### Aligning the Common Agricultural Policy (CAP) with environmental goals

As payments have become increasingly decoupled from production, the CAP has come closer to being a system for delivering public goods and supporting various rural and environmental objectives. The CAP agreement reached on June 2013 moves in the right

direction by distributing payments in a fairer way, by better targeting to active farmers, by phasing out of existing restrictions of production volumes, and by further supporting green practices and innovation, in line with recommendations in OECD (2011c). However, more decisive reforms should be considered as the efficiency of the agricultural sector remains very low in some part of the EU, especially in new EU member states such as Poland or Slovenia (Figure 28).

**Figure 28. The agricultural sector efficiency is low in several EU countries**  
Value added per employed person,<sup>1</sup> EUR thousand, 2011<sup>2</sup>



1. In the agriculture, hunting, forestry and fishery sector.

2. Or latest available data.

Source: OECD, Structural Analysis (STAN) and OECD Economic Outlook Databases.

StatLink  <http://dx.doi.org/10.1787/888933010318>

CAP subsidies represent two fifths of the value added of the EU agricultural sector, and such large scale support allows inefficient farms to postpone restructuring. The last agreement reduces the overall level of agricultural support, but real per capita support will remain almost unchanged. EU initiatives to encourage efficiency enhancing investments only partly offset this drawback. For instance, although the Common Agricultural Policy has fostered the modernisation of large farms in Poland, it has had little impact on small farms' restructuring there (OECD, 2010c). In addition, these initiatives generate cumbersome procedures. Efficiency gains would be better encouraged by a significant reduction of agricultural subsidies, with the aim to provide payments on the basis of the provision of common goods only. Ultimately, a sharp reduction of resources allocated to the agricultural sector would allow reallocating EU budget resources towards innovation policies in other sectors with higher growth potential.

## Recommendations on climate change

### Key recommendations

- Strengthen the EU Emission Trading Scheme (ETS) by adopting an ambitious 2030 target accompanied by a tight ETS allowance cap. In this context, the renewable energy target and subsidy schemes should avoid creating distortions within the Single Market.
- Make sure that each sector is either subject to CO<sub>2</sub> taxation (for example, under the planned Energy Taxation Directive) or participates in the ETS, as appropriate.
- Encourage ownership unbundling of generation, supply and network activities within vertically-integrated electricity utilities, and streamline permit procedures to support electricity grids investment.

### Further recommendations

- Eliminate remaining inefficient fossil fuel subsidies.
- Further reform the CAP to create a stronger link with environmental and productivity objectives. Move further away from unconditional direct income support and market measures.

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# Thematic chapter



## Chapter 1

# Reinvigorating the EU Single Market

*The EU Single Market remains fragmented by complex and heterogeneous rules at the EU and national levels affecting trade, capital, including foreign direct investment, and labour mobility. Further development of the Single Market and removing barriers to external trade would bring substantial growth and employment gains by enhancing resource allocation in Europe, by generating economies of scale and by strengthening competition and hence incentives to innovate. Reforming regulation and other implicit barriers can also yield a double dividend: it would stimulate cross-border activities and support the necessary reallocation process within countries. Such reallocation can cause hardships, especially for the less-skilled workers who may not be able to compete. To deal with such problems, it is important to enhance active labour market policies and training. The Single Market would also benefit from better networks between countries that can be supported by a well-targeted infrastructure policy. New digital networks can be promoted by an appropriate regulatory framework to strengthen confidence and to promote fair competition. Regarding external trade, the first-best solution is clearly multilateral trade negotiations, but short of that external trade and investment barriers can be reduced with Free Trade Agreement negotiations with the United States and other partners.*

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

The Commission has estimated that the Single Market generated an extra 2.8 million jobs in the EU and an additional 2% in GDP from 1992 to 2008 (EC, 2012a). As internal barriers remain considerable, there are additional gains from further reducing unnecessary regulatory burdens and regulatory heterogeneity in the Single Market. The Commission, reflecting Monti (2010), has identified in its Single Market Act II four Single Market drivers that could enhance these gains by reducing fragmentation and raising productivity: integrating networks; fostering mobility of citizens and businesses; supporting the digital economy and strengthening social entrepreneurship, and listed a relevant list of key actions to be taken (EC, 2012a). But more can be done to deal with the complexity and the heterogeneity of numerous rules and policies that impede the Single Market. However, this requires a step change in efforts devoted to encouraging economic integration. As reforms require the support of all EU member states, more detailed and convincing analysis of the role of implicit barriers and hence of opportunities arising from their removal, is needed to identify priorities and accelerate the process of reforms.

The first section discusses growth gains that can be reaped from completing a genuine Single Market. The second section considers regulatory barriers to trade within the Single Market. In particular, the heterogeneity of regulations across countries generates hurdles for cross-border activities. The third section examines barriers to labour mobility. The fourth section discusses policies to reduce fragmentation of network sectors. The fifth section broadens the discussion to the rest of the world by considering the role of Free Trade Agreements (FTA) to further enhance the growth potential of the Single Market.

## The potential for growth gains from a deeper Single Market are large

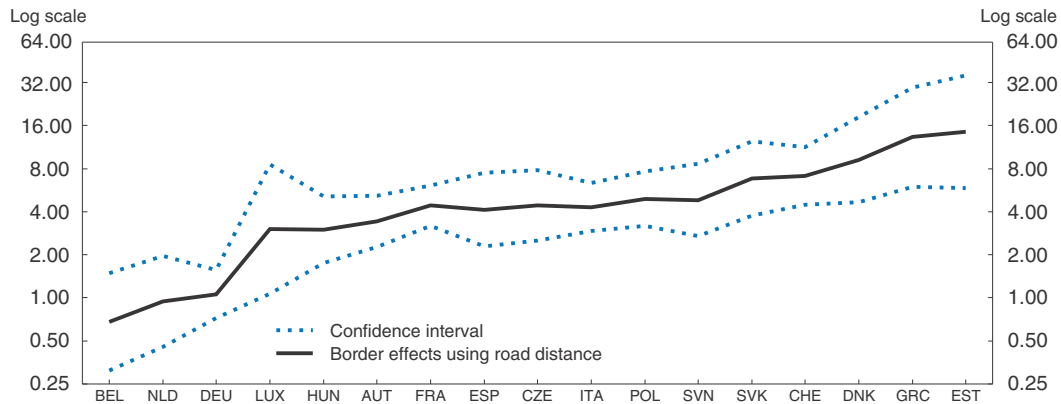
### ***The Single Market is still fragmented***

Progress with Single Market reforms and its fragmentation was already discussed in the 2012 *Survey* (OECD, 2012a). Recent trade data confirm significant remaining fragmentation (Braconier and Pisu, 2013). Trade between most countries is smaller than trade within a country, everything else equal. The gap is most important in Estonia and Greece, where within-country trade is about 15 times more intense than trade with EU partners, but is significant in most countries (Figure 1.1). Noticeable exceptions are central countries well-integrated in transport networks (Belgium, Germany and the Netherlands).

### ***Economies of scale and better resource allocation would boost productivity***

The small size of firms in the EU relative to the United States (OECD, 2012a) is one indicator of costs of fragmentation. Fragmentation can reduce productivity in the EU, as firms cannot reap the benefits of economies of scale. Van Ark et al. (2013) suggest substantial growth gains from further Single Market integration, in large part due to scale advantages. The correlation between the size of firms and their productivity in the manufacturing sector suggests that firms may have some potential to generate economies of scale (Figure 1.2). Economies of scale are crucially important for innovative firms that

Figure 1.1. **Trade between EU member states**  
Country specific border effects<sup>1</sup>



1. The border effect is a measure of the reduction of trade due to a border. For instance, in Estonia trade within the country is almost 15 times larger than trade across the border, everything else (e.g. road distance) equal. For further detail, see Source.

Source: Braconier, H. and M. Pisu (2013), "Road Connectivity and the Border Effect: Evidence from Europe", *OECD Economics Department Working Papers*, No. 1073, OECD Publishing, Paris.


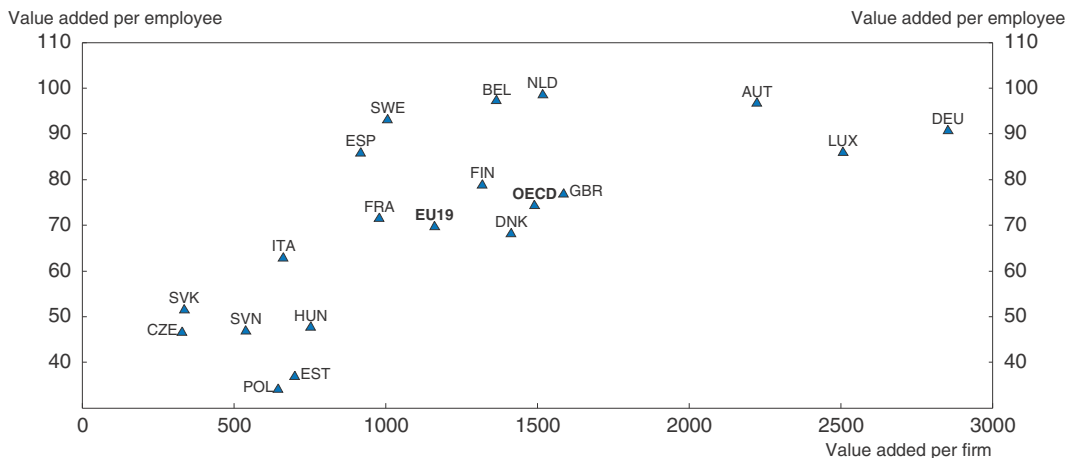

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Figure 1.2. **Productivity is higher in large firms**  
Value added in thousand EUR; manufacturing sector; 2011<sup>1</sup>



1. Or latest available data.

Source: US Census Bureau; OECD, *Structural and Demographic Business Statistics Database, Structural Analysis (STAN) Database and OECD Economic Outlook Database*.

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spend a large fixed cost in research and development (R&D) and need a large internal market to cover these costs. This may have led to lower spending on innovations in Europe.

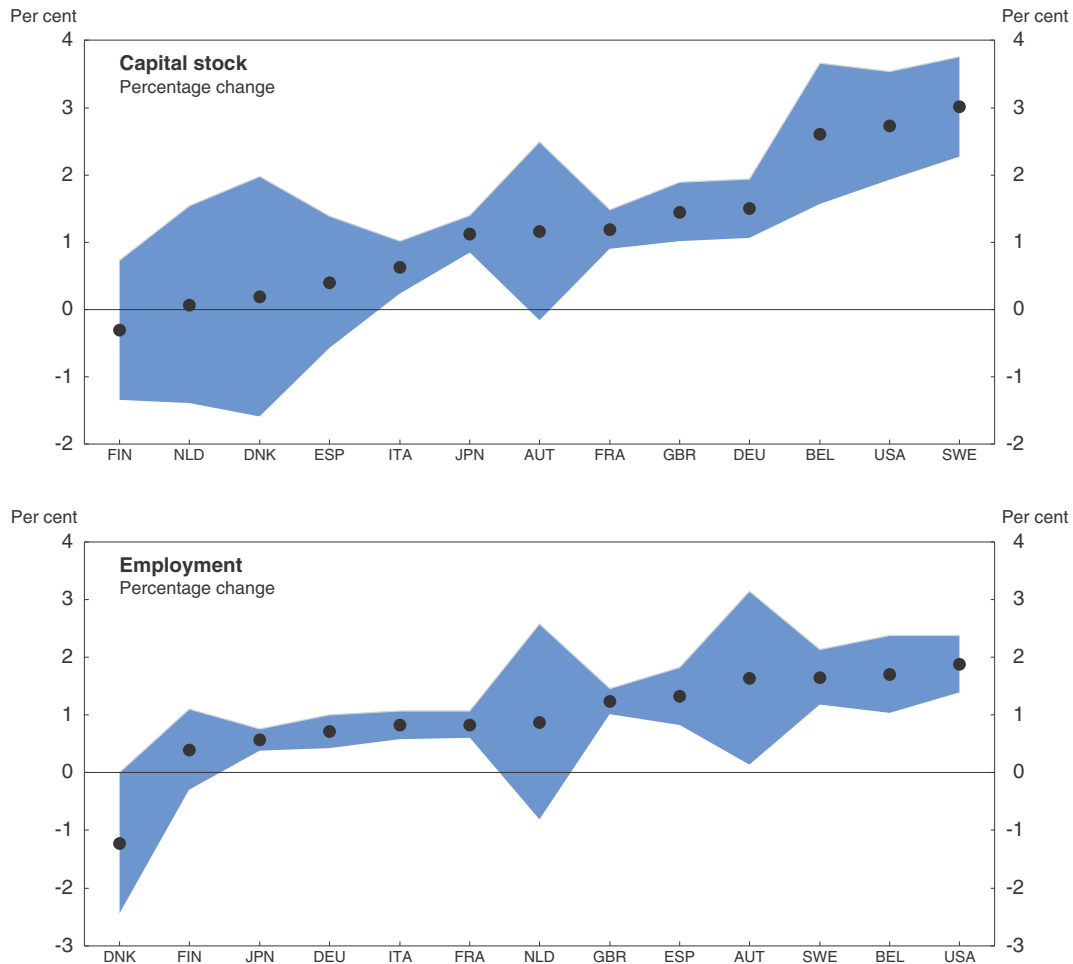
A large part of welfare gains from international trade comes from reallocation of resources to the most competitive firms in sectors where the economy has a comparative advantage (OECD, 2011a). Single Market integration also strengthens import competition and hence triggers more innovation, so that firms make a more efficient use of their production factors. Bloom et al. (2011) provide empirical evidence that firms do more innovation when they are exposed to low-cost import competition. These efficiency gains

can be more important when frictions “trap” factors of production inside firms (Bloom et al., 2013). The positive impact of trade integration on growth is also larger with a business-friendly environment within each country. Ben Yahmed and Dougherty (2012) show that the productivity gains triggered by import competition occur in firms that were already close to the technology frontier and that stringent domestic regulation reduces these potential productivity gains substantially.

The process to allocate resources is slower or less efficient in the EU than in the United States. A 10 % increase in the patent stock is associated with an increase in the typical firm’s capital stock of 3% in Sweden and the United States, against no significant increase in Austria, Denmark, Finland, the Netherlands and Spain (Figure 1.3, upper panel). Similarly, the ease with which patenting firms in the United States can attract labour is roughly twice as large as in France, Germany or Italy (Figure 1.3, lower panel). Compared to their United States peers, firms are more static in Europe (Figure 1.4). In a successful

Figure 1.3. **Do resources flow to more innovative firms?**

Additional inputs attracted by a firm that increases its patent stock by 10%, 2002-10<sup>1</sup>



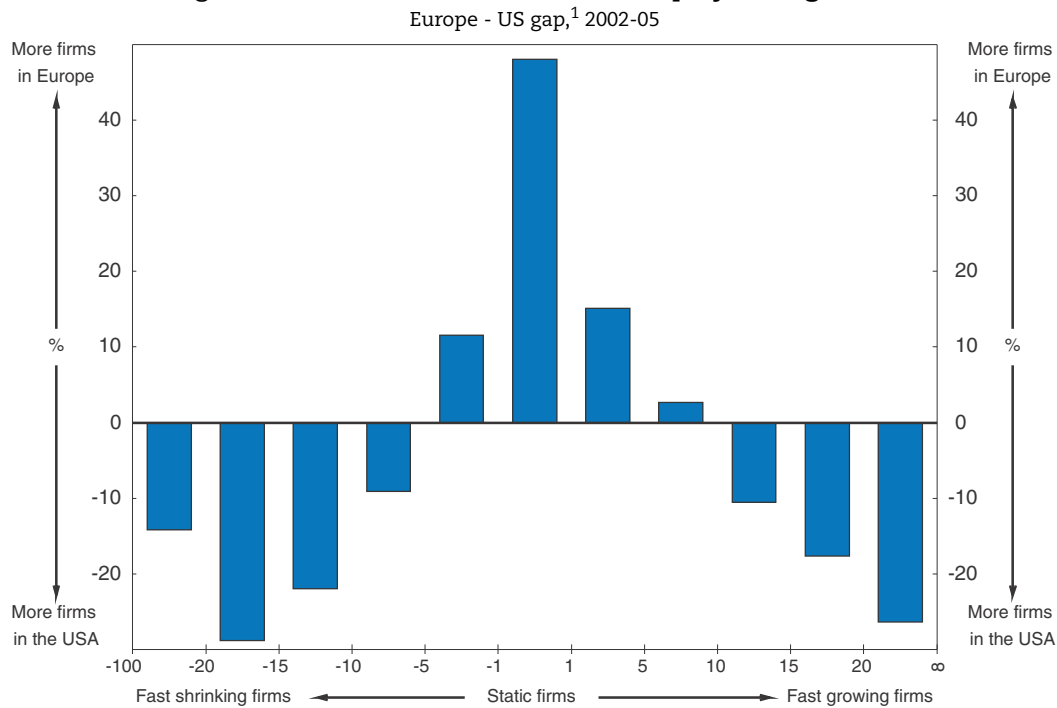
1. The light blue bands denote the 90% confidence intervals which vary across countries due to differences in the number of observations. For more details on these estimates outcomes, see Figure 10 in Source.

Source: Andrews, D. and C. Criscuolo (2013), “Knowledge-Based Capital, Innovation and Resource Allocation”, OECD Economics Department Working Papers, No. 1046, OECD Publishing, Paris.

StatLink  <http://dx.doi.org/10.1787/888933010337>



Figure 1.4. The distribution of firm employment growth



1. Seven European countries (Austria, Denmark, Finland, Italy, Netherlands, Norway and Spain) have been selected on the basis of data availability. The gap is the percentage difference between the share of firms in a given growth bracket in Europe and in the United States.

Source: Andrews, D. and C. Criscuolo (2013), "Knowledge-Based Capital, Innovation and Resource Allocation", OECD Economics Department Working Papers, No. 1046, OECD Publishing, Paris.


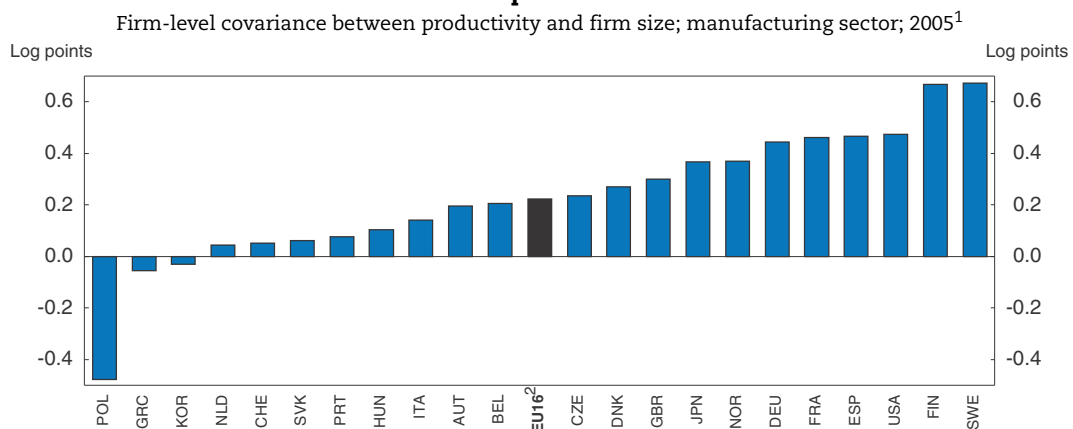
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Figure 1.5. EU countries differ in their ability to allocate labour to the most productive firms



1. Firm size is measured as its share in total industry employment. The estimates show the extent to which firms with higher-than-average labour productivity have larger employment shares. In most countries, the covariance between productivity and employment share is positive, suggesting that the actual allocation of employment boosts manufacturing labour productivity, compared to a situation where resources were allocated randomly across firms (this metric would equal zero if labour were allocated randomly).

2. EU16 is the unweighted average of Austria, Belgium, Czech Republic, Denmark, Finland, France, Greece, Germany, Hungary, Italy, Netherlands, Portugal, Poland, Spain, Slovak Republic and the United Kingdom.

Source: OECD calculations based on firm level data from the ORBIS database. For more details, see Andrews, D. and F. Cingano (2012), "Public Policy and Resource Allocation: Evidence from Firms in OECD Countries", OECD Economics Department Working Papers, No. 996, OECD Publishing, Paris.

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Single Market, productive factors should be reallocated from non-competitive firms that downsize or close, towards highly competitive firms that grow. This is especially important in countries with negative or low correlation between size and productivity (e.g. Greece, the Netherlands and Poland, as shown in Figure 1.5). Such a low correlation between size and productivity can indeed reflect the fact that factors of production are not well reallocated towards the most productive firms (Olley and Pakes, 1996).

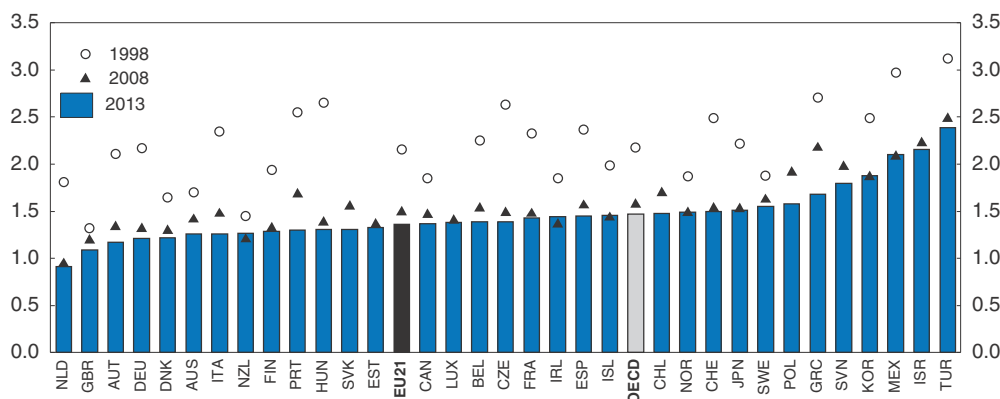
Implicit barriers discussed in this Chapter are also in many cases impediments to resource reallocation (e.g. business-unfriendly product market regulations). A package of reforms to reinvigorate the Single Market would thus both improve factor allowance across countries, but also within countries.

## Unnecessary barriers to trade and resource allocation reduce potential gains

### **Stringent regulations impede trade gains from the Single Market**

Countries belonging to the Single Market substantially increased trade (Fournier et al., 2014). This reflects trade growth triggered by the integration of Eastern European countries in the Single Market. More stringent regulation as measured by the Product Market Regulation (PMR; Figure 1.6) or the Energy, Transport and Communication Regulation (ETCR) indicators reduces trade intensity, both for the OECD overall and EU members only, while the role of employment protection policy on trade is somewhat ambiguous. Also, regulatory heterogeneity reduces trade intensity (*i.e.* the trade to GDP ratio). For instance, a broad reform package that aligned PMR indicators to the average of the top half of the best performers and cut heterogeneity by one fifth could increase trade intensity within the EU by more than 10% (Fournier et al., 2014).

Figure 1.6. **Restrictiveness of economy-wide product market regulation**<sup>1</sup>  
Index scale from 0 (least restrictive) to 6 (most restrictive)



1. The set of PMR indicators is calculated with a revised methodology. For more details, see Source. Data for Luxembourg, Mexico, Poland and Turkey are preliminary.

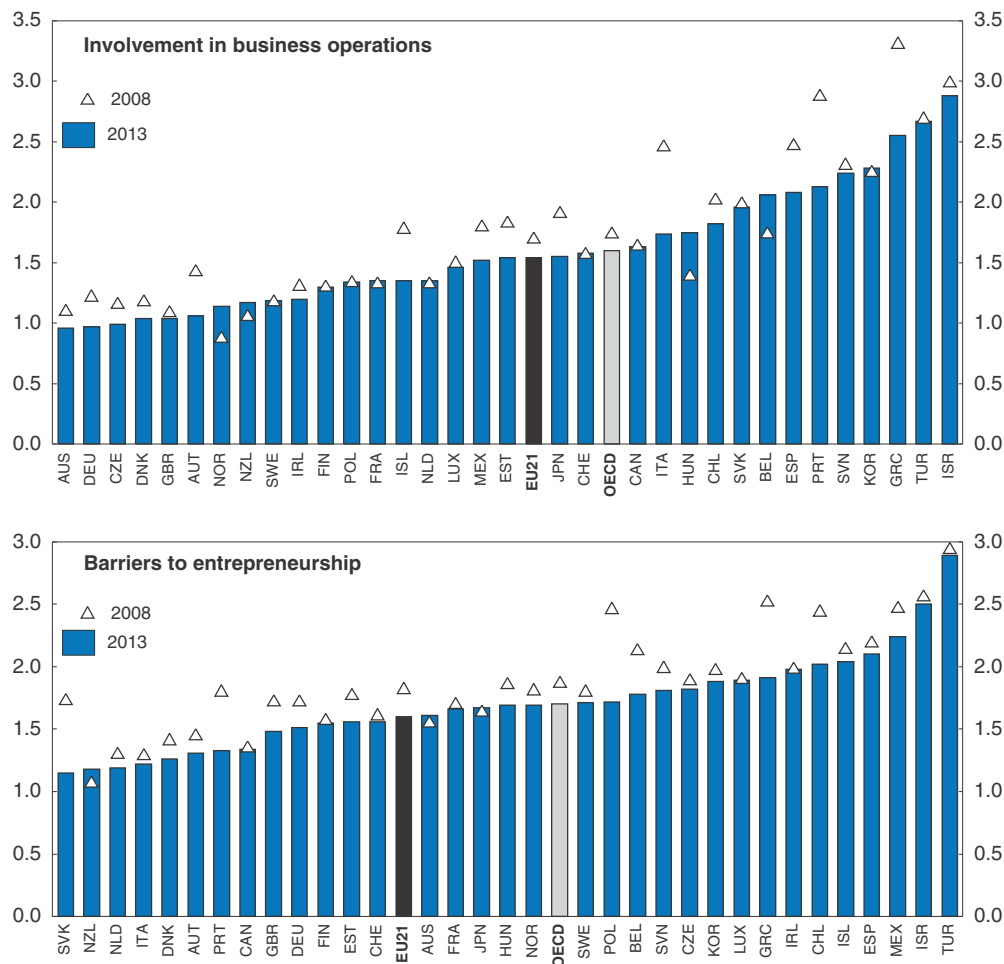
Source: OECD, *Product Market Regulation Database*; OECD (2014), *Economic Policy Reform 2014: Going for Growth, Interim Report*, OECD Publishing, Paris; Koske, I. et al. (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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Stringent product market regulations reduce the potential for growth of firms, investment in new ventures and postpone necessary downsizing of inefficient firms.

Product market regulations are negatively correlated with investment in knowledge-based capital – assets that lack physical embodiment, such as computerised information, innovative property and economic competencies (Andrews and Criscuolo, 2013). Business regulations (e.g. shop opening hours regulation, price controls...) remain in several EU countries and work against investment (Figure 1.7, upper panel). High barriers to entrepreneurship, especially in Ireland and Spain (Figure 1.7, lower panel), restrict entry of competitors. Reducing PMRs further should be a priority at the EU and country level.

Figure 1.7. **Selected indicators of product market regulation<sup>1</sup>**  
Index scale from 0 (least restrictive) to 6 (most restrictive)



1. The set of PMR indicators is calculated with a revised methodology. For more details, see *Source*. Data for Luxembourg, Mexico, Poland and Turkey are preliminary.

*Source*: OECD, *Product Market Regulation Database*; OECD (2014), *Economic Policy Reform 2014: Going for Growth, Interim Report*, OECD Publishing, Paris; Koske, I. et al. (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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Implicit regulatory barriers and strong vested interests are also reducing foreign direct investment (FDI) that is often important in boosting productivity (Kalemli-Ozcan et al., 2014; Nicoletti et al., 2003). Aghion et al. (2006) argue that catching up with the technology

frontier can be supported by the involvement of a foreign investor, who is familiar with the frontier technology. FDI flows have indeed been larger towards Eastern European countries and Ireland than towards Southern European countries. Policies that support FDI flows should thus be given high priority in southern European countries.

Cross-border FDI is reduced by unnecessary regulatory burdens and deep differences in rule setting that create additional cost to cross-border financial operations (see Nicoletti et al., 2003, for an estimation of the negative impact of regulation burdens on FDI, and Box 1.1). Business-unfriendly regulation is more burdensome for foreign competitors that are less familiar with the specific national settings. This includes regulation that impedes services trade (Nordås and Kox, 2009), for which some EU countries have large room for improvement. Some progress has been achieved since 1997, as shown by the decrease of the FDI restrictiveness index, especially in Belgium, Finland and Hungary (Figure 1.8). Still, a few unnecessary specific equity restrictions, approval requirements and other operational restrictions are still in place (see Kalinova et al., 2010, for detailed information on remaining restrictions by country and by sector). The Commission should consider an initiative to reduce such FDI restrictions. FDI would also benefit from reduced financial market fragmentation. This fragmentation has receded since the introduction of the Outright Monetary Transactions (OMT) scheme, and can be further reduced by progressing further towards banking union in Europe, as discussed in the 2014 *Economic Survey of the Euro Area*.

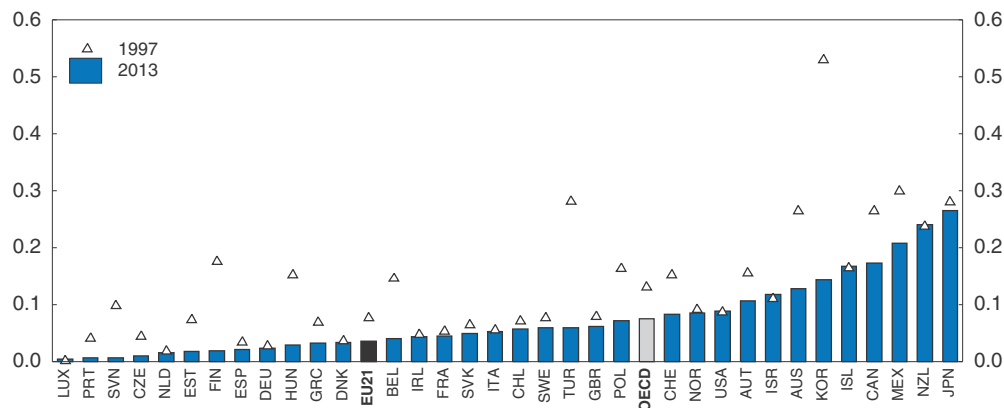
#### Box 1.1. FDI patterns within the EU: The role of policies

Firm level econometric analysis is used to investigate the determinants of FDI (Kalemli-Ozcan et al., 2014). FDI restrictions, as measured by the FDI regulatory restrictiveness index, have a negative impact on FDI. More stringent product market policies also deter foreign investment (Kalemli-Ozcan et al., 2014). This effect is stronger in countries where average productivity is lower. Stringent regulations cause foreign investors to select into high productivity firms by international standards, whereas in the absence of these policies foreigners invest in both high and low productivity firms without differentiation. Under stringent regulations, foreign investors may perceive restructuring of weak firms as too costly. Removing business-unfriendly product market regulation (PMR) in countries that need to catch up would thus broaden scope for upgrading the efficiency of the weakest firms.

The heterogeneity of economy-wide PMR has a positive impact on FDI. If countries' regulations are too different, entry cost may be lowered by the takeover of local firms, which are better accustomed to local regulatory issues. Heterogeneity of regulation can thus favour multiplicity of local presence, especially if the cost to deal with the heterogeneity is high relative to losses of economies of scales implied by multiple local bases. By contrast, the heterogeneity of financial services regulations is found to deter FDI, as it increases costs for foreign investors. This may deter efficient FDI. Thus reducing financial services regulations can have important efficiency gains not just for local producers but for FDI.

This study also examined origins of FDI in Europe. Financial centers seem important sources of FDI, but ultimate ownership data show that more than 10% of the German, British and Dutch foreign investment stocks have their ultimate owners in Far East and Central Asia. OECD and the Bureau van Dyck (BvD) direct ownership data cannot describe these patterns. This suggests that a significant share of these North American and Asian investments are channeled through West European financial centers (e.g. Ireland and the United Kingdom).

Figure 1.8. **FDI restrictiveness index**<sup>1</sup>  
Index score from 0 (open) to 1 (closed)



1. For information on the methodology, see Kalinova et al. (2010).

Source: Kalinova, B. et al. (2010), "OECD's FDI Restrictiveness Index: 2010 Update", *OECD Working Papers on International Investment*, No. 2010/3, OECD Publishing, Paris; OECD, [www.oecd.org/investment/index](http://www.oecd.org/investment/index).

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Efficient investment is also influenced by takeover rules. The EU Takeover Directive passed in 2004 sets standards for takeover bidders, such as mandatory bid rules and minimum price rules, and on anti-takeover provisions. This has led to investments by EU companies that are less profitable (as proxied by takeover returns) and that take longer to complete than before (Humphery-Jenner, 2012). Humphery-Jenner (2012) argues that legal uncertainties generated by a large room for interpretation of the rules at the national level increased availability of anti-takeover provisions. In addition, mandatory bid rules and minimum price rules discourage profitable takeovers. Lower takeover threat can increase the opportunity for managerial slack, reducing firms' efficiency (Giroud and Mueller, 2010). The Takeover Directive should be replaced by a revised version that renders takeovers more profitable, such as reducing legal uncertainties, the availability of anti-takeover provisions and limiting the scope of application of the minimum price rules.

### **Policies to support efficient allocation**

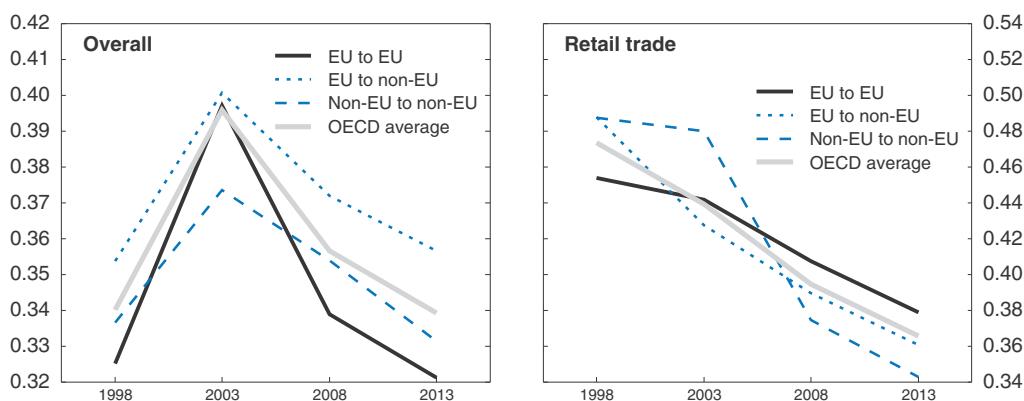
Financial, tax and innovation policies can influence efficient reallocation. First, the emergence of new firms requires well-functioning financial markets; this can be achieved by sound regulation, as described in the 2014 *Economic Survey of the Euro Area*. Second, well-designed R&D tax incentives can support the innovation process (see the *OECD Science, Technology and Industry Scoreboard* for a cross-country comparison of existing schemes). Refundable measures with carry-over provisions would benefit all innovative firms, including young firms that do not generate profits yet. Direct government support to research can have a positive impact, possibly reflecting an improving structure of public schemes, such as a more frequent use of matching grants (Andrews and Criscuolo, 2013).

### **Heterogeneous rules and regulations impede integration**

#### **Product market regulations contribute to heterogeneity**

Numerous differences across countries in regulations raise trade costs (Kox and Lejour, 2006; Nordås and Kox, 2009). Heterogeneity of rules can be observed from PMR data (Figure 1.9). In particular, restrictions within the EU in professional services are only

Figure 1.9. **Indicators of differences in regulations**<sup>1</sup>  
Share of different regulations



1. Underlying PMR data for Luxembourg, Mexico, Poland and Turkey are preliminary.

Source: OECD, *Product Market Regulations Database* and OECD calculations. For more details, see Fournier, J.-M. (2014), "The Heterogeneity of Product Market Regulations", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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slightly more similar than between EU countries and other OECD countries (Fournier, 2014). This analysis provides a lower bound of the true difference, as in some cases, countries can report the same level of stringency, but with different kind of procedures behind.


Product market reforms can also help to reduce the heterogeneity of regulations. Countries that were further away from common practices in 2008 made more reforms that reduce bilateral regulatory heterogeneity (Figure 1.10). More broadly, countries that have most reduced the overall stringency of regulation are also countries that reduced their

Figure 1.10. **Heterogeneity in countries diminishes more the farther they are from common practices**



1. The vertical axis shows the difference between the average bilateral heterogeneity of a given country in 2013 and the average bilateral heterogeneity that would be observed if no change had been made in this country's regulations between 2008 and 2013. Data for Luxembourg and Poland are preliminary.

Source: OECD, *Product Market Regulations Database* and OECD calculations. For more details, see Fournier, J.-M. (2014), "The Heterogeneity of Product Market Regulations", *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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heterogeneity relative to other OECD countries (Fournier, 2014). This reflects the fact that the most common practices across OECD countries are also in most cases business-friendly practices. Kox and Lejour (2005) estimated that if the EU made more use of mutual recognition, bilateral trade in commercial services among EU countries could increase by 30 to 60%. Progress has been too limited in this area, and a broad-based initiative to develop mutual recognition is necessary to achieve substantial trade gains as well as fostering labour mobility as discussed below.

### ***The unitary patent reduces heterogeneity***

The establishment of an EU unitary patent is a major improvement to harmonise and simplify the patenting process and boost innovation. Before the set-up of this EU unitary patent, a European patent validated in 13 countries was more than ten times more expensive than a patent in the United States or Japan (van Pottelsberghe de la Potterie and François, 2006). These high costs include translation cost, fees charged by patent agents, publication and renew fees. As a result, the vast majority of patents were validated in only a few EU member states (EC, 2011d). The EU unitary patent will sharply reduce translation costs: following the transition period, applicants will have to provide a translation in the three official languages (English, French and German) of the European Patent Office only. The necessary information on patents will be available in all EU languages via machine translation once a reliable and efficient system is in force. The EU member states also agreed to set up a single and specialised patent jurisdiction (the “Unified Patent Court”), which should be ratified as soon as possible to reduce litigation costs and enhance legal certainty. While this simplifies and unifies the patent registration procedure in the EU, Croatia, Italy and Spain are not part of the agreement (though Croatia has announced its intention to join), which may lower the benefits of the unitary patent system in the EU.

### ***Tax administration burdens vary***

Harmonisation of tax-related administrative burdens would also reduce heterogeneity of rules. Existing EU tax frameworks (e.g. EU VAT legislation) tend to have uncertainties as regard the applicable rules, or instances of double taxation or tax discrimination (Monti, 2010). As regards the VAT, the Commission’s Regulatory Fitness (REFIT) initiative, which aims to reduce EU-origin regulatory burdens, includes an appropriate proposal to reduce VAT-related administrative burdens through harmonisation of procedures and the promotion of e-invoicing. There should also be increased co-ordination in procedures for corporate income taxes and employer’s social security contributions. A common definition of corporate tax bases and moving forward with the code of conduct on business taxation can help in this respect (Monti, 2010). The heterogeneity of national preferences can still be taken into account in a harmonised framework by setting tax rates nationally.

Tax administration harmonisation can go hand in hand with the need to reduce tax erosion and to suppress tax expenditures that generate inefficiencies. Co-ordination can be an opportunity to reduce compliance costs by eliminating mismatches causing tax base erosion. This would go in the same direction as the on-going OECD/G20 initiative on Base Erosion and Profit Shifting (BEPS).

### ***Bankruptcy laws contribute to heterogeneity***

Bankruptcy laws are different in each country, and this creates an additional cost for foreign investors to assess the risk properly. EU guidelines for efficient bankruptcy

practices (e.g. by introducing non-judicial debt settlement schemes), if implemented at the country level, could reduce uncertainties for investors. Better bankruptcy rules and procedures would also further increase the consistency of the assessment of banks' assets in the banking union, as discussed in the 2014 *Economic Survey of the Euro Area*. At the same time, such a framework can support investment in knowledge-based capital by not penalising failure too much (Andrews and Criscuolo, 2013).

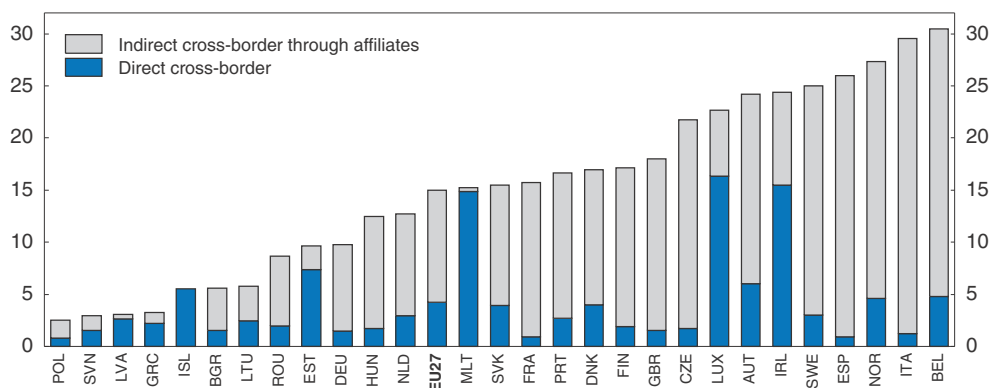
### ***Differences in competition policies add to heterogeneity***

While all EU countries share the same principle on competition policies, the current framework opens the way to some differences on the enforcement of competition law across countries as shown by the competition law and policy indicator (Alemani et al., 2013). Differences should be reduced by moving towards best practices. In particular, in antitrust law, the EU legislation does not harmonise procedures and sanctions. In the case of merger control there are still a few cases when governments overturn a decision concerning the prohibition of merger in a few countries. Some national competition authorities cannot impose interim measures while performing an investigation. In some countries, new public policies that have implication for competition are not subject to any competition assessment. Governments are obliged in a few countries only to reply to the recommendations made in market studies concerning an obstacle or restriction to competition caused by an existing public policy. These differences should be tackled within an updated framework at the EU level.

### ***Public procurement rules have been overhauled***

Public procurement markets are also fragmented, thus reducing potential gains from integration. In 2005, import penetration in the EU stood at 7½ per cent of demand in the public sector, against about 19% in the private sector (EC, 2011b). Opening public procurement to other EU members needs to be more ambitious to reduce loopholes in the existing EU Procurement Directive, as discussed in the 2012 *Survey* (OECD, 2012a). The openness of public procurement varies widely across countries (Figure 1.11). National policies still need to be improved on a number of issues (e.g. provision of evidentiary

**Figure 1.11. Cross-border procurement**  
As a percentage of the number of awards, average 2007-09



Source: EC (2011), "Cross-Border Procurement Above EU Thresholds", *Final Report*, DG Internal Market and Services, March.

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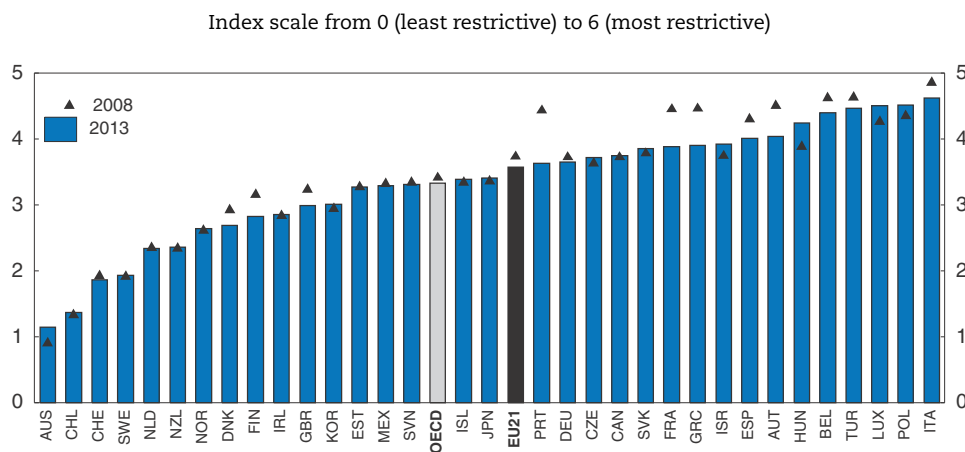
documents) to facilitate cross-border participation in practice in many EU countries, and procedures generate disproportionate cost for small contracts (EC, 2011c). The public procurement legislative package adopted in February 2014 to streamline cumbersome procedures is a move in the right direction. At the same time, this package can promote a more sustainable growth by enabling purchasers to better take into account innovation, environmental and social objectives in their choices (e.g. taking into account life-time costs, sanctioning violation of mandatory social, labour or environmental law).

### The EU Services Directive aims at tackling regulatory barriers

The Services Directive, passed in December 2006 and due to be implemented fully by the end of 2009, marked a small step in removing barriers to services integration, as the final Directive is much less ambitious than the initial proposal. The Services Directive removes discriminatory, disproportionate and unjustified national requirements on service providers, clarifies the requirements to ensure freedom of establishment, adopts the “silence is consent” rule and creates Points of Single Contacts (PSCs) for investors. Its sectorial coverage is broad, but key services were left out because they were already covered by other EU legal acts (such as telecommunications, electricity, financial). The Directive does not eliminate all barriers to trade and all regulatory differences between EU member states. It does not apply the rules of the service providers’ country of origin in a foreign country, which in turn reduces competition from foreign providers.

On the basis of PMR indicators, the Directive has had little impact so far on reducing barriers. PMR indicators show that barriers in services hardly changed between 2008 and 2013, and even seem to have deteriorated in several EU countries (Figure 1.12). EU member states can maintain a number of regulatory requirements if they are assessed to be non-discriminatory, necessary and proportionate. EU member states were to screen these requirements as part of the transposition process of the directive. This requires

Figure 1.12. **Barriers in services show little change between 2008 and 2013 in the EU<sup>1</sup>**



1. The set of PMR indicators is calculated with a revised methodology. For more details, see Source. Data for Luxembourg, Mexico, Poland and Turkey are preliminary.

Source: OECD, *Product Market Regulation Database*; OECD (2014), *Economic Policy Reform 2014: Going for Growth, Interim Report*, OECD Publishing, Paris; Koske, I. et al. (2014), “The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries”, *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

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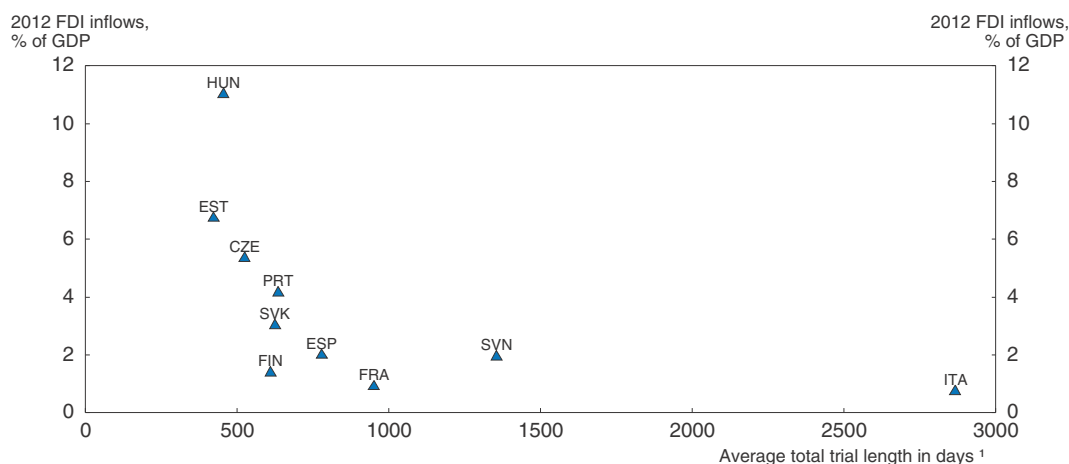
judgment on a case-by-case basis. As discussed in EC (2013a), unjustified and disproportionate requirements still remain widespread among EU member states. Administrative barriers to entry can thus be further reduced, and regulatory burdens to cross-border service trade eased. This can be best achieved by considering a revised directive that prohibits more systematically requirements that can be unjustified and disproportionate. But such a process would take time, and action by EU member states is necessary to reduce undue requirements as soon as possible. Measures taken by EU member states to implement the Services Directive have been estimated to increase GDP by approximately 0.8% over 5-10 years. A more ambitious implementation of the Services Directive could generate an additional 0.6%-2.6% of GDP (Monteagudo et al., 2012).

The Commission peer review on the implementation of the Services Directive (EC, 2013a) confirms that there are still many obstacles. For example, there are still too many restrictions on the right of establishment, such as the obligation for companies to have a certain legal form or shareholding and capital requirements. Also, the peer review identifies room for progress in the implementation of the Points of Single Contact (PSC) in many EU member states. This can be achieved in particular by integrating PSCs in e-government structures, as done in some EU member states.

### **Enforcement of rules adds to barriers**


Regulatory reforms cannot be effective unless the rule of law is strong in enforcing their implementation (O'Brien, 2013). In several EU countries civil proceedings are lengthy, especially in Italy. There is a negative correlation between trial length and FDI inflows (Figure 1.13), as slow civil justice can create uncertainty and costs for investors. This length is related to the structure of justice spending and the structure and governance of courts rather than to the sheer amount of resources devoted to justice (OECD, 2013a). While the harmonisation of civil justice practices across the European Union is out of reach given the deep-rooted differences in legal systems, the EU can consider two types of action to increase civil justice effectiveness in EU member states. First, an EU initiative on the

**Figure 1.13. Long trial length is associated with a lower share of FDI**



1. Total trial length includes 1st instance, 2nd instance and highest court trial lengths.

Source: Palumbo, G. et al. (2013), "The Economics of Civil Justice: New Cross-country Data and Empirics", OECD Economics Department Working Papers, No. 1060, OECD Publishing, Paris; OECD, Foreign Direct Investment Database.

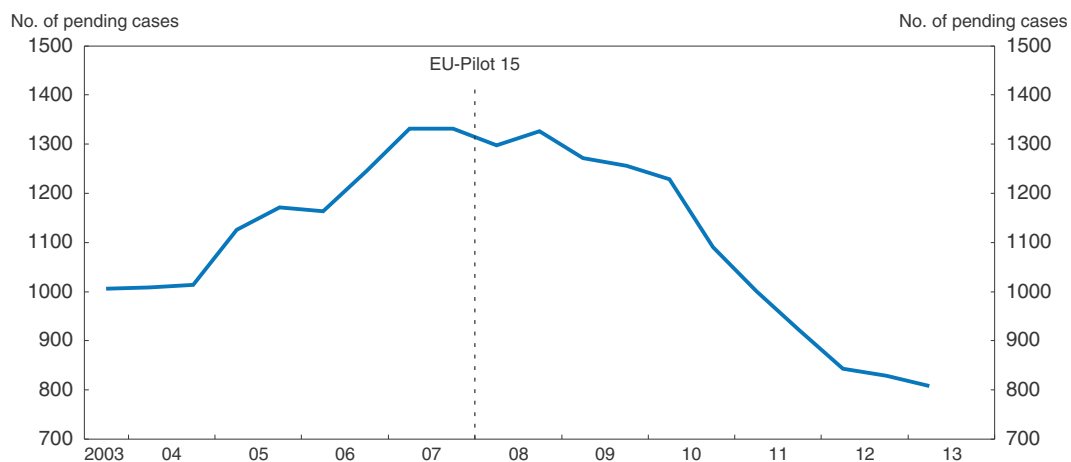
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harmonisation and minimum standards on judiciary statistics would help setting objectives. Comparable data on both inputs such as spending (salaries, computerisation...) and outcomes (number of pending and resolved cases, appealing outcomes...) would be needed. Second, country-specific recommendations in the context of the European Semester can include reforms to streamline civil justice procedures, where appropriate.

### ***Enforcement of EU laws at the national level remains uneven reducing trade gains***

National level enforcement of EU regulations can also create heterogeneity in practice (Pelkmans and Correira de Brito, 2012). The pace of transposition of EU directives has been uneven across EU member states, creating some heterogeneity in practice (Kalemli-Ozcan et al., 2013). The transposition process takes time, since it requires modifications of existing institutional structures, the removal of previous regulations and, in many cases, the establishment of new agencies and infrastructure. Making sure that EU directives are implemented is a prerequisite to foster the Single Market. The recent decrease of the number of infringement cases is encouraging (Figure 1.14). The EU Pilot introduced in 2008 has helped to reduce infringement cases. This is an online platform used by EU member states and the Commission to clarify factual and legal background of problems arising in relation to the application of EU law. The project was initiated in 2008 with the participation of 15 EU member states. Participation of all EU member states was achieved by mid-2012 (with Croatia joining from the day of accession). Nevertheless, in some areas, such as environment and transport, the number of infringement cases remains high (EC, 2013b).

**Figure 1.14. The number of infringement cases<sup>1</sup> is decreasing**



1. Infringement proceedings based on multiple complaints are treated jointly under one single case and thus excluded from the calculation.

Source: EC (2013), *Single Market Scoreboard – Infringements*, Reporting period: 11/2012-05/2013, <http://ec.europa.eu/single-market-scoreboard>.

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The SOLVIT network created in 2002 is another positive step to improve the implementation capacity of the EU law at national level. This online network for settling cross-border disputes informally over the incorrect application of the Single Market rules is based on mutual co-operation among national SOLVIT centres. The network has also been integrated within the Internal Market Information System (IMI). IMI is a secure online

application that allows national, regional and local authorities to communicate easily with their counterparts abroad regarding legislative domains. Fostering the visibility and the capacity of the SOLVIT network may be necessary to fully reap the benefits.

In the longer run, the Single Market needs to move closer to a single rule book. A more integrated Single Market would require a much more similar set of basic institutions across countries, as detailed in the 2012 *Survey* (OECD, 2012a). Gathering a basic set of rules in a single rule book would considerably reduce informational barriers.

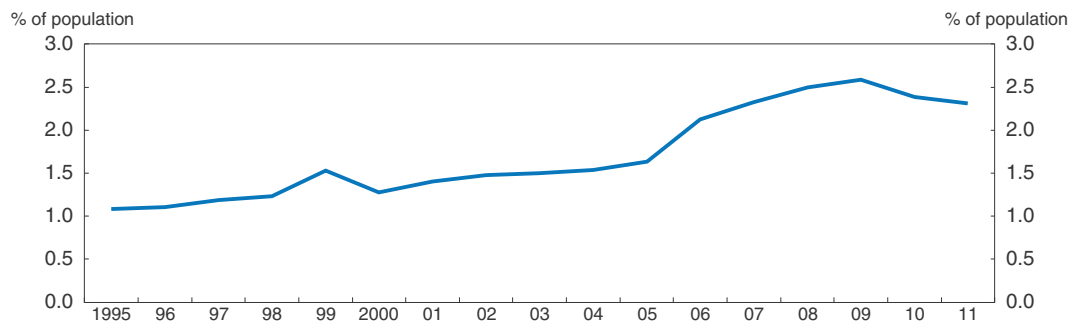
#### **Main recommendations to reduce implicit barriers within the Single Market**

- Improve the implementation of the Services Directive, in particular by eliminating unjustified and disproportionate restrictions to the cross-border provision of services and to the establishment of businesses.
- Consider a broad-based initiative to develop mutual recognition of standards.
- Identify areas where the heterogeneity of regulations and tax-related procedures can be further reduced and strengthen efforts to enforce the EU law at the national level.
- Promote the reduction of unnecessary product market regulations, with a particular focus to reforms reducing regulatory heterogeneity.
- Move forward with plans to reduce VAT-related administrative burdens, systematically address double taxation issues and increase co-ordination of procedures related to corporate taxation and social security contributions.
- To encourage FDI, consider an initiative to further reduce equity restrictions, approval requirements and other operational restrictions.
- Strengthen recommendations to streamline civil justice procedures.
- Consider an initiative to identify and support best bankruptcy practices, such as bankruptcy laws that do not overly penalise failure.
- Revise the Takeover Directive to render takeovers more profitable, by reducing legal uncertainties, the availability of anti-takeover provisions and limiting the scope of application of the minimum price rules.

### **Enhancing labour market mobility within the Single Market adds to gains**


Potential benefits for growth and employment from trade integration can be reaped faster in countries with flexible labour markets (Kambourov, 2009). Stringent labour market regulations make it difficult for firms under stress to cut redundant employment, as well as impinge on hiring in risky ventures. In the case of the EU, this reinforces the need for removing unjustified labour mobility barriers within the Single Market. The labour reallocation process is impeded by barriers to residential mobility within and between countries as discussed in the 2012 *Survey* (OECD, 2012a).

Labour market mobility has risen in the EU according to the *OECD Migration Outlook* (OECD, 2013b). This rising trend mainly reflects emigration from Eastern European countries following their integration within the area that is covered by the EU legal acquis in the field of free movement of workers – see the 2012 *Survey* (OECD, 2012a) for more details on the modalities of the establishment of free movement of people following this integration. As a result, the number of EU mobile citizens (migrants) has risen since 2004 (Figure 1.15).

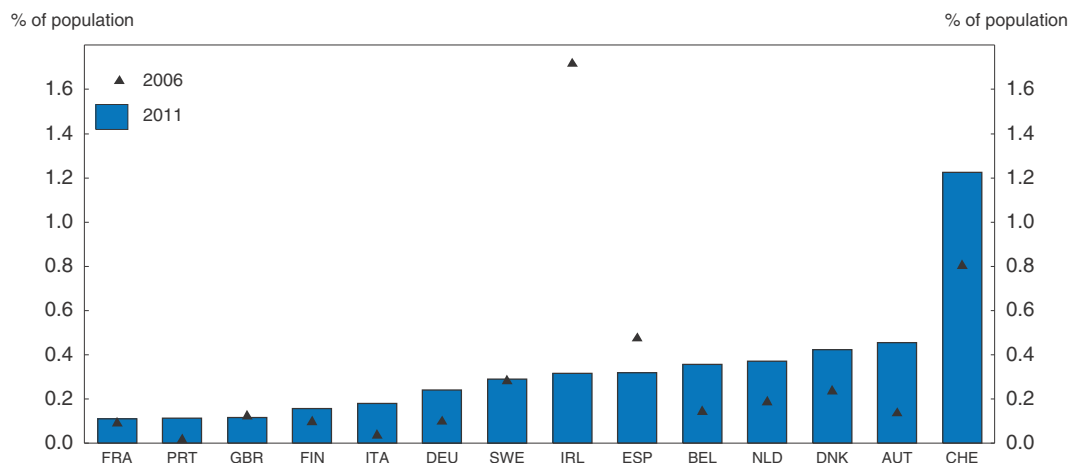
Figure 1.15. **Stock of migrated population within the EU<sup>1</sup>**

1. Population coming from an EU country (28 countries) and living in an EU country that is also a member of the OECD (21 countries).

Source: Eurostat and OECD, *International Migration Database*.


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There is also tentative evidence that the migration response to the crisis has been stronger in Europe than in the United States (Jauer et al., 2014). Migration flows towards countries hit by unemployment such as Spain have collapsed (Figure 1.16). Larger migration flows could reduce somewhat unemployment rates in crisis countries, impact positively on wages and employment levels in destination countries, and mitigate skill shortages (OECD, 2012b).

Figure 1.16. **Immigration flows<sup>1</sup> into western EU countries**

1. Harmonised data of permanent migrants.

Source: OECD calculations based on Eurostat and OECD, *International Migration Database*.

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Generally, the relatively low level of labour mobility within the EU can be explained by a number of non-policy factors (linguistic and cultural barriers, family ties), and policy barriers (lack of harmonisation of social security and taxation systems and of professional qualifications, as well as legal or administrative barriers). The EU has addressed some of these policy barriers, e.g. by establishing a EU system of recognition of professional qualifications and a EU system of co-ordination of social security benefits ensuring that EU workers do not lose out on acquired rights when taking a decision to cross borders. The EU regulations on the co-ordination of social security systems cover benefits like first pillar

pensions and unemployment benefits. Certain co-ordination mechanisms, such as the aggregation of periods fulfilled in another EU member state, ensure that the exercise of the right to freedom of movement does not have the effect of depriving a worker of social security advantages which he would have been entitled to if he had spent his working life in only one EU member state.

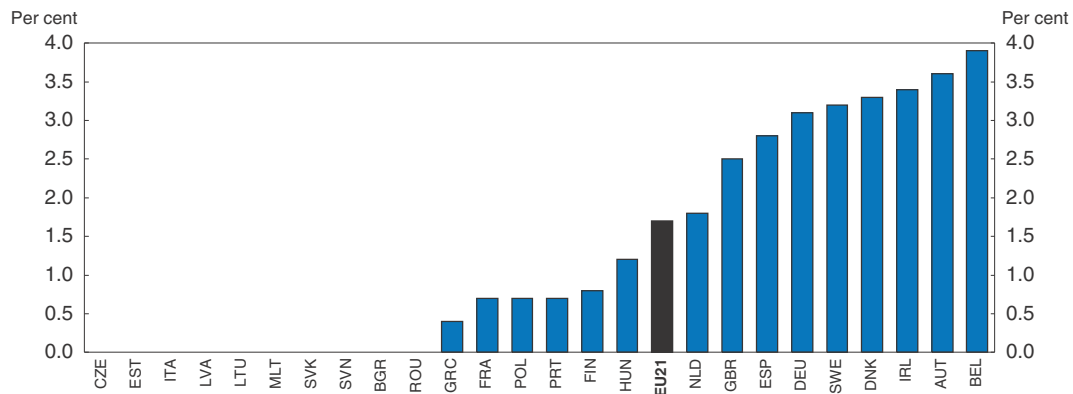
However, as discussed in the 2012 *Survey* (OECD, 2012a) strong impediments to labour mobility can be further removed. A person who goes to another EU member state to seek work can “export” the unemployment benefits rights for a period of three months, and national institutions can extend this period up to a maximum of six months. Many EU member states apply the minimum period of three months only, such a limited portability can reduce labour mobility. Mobility is especially difficult for public sector jobs, which should be open to other nationals as discussed in the 2012 *Survey* (OECD, 2012a). Recognition of qualifications remains uneven across EU member states. Cumbersome recognition procedures for skills imposed by national authorities could, in most cases, be replaced by automatic recognition: more than 90% of professionals requesting the recognition of their qualifications in another country receive a positive decision according to the EU regulated professions database.

The EU should move forward by adopting the proposed directives on free movement of workers and on acquisition and preservation of supplementary pension rights. These welcome directives would require EU member states to take concrete action to guarantee a more effective and homogeneous application of EU law in this area. Their adoption (foreseen for April 2014) would implicate the existence of at least one body in every EU member state to provide assistance and information to EU workers and their family members on their EU rights, and would improve portability of pension rights. These initiatives should be broadened to eliminate double taxation of pensions and develop automatic recognition of documents and qualification.

Apart from measures that generate advantages to national workers, hurdles faced by migrants within each country are also created by inappropriate national policies, such as high housing transaction costs as discussed in the 2012 *Survey* (OECD, 2012a). Such mobility barriers affect both nationals and non-nationals, and hence reforming national policies will also entail spill-over effects. Within the European Semester, more emphasis could be put on such mobility barriers, where appropriate.


Language barriers are important in the labour mobility field, and they need to be addressed by continuing efforts to strengthen language skills of EU citizens. The Erasmus programme that encourages cross-border mobility of EU students tackles this issue at its roots, but it has limited impact as only 1% of EU students benefit from the programme each year. Foreign language education can be promoted by a wider use of non-national teachers, which accounted for only 1.7% of all teachers in 2005 (EC, 2006 and Figure 1.17). In this field, country specific design of recruitment processes can act as an implicit barrier to mobility. For language teachers, the recruitment process should put more weight on language skills, so that those whose mother tongue is foreign would have an advantage. Recruiting more non-national language teachers would help overcome the shortage of language teachers in primary education (EC, 2012b). In addition, temporary mobility of national teachers can be substantially increased, as over 70% of all teachers say they are willing to take part in mobility (Williams et al., 2006). This can be enhanced by reconsidering selection

Figure 1.17. **Share of EU25 non-national teachers**<sup>1</sup>  
2005



1. Zero denotes no reported non-national teachers. However, it should be noted that the Labour Force Survey reports figures in thousands, therefore, it is possible that when countries report zero, they may have fewer than 500 non-national teachers.

Source: GHK (2006), "Study on Key Education Indicators on Social Inclusion and Efficiency, Mobility, Adult Skills and Active Citizenship – Lot 2: Mobility of Teachers and Trainers", *Final Report*, European Commission DG EAC, Table 3.11.

StatLink  <http://dx.doi.org/10.1787/888933010565>

procedures so as to give less weight to the command of the foreign language, as well as simplifying the procedures across countries (Williams et al., 2006).

Dealing with short-term (labour) costs of adjustment makes the gains from Single Market integration more inclusive. In the short run, many workers may lose their jobs as integration advances. Activity losses in low productivity firms can dominate activity gains in productive and exporting firms if factor reallocation is slow. To reduce these losses and resistance to change, more emphasis on efficient active labour market policies may be needed. A comprehensive evaluation of each scheme can help to identify best practices. Training can be particularly important, if workers need to switch to a new specialisation. It can be necessary also to address these short-term cost with some compensation to avoid large welfare losses for some and to make reforms happen, as discussed in OECD (2010a). However, in a repeated game, paying the opponents of reforms may also reinforce opposition to future reforms as perceived weakness of the government can encourage agents to push for maximum concessions (OECD, 2010a).

#### **Main recommendation to enhance labour mobility**

- Move forward with the adoption of the proposed directives on free movement of workers and on acquisition and preservation of supplementary pension rights. Take measures to eliminate double taxation of pensions, develop automatic qualification recognition, and eliminate disproportionate national barriers related to regulated professions.

### **Better network interconnections across borders would enhance integration gains**

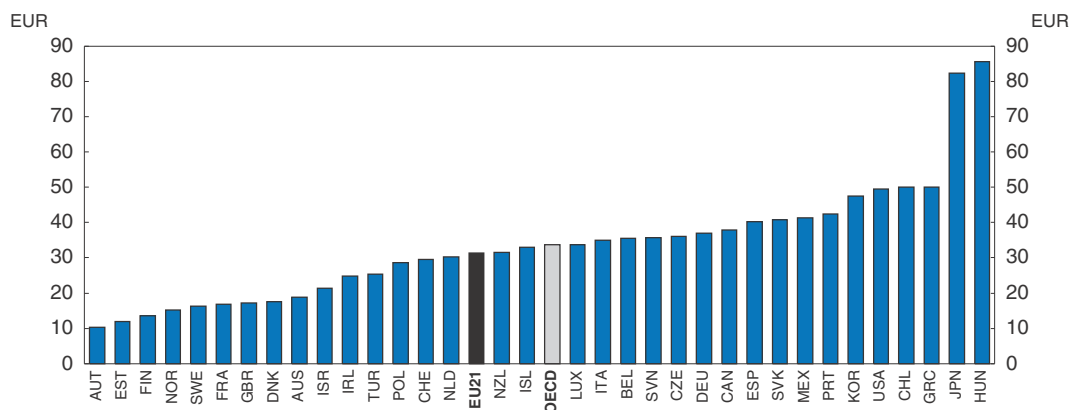
Among regulatory barriers that impede trade, regulations in network industries such as airlines, telecommunications, postal services, road transport and electricity are

important for trade outcomes (Fournier et al., 2014). If EU countries were to align their ETCR indicator to the best performers (e.g. average of first half), this could boost trade within EU countries by more than 5%.

For the Single Market to function fully, network industry connections (for example, the electricity grid) between countries need to be upgraded to stimulate cross-border competition. Integration of international networks is far from complete as illustrated for instance by price gaps in electricity or telecommunication services across countries (see OECD, 2012a and Figure 1.18). This reflects a history of national networks. As national regulators address competition, technical or safety issues, transnational firms have to deal with numerous regulators, and no national regulator can fully consider international connections. Strengthening co-operation with a view to move towards cross-border regulators would reduce the regulatory burdens for transnational firms, making it easier for firms to enter new countries and hence in all likelihood reduce the market share of incumbents.


Figure 1.18. **Mobile phone prices are widely dispersed**

Cost of a basket of 300 calls + 1 GB for a mobile phone,<sup>1</sup> VAT included, August 2013



1. Mobile phone price dispersion would be roughly similar if one considers another basket of mobile services, as illustrated in Source.

Source: OECD (2013), *Communications Outlook 2013*, OECD Publishing, Paris, Figure 7.22 with updated data.

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### Fragmentation in the transport sector

In transport, road networks have historically better connected cities within countries compared to between countries (Braconier and Pisu, 2013). New road plans are needed to focus on international connections. In the rail passenger services markets, restrictions to international competition reduce efficiency and hence increase transport costs (EC, 2012a). EU institutions should continue to make efforts to open transport markets to competition, as it did in other fields (e.g. telecommunication, energy). The fourth railway package proposed by the Commission would facilitate the entry of new operators by introducing mandatory tendering of public service contracts, addressing risks of cross-subsidisation, reducing administrative and technical barriers. As regards air transport, air traffic management is fragmented, and progress to strengthen co-operation between air navigation service providers has been limited (EC, 2013c). Air traffic management needs to be further integrated to face safety and capacity challenges raised by the growth of air traffic at the least cost (EC, 2013c). Airline flight routes can be shortened, and this would



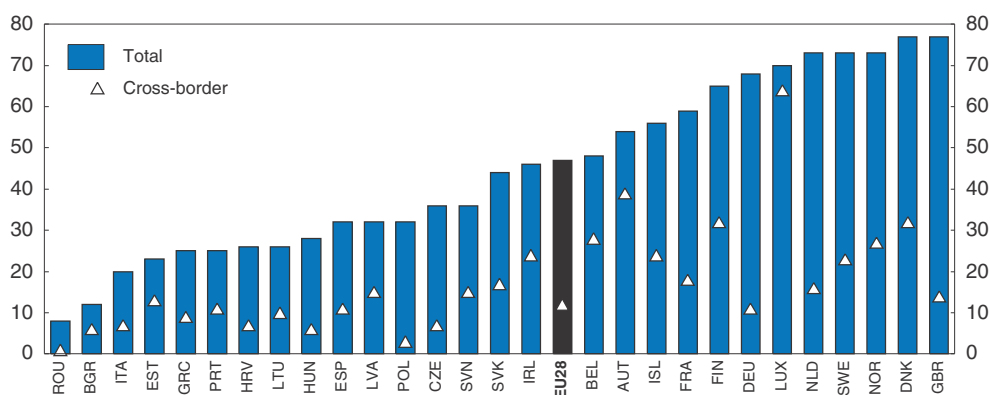
reduce carbon emissions. Cohesion funds can be an appropriate lever to improve international transport connections, provided that private co-investors more systematically bear a large share of risks in transport infrastructure programmes to make sure that the most efficient programmes are chosen.

Goods transported between EU seaports are still subject to the same administrative formalities as goods arriving from outside the EU. These obstacles generate costs and delays for carriers and should be removed, as concerns about custom duty fraud can be addressed by new technologies (e.g. satellite observation). Ships that carry mainly Union goods can already be exempted from these formalities following the regular shipping service procedure if they are properly registered and if they travel only between EU seaports on a predetermined route. However, this procedure is considered cumbersome by the shipping industry (EC, 2013d). The EU “Blue Belt” initiative (EC, 2013d) would simplify the regular shipping service procedure and would introduce an electronic cargo manifest to streamline custom procedures for Union goods of ships that cannot apply for the shipping service procedure because they carry both Union and non-Union goods or make regular stops in third country ports.

### **The growth of the digital economy raises new regulatory issues to ensure fair competition**

In 2013, half of Internet users in the EU have made individual purchases over the Internet (Figure 1.19). The digital economy (e.g. e-commerce) is expected to expand rapidly (OECD, 2013c), and this growth is a great opportunity to invigorate the Single Market. In practice, this new channel can reduce entry cost for foreign competitors and it circumvents many regulations, such as regulations that impede the establishment of retailers. At the same time, it raises new regulatory issues. As digital activities can easily move across countries (OECD, 2008), regulation would be more effective at the EU level rather than at the country level.

Figure 1.19. **Individual purchases over the Internet**<sup>1</sup>  
Per cent of Internet users, 2013



1. Percentage of individuals who bought or ordered goods or services for private use over the Internet in the last 12 months.

Source: Eurostat.

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More than one third of Internet users are concerned about someone taking or misusing personal data, and about the security of online payments (EC, 2013e). Consumers' trust in e-commerce companies calls for consumer protection, data protection and security measures. Consumers may not fully understand which regulations apply to online transactions; better informing consumers can help (OECD, 2012c). However, there are limits to awareness initiatives (OECD, 2010b), and the multitude of payment systems used across EU countries impede cross-border operations (OECD, 2012c), calling to move towards common and secure standards. In particular, a legislation ensuring the mutual recognition of electronic identification and authentication, as proposed in the Single Market Act communication (EC, 2012a), would help enhancing minimum technical and legal standards. This is the purpose of the proposed regulation on electronic identification and trusted services for electronic transactions.

Privacy protection demands and fundamental rights obligations also need to be implemented, and in a manner that enables the benefits derivable from the use of personal data (OECD, 2011b). The implementation of the EU Data Protection Directive at national level has left inconsistencies across the EU, creating complexity, legal uncertainty and additional administrative costs. Rules need to be updated, following the recommendations of the 2013 OECD Privacy Guidelines (OECD, 2013d). The proposed reforms to the EU data protection framework, which would strengthen individual rights (e.g. introducing the right to be forgotten: people would be able to delete their data if there are no legitimate grounds for retaining them), are intended to impose a more consistent approach across the EU.

The telecommunication sector faces fragmentation of regulatory frameworks along national borders. In most cases, operators active across several EU member states tend to run their activities separately in each member state (EC, 2013f). The Commission proposed a telecommunication package with the aim of reducing this fragmentation, *inter alia* by eventually eliminating roaming surcharges, harmonising end-user protection rules, simplifying rules for cross-border operation of electronic communications services (EC, 2013h). However, it leaves the existing regulatory framework largely untouched, including in the way that national regulators supervise markets, with the aim to avoid disrupting operations (EC, 2013g). The OECD PMR indicator shows that rules applied to network providers vary across EU member states. For example, whether network access providers are allowed to give network bandwidth priority to content and application providers or not, depends on countries (Koske et al., 2014). The provisions related to net neutrality that are part of the proposed "Connected Continent" package aim at ensuring the openness of the Internet while enhancing the introduction of innovative services (EC, 2013f). However, the European Data Protection Supervisor believes that providers would still be given large rights to manage Internet traffic (EDPS, 2013). This issue needs to be monitored carefully with the aim to prevent dominant providers from undertaking practices that abuse market power in the provision of Internet services.

The deployment of high speed communication infrastructure needs a fair wholesale price, so that associated revenues participate in the coverage of the network's fixed costs (Laffont and Tirole, 2000). On the other hand, a high level of competition has to be granted by the regulatory environment. To some extent the EU has succeeded in this through local loop unbundling, which introduced new players in the market that innovated and delivered new services at affordable prices. The result is a high basic broadband penetration in many EU countries, combined with affordable prices in most EU countries. The most competitive markets exhibit record levels of investment such as in France (in

2012 investment was the highest since the liberalisation of the market). Achieving sufficient investment in other countries requires an efficient and credible regulator. According to the Commission, there is still a lack of investment in high speed communication networks (EC, 2012a), which could imply a need for better implementation of competition policies, and stable and consistent access regulation throughout the EU so that private firms can set up long-term investment plans. This is the objective pursued by the “Commission Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment” (EC, 2013h). The main mechanism that has so far spurred investment by existing players has been competition, either from competing existing infrastructures (such as cable vs. public switched telephone network), new entrants or publicly-controlled utilities (as in the Scandinavian countries).

In addition, civil engineering costs represent up to 80% of the cost of deploying new networks (EC, 2013i), an important part of which is related to inefficiencies (e.g. in granting permits), which should be suppressed. This deployment would also be facilitated by cutting red tape and by encouraging cross-utility reuse of infrastructures, including those of other utilities, following best practices observed in Lithuania and Portugal (EC, 2013i). Synergies across sectors may significantly reduce the need for civil works. The Commission has proposed measures aiming to reduce the cost of network deployment (EC, 2013i).

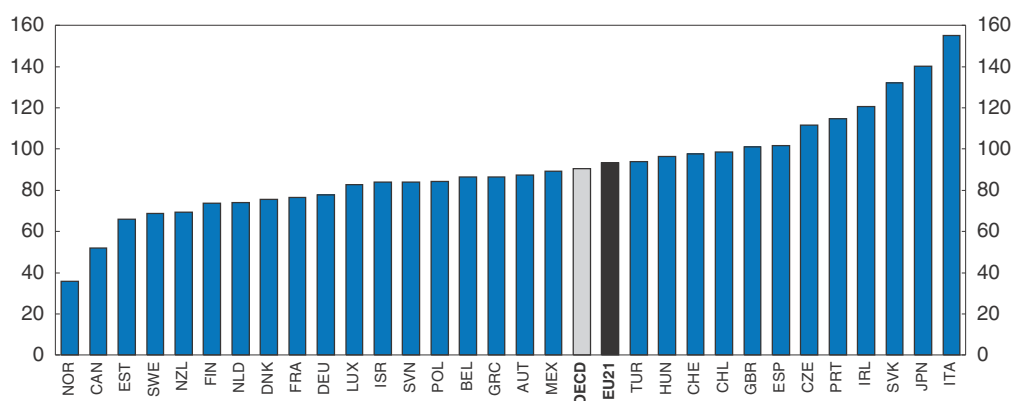
Differences in the timing, the conditions and the costs of procedures for acquiring spectrum make it hard to develop integrated wireless networks between countries. Strong reform could be possible, such as harmonisation of spectrum allocation, harmonisation of the dates in which spectrum is being used and assignment of numbering resources. One important example is machine-to-machine communication, which is expected to be the telecommunication market’s main growth driver. Research conducted by the OECD’s Directorate for Science, Technology and Industry indicates that an enormous potential lies in breaking up the exclusive right of spectrum holders to issue SIM cards (OECD, 2012d). Permitting third parties like non-telecom operators to issue their own SIM cards and to freely choose their network would enable businesses and consumers in all sectors to seamlessly switch network providers, to purchase mobile roaming at lower cost and increase reliability, generating large cost savings. The proposed “Connected Continent” package establishes a co-ordinated approach to the assignment of radio spectrum, potentially leading to the consistent availability of this key input throughout the Single Market.

The development of the Internet economy across borders, using mobile devices, is impeded by data roaming prices, which are currently much higher than domestic rates (OECD, 2011c), and well above marginal costs. Effective competition can help to address this barrier to the Single Market, as illustrated with the first ‘off-net roaming’ offers that enable users to use mobile services in other EU countries, as part of their regular bundles, without additional costs. That is why the EU roaming regulation adopted in 2012 introduces competition in the provision of roaming services, by enabling customers to choose a roaming operator distinct from his domestic operator (“decoupling” obligation), on a permanent basis or at the destination during travels for data roaming. The regulation also maintains gradually decreasing caps on roaming prices. Addressing barriers to cross-border use of devices, such as in the area of machine-to-machine communication, is likely to quickly transform the mobile market in areas such as data roaming.

### Electricity grids lack investments

Commission estimates point to considerable investment needs for networks by 2020 (EUR 140 billion for electricity and EUR 70 billion for gas; EC, 2011a). Renewable energy growth can only occur with additional electrical network infrastructure, with a special focus on interconnection of national networks. Some areas in the EU, like the Iberian Peninsula, still have only limited connections to European electricity and gas networks. Price differences between neighbouring countries such as France and Italy show that network bottlenecks prevent efficient electricity resources allocation (Figure 1.20). In addition, better interconnection would reduce production capacity needed to handle demand peaks.

Figure 1.20. **Electricity prices for industry**  
EUR per thousand kilowatt hours before taxes, 2012<sup>1</sup>



1. Or latest available data.

Source: IEA, Energy Prices Database.

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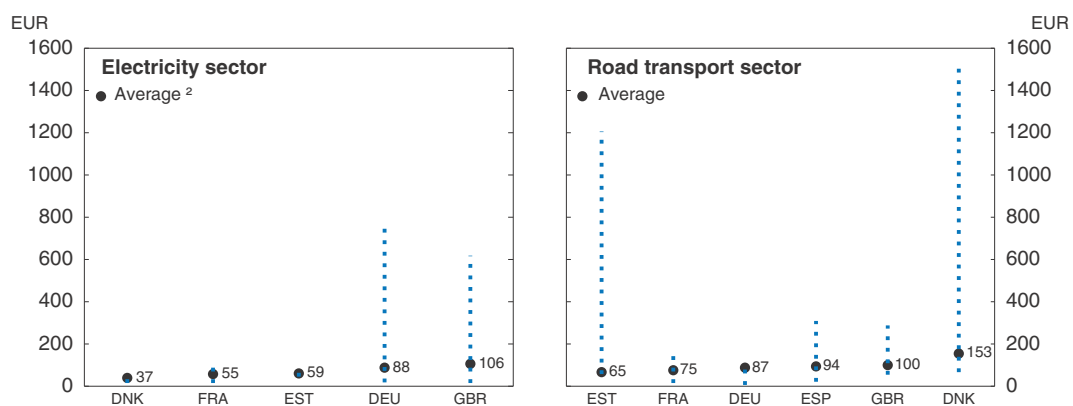
Decisive policy actions can support investment in electricity grids. National incumbents with large market shares in home countries have a strong interest in stifling investment in interconnection capacity to protect their own national markets. Ownership unbundling of generation, supply and network activities within vertically-integrated electricity utilities is needed, in the EU member states where they are not realised so far, to address conflicts of interest. Permit procedures should be streamlined where possible. In addition, the Commission should continue its efforts to promote smart grids that minimise consumption to develop binding network codes and guidelines.

Energy regulation is still mostly in the hands of national authorities, contributing to inefficiencies, and co-ordination at the EU level has been slow to develop (Black, 2013). Complex burdens for cross-border firms, low import competition in the energy sector and higher administrative costs reduce efficiency. Varying interest among EU member states explains the lack of co-operation. EU framework should aim at achieving convergence of these interests (e.g. generalising non-state ownership of energy firms), with the ultimate goal to move towards a genuine EU-level regulation of energy. There is a strong case for gains from co-operation in the assessment of production capacity needs. National decisions taken independently have led to over-investment in production capacities, illustrated by levels of spare capacities. As each country is making conservative and hence

low assumptions of the evolution of the production capacity of its neighbours, it overestimates investment needs in production capacities.

In some network sectors that generate large greenhouse gas emissions (e.g. electricity, road transport), current policies to curb emission differ widely across countries (Figure 1.21). This goes against the main goal of EU competition rules, namely to make sure that all companies compete fairly within the Single Market. In addition, this is an inefficient way to curb carbon emission: emission cuts are not achieved where the gains are the cheapest to reap, but where subsidies are the highest. In particular, a general overhaul of state aid guidelines for renewable energy is thus necessary to level the playfield with the aim to remove unnecessary subsidies on production.


Figure 1.21. **Effective carbon prices in selected countries**  
2010 EUR per tonne of CO<sub>2</sub> abated<sup>1</sup>



1. The dotted lines indicate the minimum and maximum price range.

2. Single weighted average for Denmark and average of weighted averages for the others.

Source: OECD (2013), *Effective Carbon Prices*, OECD Publishing, Paris, Figures 3.1 and 3.9.

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### Main recommendations for network sectors

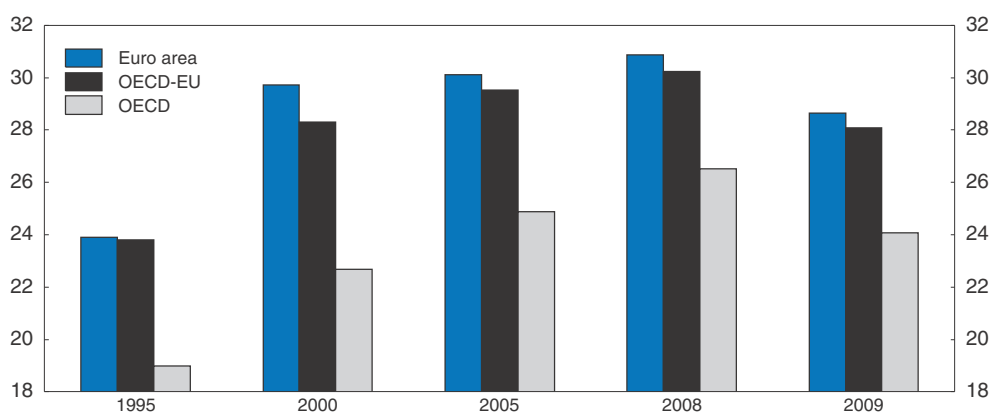
- In network sectors that require regulation, further strengthen co-operation between national regulators, with a view to moving towards cross-border regulators.
- Deepen the internal energy market through further development of energy interconnections.
- Generalise best practices to promote cross-utility reuse of infrastructure.
- Build a regulatory framework for the digital economy by establishing technical and legal security and privacy standards, enabling authorities to prevent dominant providers from undertaking practices that abuse market power in the provision of Internet services.
- Take dispositions to harmonise spectrum allocation and assignment, and to systematically enable mobile customers to choose operators during travels.
- Encourage ownership unbundling of generation, supply and network activities within vertically-integrated electricity utilities, and streamline permit procedures to support electricity grids investment.

## Free trade agreements (FTAs) can boost integration gains from the Single Market


### **Building stronger trade ties with the rest of the world would further boost integration gains**

The foreign value added content of gross exports in the EU has risen sharply since 1995, as supply chains are becoming more and more global (Figure 1.22). This points to imports being essential for exports, especially in complex value chains, and hence tariffs and non-tariff barriers are effectively a tax on exports. Further integration of EU firms with these global value chains can enhance trade gains with countries that have different specialisation. This can be done by further opening the EU to the rest of the world.

Figure 1.22. **Foreign value added content of gross exports**  
As a share of gross exports



Source: OECD-WTO, Trade in Value Added (TIVA) Database and OECD calculations.

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Completing the Single Market and building stronger trade ties with the rest of the world are mutually reinforcing goals. Multilateral trade agreements would be the best way to reducing trade barriers. However, multilateral liberalisation progresses slowly: the Doha round started in 2001 and reached agreement on its trade facilitation chapter only in December 2013. Plurilateral agreements, provided that they are open and cover a critical mass of world trade, are a useful tool to address trade barriers among a range of WTO members in certain sectors and can serve as building blocks for multilateralism. Examples in which the EU is involved include the negotiations on an Information Technology Agreement, Trade in Services Agreement and the recently-launched Environmental Goods initiative.

Bilateral FTAs, notably with the United States and Japan, are other important means for EU firms to realise benefits of globalisation of value chains across the world. They should also not only remove tariffs, but also lower barriers beyond the border. This includes barriers to investment, openness of public procurement markets, and alignment of rules and technical product standards, potentially with mutual recognition agreements. In particular, the largest gain from a trade agreement with the United States is to be won from regulatory reforms (OECD, 2005).

As value chains are global, third countries can also benefit from more active trade between two countries. Strengthening the Single Market can stimulate trade between the

EU and the rest of the world, and trade agreements with non-EU partners can stimulate trade within the EU. Regulatory impediments to trade within the EU are also important impediments to trade with the rest of the world. Complexity of regulation can be even more costly for non-EU firms that may operate in a very different regulatory environment in their home country. Non-EU exporting firms, that enter the Single Market and lack single entry points for the whole EU, have to deal with regulatory rules on country-by-country basis. The harmonisation and simplification of rules to reduce implicit barriers within the Single Market should ensure that non-EU competitors can reap the same benefits. This can be achieved by promoting EU-wide single entry points for outsiders as well.

### ***An agreement is under negotiation with the United States***

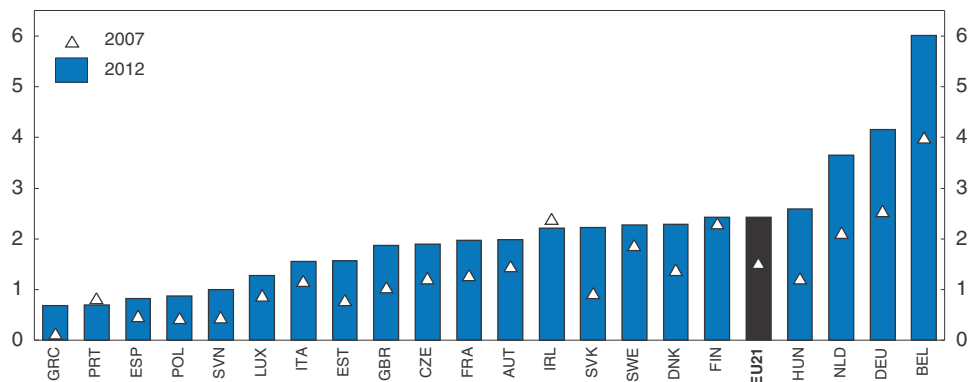
An FTA with the United States would be a major step: it could cover almost one half of world output and trigger more trade and growth for the two partners. It could become a building block for future multilateral initiatives. Beyond the cut of remaining tariff barriers, this negotiation is an opportunity to reduce non-tariff barriers (NTBs). The existing estimates, while using quite different approaches, suggest gains ranging from around 0.5 to around 3.5% of annual GDP (OECD, 2005; Berden et al., 2009). However, there is significant uncertainty surrounding these estimates. Francois et al. (2013) estimate that an ambitious scenario results in gain in GDP of only 0.5%, while the IFO Institute arrives at estimates of 13% and 10% welfare increase in the United States and the United Kingdom and 5% and 3% increase in Germany and France. The lower gains for France and Germany, despite high barriers reductions, reflect inefficiencies in the resource reallocation process.

The EU-USA FTA negotiation has to be broad based to deliver substantial gains. It could tackle barriers at sub-federal level of government in the United States, as well as at national level in the EU, especially in the services and public procurement sectors where barriers are still high. It could also introduce mutual recognition of standards and procedures, as well as harmonisation of property rights regimes. Overall, some business survey-based estimates suggest that up to 50% of the estimated impact of NTBs – defined as all non-price and non-quantity restrictions on trade – on costs or prices can be removed (Berden et al., 2009). Non-tariff barriers are the highest for food and beverage products and financial services in the United States, and for the business and ICT sector, communications sector, construction, and personal, cultural, other services in the EU (Berden et al., 2009). This negotiation could also cover high tariffs in motor vehicles, textiles, processed foods and agricultural commodities.

### ***Negotiations are going on with many other trade partners***


Keeping its engagement to the multilateral trading system, the EU should continue its efforts with other counterparts, with an emphasis on trade agreements with partners that have a large potential for gains, on grounds of size, different specialisations, large trade barriers, or because the partner's fast trend growth creates major business opportunities. The EU applies FTAs with South Korea, Central America, Peru and Colombia. Agreements were concluded with Georgia and Moldova, and political agreement reached with Canada and Singapore. In addition to the United States, the EU is currently involved in negotiations with Japan, India, Mercosur, Vietnam, Malaysia, Ecuador and Morocco. In particular, rapidly-growing Asian economies already represent a substantial share of EU output (Figure 1.23), despite the persistence of many tariff and non-tariff barriers suggesting that

Figure 1.23. **Exports to dynamic Asian economies**<sup>1</sup>  
As a percentage of GDP



1. Dynamic Asian economies refer to China, Chinese Taipei, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, Thailand and Viet Nam.

Source: OECD, *Trade by Partner Countries* and OECD Economic Outlook Databases.

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on-going FTA negotiations with dynamic Asian economies can yield substantial gains. While the EU is pursuing many negotiations at the same time, two out of the five most important trading partners (China and Russia) are not covered by current FTA initiatives.

#### Main recommendation to promote trade

- Continue the intensive engagement in multilateral trade negotiations, move forward with a trade agreement with the United States to reduce non-tariff barriers, while continuing to negotiate trade agreements with other partners.

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## Glossary

|                |   |
|----------------|---|
| <b>ABR</b>     | Administrative Burden Reduction                       |
| <b>BEPS</b>    | Base Erosion and Profit Shifting                      |
| <b>BRIICS</b>  | Brazil, Russia, India, Indonesia, China, South Africa |
| <b>CAP</b>     | Common Agricultural Policy                            |
| <b>CSR</b>     | Country Specific Recommendations                      |
| <b>EDPS</b>    | European Data Protection Supervisor                   |
| <b>EPL</b>     | Employment Protection Legislation                     |
| <b>ETCR</b>    | Energy, Transport and Communication Regulation        |
| <b>ETS</b>     | Emission Trading System                               |
| <b>FDI</b>     | Foreign Direct Investment                             |
| <b>FTA</b>     | Free Trade Agreement                                  |
| <b>GDP</b>     | Gross domestic product                                |
| <b>GHG</b>     | Greenhouse Gas Emissions                              |
| <b>GNI</b>     | Gross National Income                                 |
| <b>HICP</b>    | Harmonised Index of Consumer Prices                   |
| <b>IMI</b>     | Internal Market Information System                    |
| <b>KBC</b>     | Knowledge Based Capital                               |
| <b>NIIP</b>    | Net International Investment Position                 |
| <b>NTB</b>     | Non-Tariff Barriers                                   |
| <b>OMT</b>     | Outright Monetary Transactions                        |
| <b>PCI</b>     | Projects of Common Interest                           |
| <b>PISA</b>    | Programme for International Student Assessment        |
| <b>PMR</b>     | Product Market Regulation                             |
| <b>PSC</b>     | Point of Single Contact                               |
| <b>R&amp;D</b> | Research and Development                              |
| <b>REFIT</b>   | Regulatory Fitness                                    |
| <b>SME</b>     | Small and Medium Enterprises                          |
| <b>SOLVIT</b>  | Internal Market Problem Solving System                |
| <b>VAT</b>     | Value Added Tax                                       |
| <b>WTO</b>     | World Trade Organisation                              |

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**Volume 2014/6**  
**April 2014**

OECD publishing  
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ISSN 0376-6438  
2014 SUBSCRIPTION (18 ISSUES)  
ISSN 2072-5078  
SUBSCRIPTION BY COUNTRY

ISBN 978-92-64-20680-9  
10 2014 06 1 P

