Chapter 10

The operation of the internal market

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1 Introduction

The 2004 enlargement of the European Union towards middle and eastern Europe would not have been possible without the collapse of the Soviet Union (USSR) and of the economic system she imposed on the countries in her sphere of influence.[1] But at the

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[1]The collapse was finalised on 26 December 1991 when the Supreme Soviet officially dissolved the USSR

time of that liberating collapse, the former British Prime Minister Edward Heath (1991) warned against hasty enlargement of the European Community (EC):

> "If they [the formerly Soviet Union oriented socialist countries, GMA] enter the EC now, they will be wiped off the face of Europe ... There is nothing we want to buy from them. They want our products."

This assessment appears to be very outdated by now. Less than twelve years later, eight of such seemingly problematic candidate countries had their accession treaties signed. In a few years to come, Romania and Bulgaria are expected to follow suit. But long before accession happened or will happen, all these countries had established free trade agreements with the EU. Since then, i.e. since the middle of the 1990s, protecting their national markets – as Edward Heath's concern seems to have been – was not an issue any more. In this sense one must agree with the observation: "In terms of economics, eastward enlargement is largely yesterday's news." (Barysch 2003, p.1)

Nevertheless, Edward Heath's comment conveys a relevant and lasting concern over the ability of the new member states to participate fully in the economic exchanges of the European Union. Looking back at the years 1989 to 2001, Landesmann (2003, p.32) observed that all eight central and east European accession countries "(with the exception of Slovenia) experienced at times dramatic - and unsustainable - deficits in the current accounts."[2]

Concern about the sustainability of the economic situation of those countries stresses the great importance of the working of the European internal market for the cohesion of the European Community and for the well being of the respective national citizens. It is quite clear that great challenges lie before the enlarged Union in this regard. The

[2]For a good collection of data concerning the applicant and acceding countries see Task Force Enlargement (2002).

pre-accession process did establish, of course, that the legal, economic and societal prerequisites for membership were met. But that not withstanding, it will be important to be conscious of the type of economic expectations which were implied by attesting the new members that they will be able to participate in the economic life of the European Union on an equal footing.

The following chapter will go deeper into this matter by asking about the important challenges and promises offered by the workings of the internal market of the European Union. The challenges naturally are particularly great for the formerly socialist countries and therefore we will mainly refer to the formerly socialist CEECs (**C**entral and **E**ast **E**uropean **C**ountries).

Since socialism means that society and not individual "capitalists" should own a country's "means of production", it was an essential characteristic for the formerly socialist countries that private ownership of factories was forbidden. The internal economic exchanges were not left to the 'chaos of the market'. Instead, they were predominantly dictated by the central planning authorities. In the absence of private capital, there were, of course, no capital markets, there were no commercial banks and no credit markets. Foreign trade was predominantly pre-planned in the context of the Soviet Union dominated "Council of Mutual Economic Assistance" (COMECON). Thus, these countries enter the European Union with an economic and administrative background which was very much opposed to the market-oriented institutions and traditions built up in the European Community. It is therefore small wonder that a group of economic experts recently emphasised that "Enlargement will further increase the heterogeneity of the EU."(Sapir *et al.*, 2003, p.4). But what does this imply for the progress of European integration and for the operation of the internal market?

2 Concept and "completion" of the internal market

The "Eurocrats" responsible for the European Union are often criticised for using unintelligible jargon so that an uninitiated person often has difficulties to understand the issues under debate (for such a criticism see, e.g. Charlemagne 2003). The term "internal market" is maybe a good case in point. Its specific meaning in the context of the European Union is defined in article 14 (2) of the "Treaty Establishing the European Community" (TEC).[3] This is not a document which makes for light reading, but it is the contractual basis for European integration. According to this document the term "internal market" is meant to "comprise an [integrated European, GMA] area without internal frontiers in which the free movement of goods, persons, services and capital is ensured". The list of free movements just given enumerates the famous "four freedoms" which are the concern of the EC and its internal market. We will look at them in more detail below. They have a paramount position in the enlargement negotiations and constitute the first four "chapters" out of the 31 total ones which made up the enlargement agenda, many of the other chapters being elaborations of the ones just named, however.[4]

The expression "internal market" stands not just for a term but for an aim. This follows from the beginning of the said art. 14 TEC where the first sentence states that the EC should adopt "measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992". This statement is likely to appear as rather strange to the uninitiated reader, however. Is establishing the internal market a project which is over and done with since the end of 1992? If so, why do we still have

[3] For the currently relevant text of the treaty see Office des publications officielles des Communautés européennes (2002a) or any other publication of the treaty.

[4] For the complete list of the chapters see appendix 2 of this book.

this passage in a treaty which has been three times re-negotiated since that provision was written? The fact is that the European Union is still working at making the aim of an "internal market" come true, i.e. at the "completion of the internal market" as the jargon has it. This aim involves the basic European treaties, as we just gathered from the TEC. In the last resort it involves the individual member states who are the signatories of the EU's treaties and their citizens and firms. If they do not cooperate in the spirit of the treaties, their substance would be eroded. To avoid this outcome, the treaties provide for "sticks" and "carrots" – for disciplinary measures and for incentives – to assure the agreed outcome, namely the market integration in the present case.

The administrative organ which is charged with applying the "sticks" and "carrots" provided for in the treaties is the European Commission, of course. She is the driving force and the guardian of the EU's treaties. With regard to the internal market she keeps a "scoreboard" in which she monitors and quantifies the realisation of the aim of its completion and realisation. It is remarkable that in May 2003 she alerted the public that in recent years this completion has not progressed but regressed among the EU15 countries – in the sense that the national legislation is increasingly lagging behind agreed targets (see Commission 2003b). In September 2003 the commissioner charged with internal market affairs put this matter in rather dramatic words, declaring (see Commission 2003d, p.1):

> "The growth of intra-EU trade has slowed to a crawl. Intra-EU trade in services as a share of GDP is less today than it was 10 years ago. Foreign direct investment has taken an even bigger dip. Member States seem to be turning increasingly to their domestic economies. Price convergence, which was rapid immediately after the launch of the Internal Market in 1993, has

> – like trade integration – come to a halt. ... This is all bad news for our competitiveness. We should not forget that the Internal Market Strategy is all about competitiveness."

If even the old EU15 members had such difficulties with the aim of an internal market, it is not very reasonable to expect that the enlarged EU25 have less problems of this kind. What are their underlying causes and issues?

The administrative problems with the completion of the internal markets fall under three headings: "implementation", "infringement", and standardisation. The first of these concerns the implementation of "directives", of "framework laws" passed by the European Council of Ministers in cooperation with the European Parliament and which have to be translated into national laws according to a fixed time-table. This legislative process, also referred to as "transposition of legislation" in the relevant documents,[5] was one of the main preparatory tasks the new member countries had to master in order to comply to the "*aquis communautaire*", the current *status quo* of European integration. Problems in this field pertain to the mechanisms of national legislation. They are, of course, quite different in federal systems where there are several levels of legislation (like the Federal Republic of Germany where there are national and regional elements in the passing of laws) on the one hand and centralist governments (like France) on the other hand. It might well be, however, that details of the legislative processes are not decisive when it comes to explaining problems of implementation.[6] If the indications are correct that implementation hinges most of all on the political will behind it, then the question arises why that will could be lacking in some cases. Section 5 below will give some indications for economic reasons for such political behaviour.

[5] See, e.g. Commission (2002a).

[6] According to the findings of the (Commission, 2002a, p.10, Figure 7), the national organisation of the legal process seems less important for implementation than the political will to perform.

The second set of problems with the completion of the internal market relates to member states' non-conformity with or misapplication of Internal Market laws. Such cases of "infringement" have increased from 700 in 1992 to over 1500 cases in 2002 which were reported to the European Commission as complaints (see Commission (2002a), p.11). Again, there are several factors at work. Among them are: the great increase in the number of internal market related laws naturally increases the number of potential misapplications of such laws; then there is the possibility that the laws are formulated in such a way that they are not followed because they are too difficult to understand; and there might be cases of lacking determination to apply the laws in the sense they were intended. The European Commission has devised a consultative mechanism to address these type of problems which runs under the acronym SOLVIT.[7] It brings together the parties concerned so that no formal measures are required for dealing with the infringement complaint. No doubt this latter approach is to be commended as conducive for a integrative approach to problem solving in a transnational context. The SOLVIT approach seems to be particularly appropriate for the new EU members in view of the yet unexperienced administration there. The normal procedure in a case of unwarranted infringement of internal market law is for the European Commission to file a case with the European Court of Justice against the uncooperative culprit nation.[8] There is the apprehension that in the enlarged EU25 this approach will put too much strain on the European judicial system.[9] The SOLVIT approach might therefore be a promising alternative although the danger here is that its negotiation oriented approach might give the wrong impression to inexperienced administrators that the existing *acquis* concerning

[7] `http://europa.eu.int/comm/internal_market/solvit/index_en.htm`

[8] For further details concerning infringement procedures see `http://europa.eu.int/comm/internal_market/en/update/infr/index.htm`

[9] See (Sapir *et al.*, 2003, p.155) for a critical assessment of existing infringement procedures in view of the current enlargement.

the internal market itself is open for renewed negotiations. Some

The current apprehensions and suggestions in this field are quite well expressed in the recent Internal Market Strategy paper where the Commission (2003c, p.33) declares:

> "In the end, success in an Internal Market of 25 countries will depend on mutual trust and confidence. The key is administrative co-operation and understanding between officials in competent authorities leading to ways of finding practical solutions to problems. This can only develop over time - there is no magic solution."

The third set of problems, standardisation, concerns one of the main obstacles to a smooth functioning of the European internal market, namely the co-existence of many national technical, medical, environmental and other norms. They can and do constitute severe barriers to trade. They were a major reason for the first re-formulation in 1987 of the old Rome Treaty of the EC. The main issue is here that

In the process of European integration there has been a multitude of approaches to these type of problems. Indeed, the changing awareness of non-tariff barriers to trade and the changing approaches to these barriers explains much of the dynamics of European integration.

3 The 'market bias' of European integration

The preoccupation with the internal market and its "completion" as documented in the preceding section might easily appear to express an unsound overemphasis on economic aspects of European integration. The rich and varied cultural heritage of Europe, the traditional intellectual communication of European thinkers across many political, ad-

ministrative, and eve cultural borders, the yearning for peace in Europe which found such a fruitful expression in the declaration of Robert Schumann at the beginning of the present European integration on 9 May 1950 – all these elements of a pan-European tradition seem to find far too little consideration in much of what goes on in contemporary debates. If non-economic aspects of European integration do find expression on the level of official European activities, they seem to be nebulous like the many appeals to common European values or they are inconsequential like the invocation of the Western European Union (WEU) in article 17 TEU (ex-article J.7 TEU) of the Amsterdam Treaty.[10] This European military treaty organisation was declared to be "an integral part of the development of the Union". It was envisaged "as supporting "the Union in framing the defence aspects of the common foreign and security policy", and that passage speculated even about "the integration of the WEU into the Union" (all quotes from article 17, ex-article J.7, Amsterdam Treaty). None of these passages reappeared in the new Nice Treaty.[11] But this lack of performance occurs not because there is a lack of awareness of these larger aspects of European integration. Quite to the contrary: the military integration of continental Western Europe was envisaged long before the European Common Market was created in 1957. The problem was that the treaty for a European Defence Community, first envisaged in 1950 and then signed in 1952 by the later founding members of the Common Market was not ratified in 1954 by the French Parliament.

If seen in an historical context, the market-oriented preoccupation of European integration is not the *cause* but the *consequence* of the lack of military and political integration. What we witness now, e.g. with regard to the role of the WEU is nothing new.

[10] See Office des publications officielles des Communautés européennes (1997).
[11] See Office des publications officielles des Communautés européennes (2002b), Art. 17.

In spite of all professed intentions with regard to military integration we are today not much beyond the state in which Western Europe was in 1954. The force which was really driving European integration forwards in the last half-century was thus predominantly *economic* integration.

In principle, economic integration could be approached in two alternative ways:[12] *via* creating a free trade area or *via* a customs union. Under both regimes, the partners of the integration abolish trade restrictions among each other, in particular tariffs on goods imported from the partner countries. The scope of this liberalisation of trade can be narrow or wide in both cases, embracing for example only manufactured goods or including also agricultural produce and services. The crucial difference is the treatment of non-partner countries. In a free trade area that is left up to each member. Thus the utmost of national sovereignty is preserved for each member of a free trade area.

A customs union is different in that it is based on the decision to have a *common* external trade policy. Thus national sovereignty is abandoned, or rather one should say: among equal partners of a customs union sovereignty is pooled and exerted collectively in trade political matters. Both types of integration have been and are being tried in Europe. The Europe Agreements which prepared the CEECs for accession were, trade politically speaking, free trade agreements. Other European examples of free trade areas are the EFTA,[13] founded in 1960 as a response to the founding of the Common Market in 1957 or the CEFTA[14] which gathered a number of former COMECON countries. Both have lost most of their former members to the European Community resp. European Union which was established as a customs union of 6 founding members in

[12] We omit here the socialist model of integration which was tried and which failed in the context of COMECON as mentioned in the introduction of this chapter.

[13] For some further information see `http://secretariat.efta.int/Web/EFTAAtAGlance/history`.

[14] See `http://www.cefta.org/cefta/milestones.htm` for some further details.

1957. The fact that membership has grown from 6 to 25 seems to suggest that European integration has shown that the concept of a customs union is the more fruitful one as far as integration is concerned. But this is and was by no means a foregone conclusion as we will see instantly.

The seminal passage of article 23 TEC (ex-article 9 of the treaty signed in Rome in 1957):

> "The Community shall be based upon a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries."

has survived all the subsequent revisions and enlargements of the treaties. This sentence still describes the basis of the European integration. That this basis was a customs union turned out to be so seminal because right from the beginning of European integration this idea was firmly wedded to the intention of creating a Common Market – this indeed was the "nickname" given – quite appropriately – to the European Economic Community. This combination stressed that the aim was not just free trade, i.e. not just the *abolition* of obstacles to trade or "negative integration", but rather the perspective was one of *creating* a new and common market, on "positive" integration.

These historical remarks are not just backward oriented reminiscences but indications of fundamental principles which are basic for what does and will go on in the EC. The positive creation of European market exchange where there was none - or too little - is on the agenda not just now but it is an obligation which was assumed and confirmed long ago. Indeed it was the reason why we have European integration in the form which

we have. This need not necessarily tie us for the future. But reason shows us that there is no sensible economic alternative to European integration and experience shows us that there is no viable basis for European integration but economics. In other words, the heading of this section should maybe better not refer to a market *bias* but rather to a market *centered* approach to European integration.

There are critics, of course, who regard the EU as being not to much but to little market oriented. Maybe Vaclav Claus, former Prime Minister and then President of the Czech Republic is a good example in view of his Euroscepticism proclaimed as "Eurorealism" by himself. In this context it might be instructive to remember that some free-marketeers initially saw matters also quite sceptically at the time the EC was created. They, in particular the German minister of economics and so called "father of the German economic miracle" Ludwig Erhard, thought that a free trade area would liberalise foreign trade far better than a customs union could. They therefore favoured that alternative. Indeed, economic theory suggests that generally speaking there is reason to expect that economic welfare, efficiency, and the volume of trade would be higher in a free trade area than in a comparable customs union. The reason is that it leaves scope for individual member countries to be more liberal in foreign trade policy than the rest of its partners.[15] In a customs union a common stand has to be reached among the members of the union and the supposition is that the over-all level of protection against third countries would then be higher. But these arguments mostly forget to mention transaction costs. They can make a crucial difference. Look in particular at the provision of Art. 24 TEC which states: "Products coming from a third country shall be considered to be in free circulation", i.e. they can be freely traded in the whole territory of the union if

[15] See, e.g. (Robson, 1998, ch.2) for a comparison of customs unions and free trade areas under this perspective.

the common import formalities are made, no matter where in the customs union. Thus, a product coming from Japan, the US or any other third country can be traded in Europe freely from, say, Ireland to Hungary, once it legally crossed the customs border. This is never possible in a free trade area where members have different policies against third countries. In a free trade area any – even internal – cross-border trade must be checked and monitored lest it is a detoured third-country import. There is thus a trade-off: more trade political centralism in a customs union against more *internal* trade monitoring in a "free" trade area. For sceptical free marketeers it might seem paradoxical to say that under realistic assumptions, an area without economic borders as is envisaged for the EU is impossible in the context of a free market area. This follows from the logic of the free trade area where every member pursues its own third country policy. Of course, if the whole world were a free market area without any restrictions on foreign trade, matters would be different. But as long as that ideal state of the world is not reached, the European model of a customs union is in many ways more integrative and less transaction cost intensive than the free market model. In any case, the economic club "Common Market" with six founding members mutated by now to a "European Union" with 25 members. This is clearly a success story. Its basis is, as we have seen above, a customs union.

4 The four freedoms and enlargement

There are two famous "four freedoms". In

The scope of any cooperation and integration can only be as wide as the partners agree upon. It is remarkable that there always was the understanding that the European Common Market should be as wide in its scope as possible.

4.1 Free movement of goods

This freedom follows immediately from the 'basis' of European integration, namely from the customs union as defined by art. 23 TEC. It extends to imports from third countries as stated by art. 24, once they passed the common external border. Tariffs (and other trade political issues) are decided by the European Council of ministers after proposals made by the European Commission (art.26). One might believe that this freedom is not very important since all the new members had free trade agreements with the EU before and hence there were no tariffs applicable anyhow. The important issue in this context is, however, that "non-tariff" barriers are equally inadmissable. This means that there must be a common ground of equal technical standards, certification of goods etc. and this requires wide-ranging administrative changes in the new member-countries. Adjustment difficulties can be overcome by temporal transitional arrangements which a number of entrants (Cyprus, Poland, Slovenia) have obtained for some sensitive products like medical supplies.

4.2 Free movement of persons

From the beginning of the European Community on there was the understanding as expressed in the treaty that not only goods but also persons should be able to move freely within the community. Three articles deal with this issue in particular. Art. 39 (1) defines the aim: "Freedom of movement for workers shall be secured within the Community." It goes on to spell out what entitlements this aim implies, namely to seek work and to stay even after working in any member country – subject to common rules which have to be worked out by the Commission. There *were* serious social insurance and other legal questions involved in this aim. Art. 40 addresses them expressly. But other-

wise this freedom did not create any serious problems among the old EU15 members in the sense that one country was "flooded" by workers from another country. Quite to the contrary. The internal movement of workers in the EU is stagnant, if not declining.

Nevertheless, there is great apprehension that the domestic labour market will suffer in some of the old EU15 member countries if this freedom is used too extensively. Some of them (Germany, Austria) therefore secured for their countries longer transition periods in which the citizen of the acceding countries can not enjoy full access to those countries' labour markets.

This is a rather sensitive issue, however, since free movement of persons is the most important aspect of liberalisation and opening to western Europe for many CEEC citizen who still are conscious of their former life behind the confines of the iron curtain.

From the side of employers, the problem of free movement of workers is one of monitoring the quality and qualification of their employees. As consumers ought to be protected against the marketing of goods unfit for consumption, so there should also be minimum standards for specific job qualifications. In addition, domestic labour unions will attempt to protect their members' relatively high salaries in the EU15 countries with the argument that their qualification is also higher. There is, of course, the old issue of mutual recognition of diplomas and certificates. Art. 47 TEC gives the Council the right to regulate this aspect of the internal movement of workers by appropriate directives. This competence is by now (since the Maastricht Treaty) extended to directives concerning "the taking-up and pursuit of activities as self employed persons".

In the accession negotiations the EU put considerable stress on the aspect of proper qualification of workers and required in particular that the acceding countries reformed their public educational institutions in such a way as to guarantee a competence of workers in compliance with community norms.

4.3 Freedom to provide services

The TEC (Art. 49) expressly forbids hindering the trade in services, stating that "restrictions on freedom to provide services within the Community shall be prohibited" in the sense that suppliers of services do not necessarily have to reside in the same country of the community as their recipients. But the problems of quality control apply here as in the two previous cases and even more so because of the often intangible character of services. But the problem of potentially prohibitive requirements concerning extraterritorial suppliers of services also must be considered as one of fending off competitors through administrative measures. This is one of the reasons why for many years in the past transborder markets in services were rather limited in scope. The EU in its previous legislation and hence in the accession negotiations had to find a difficult balance between legitimate protection of regional interests and chicaning protectionism against external competitors. The acceding countries will probably see more of the latter in the fact that Germany and Austria secured temporary protection in the construction and hygiene sectors from their new competitors. But such protectionism hinders not only the trade in services but also an optimal allocation of resources in the community. The aim of more economic dynamism - to be inspected in more detail after the next section - will require further liberalisation also in this particular field of the internal market.

4.4 Free movement of capital

During the accession negotiations the chapter dealing with this issue was given absolute priority. It is also the most sensitive one for a number of reasons. The most important aspect with regard to the acceding CEEC countries is that they, as formerly communist countries, did not have private ownership of capital. This absence was *the* most

important element of their economic and societal constitution. This had enormous consequences, of course, since the associated infrastructure of banking, financial services, legal protection was absent in these countries for decades before the collapse of the former communist regimes. But even if there are no problems of systemic reform – which is the case for Malta and Cyprus as new members – there is ample scope for problems since aspects of investor protection and questions of economic criminality must also be regulated on a common footing lest regional suppliers of services and of capital have an unfair advantage within the community.

The "freedom of capital" chapter is also special and sensitive in that its subject matter is of only relatively recent time. There was a treaty title on "capital and payments" with liberalistic intentions in the original TEC of 1957. Its imperfect implementation was one of the major reasons for the wide ranging "Single Market" programme embodied in the Single European Act of 1986 which in turn then triggered much secondary legislation in form of directives and subsequent implementation in national laws. The significance of all this is that even for the older members this topic is a difficult one. Even as late as 2003 the implementation process was not satisfactorily completed as we saw above in section 2. One set of problems comes from the fact that the opening of the capital markets is based on the principle of home country surveillance. This is analogous to practices on the goods market: if a supplier of financial services is accredited in one country, then he should be admitted to the markets of all other member countries. In the field of financial and insurance services this principle is rather problematic for the consumers since the moral hazard is particularly great. Therefore community-wide standards are required for the purpose of consumer protection.

5 Competition and / *vs* competitiveness

In the spirit of "Charlemagne's" (2003) complaint about jargon mentioned in section two above, one could comment that in a way the expression "completing the internal market" means on the national level of each country the opposite of what it means on the European level and that this inherent contradiction is not addressed sufficiently clearly. This is not just a problem of words but one of substance. On a national level, fostering the "internal" market might be taken to mean two rather obvious things: (i) to stimulate market exchange, *i.e.* to strengthen market *competition* by restraining monopolies and abolishing administrative obstacles and (ii) to strengthen national *competitiveness*, i.e. the ability of national suppliers to penetrate outside markets or to protect national producers from 'unfair' outside producers.

On the one hand, (i) and (ii) clearly must go together – there can be no fair competition without competitiveness of the participants. With other words: there are no honourable laurels to be won in a race in which a running champion competes against only handicapped competitors. On the other hand it is popular for a politician to appear in front of his constituency as being eager to strengthen national competitiveness, say by "helping" (subsidising) national firms or by boosting them in other ways (e.g. in the style of Harold Wilson's and Margaret Thatcher's "Buy British" campaigns of the 1960s and 1980s). But this is like doping sportsmen, giving them an artificial advantage. In the end, such practice ruins the health of the doped individual and the morale in general. There is thus not only an agreement but also a problem in the relation between competition and competitiveness.

In economic terms there is the danger that fostering national competitiveness through government policy may involve ever mounting national subsidies if other government

follow suit with like measures. In the end such policies do not change the competitive outcome, they rather shift the cost from the producers to the taxpayers without returning to the latter appropriate benefits of such transfers. But once a situation of pervasive subsidisation is established, no government can easily opt out of such a situation because that would indeed affect the national competitiveness in relation to the subsidised foreign competitors. Examples in case are shipbuilding or agriculture where everybody bemoans the detrimental and wasteful effects of subsidies but where every country tries to keep up with the others in paying them.

It is these types of problems which are at the center of the EU's competition policy[16] and they were addressed in a remarkable way from the very beginning of the EU. The first precursor of the present EC treaty, the "Rome Treaty" of 1957 already had two addressees of competition policy, namely the companies and the national governments. The former were and are forbidden to abuse market power for obstructing the European common market and the European Commission has the task to monitor this aspect of workable competition. There is nothing extraordinary in that. Many states have comparable laws and provisions on the national level themselves. But in addition, the national governments are forbidden to pay subsidies, or, as the "jargon" of art. 87 TEC has it: "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings [or firms, GMA] or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market". In other words: such "state aid" is strictly forbidden "in any form whatsoever" – *in principle*. It is one of the main tasks of the European Commission that this principle is upheld as provided for by the

[16]For a brief overview of the EU's competition policy with reproduction of the seminal legal texts see Commission (2000a).

TEC. Even in the pre-accession period the European Commission monitored state aid in in applicant countries quite closely and also published a detailed investigation into this subject.[17]

From the monitoring of state aid there flows one of the main powers of the European Commission. The sweeping interdiction of such aid permits her, even obliges her, to critically review any favours granted by national governments except those which are expressly exempted by the EC-Treaty.[18] Since on the local level politics is mostly favours and since "all politics is local", as some political practitioners would say,[19] therefore this means that the European Commission can monitor national politics right to the local level. Since at the same time the Commission plays a crucial role in *granting* aid herself in the framework of 'competitiveness policy', this means that officials in national governments can have the impression to experience a double challenge to their authority coming from the Brussels Commission.

Critics of European integration may regret the influence which the Commission thus has. But the alternative of her *not* having these powers would be at least equally regrettable – from the national point of view. The grants which she deals out are, of course, a welcome support for the recipient individuals and regions. And if the Commission did not monitor national subsidies, wasteful competition among member states attempting to boost national competitiveness might be an even larger problem than it still is today. Such considerations underlie the economic rationale why all signatories agreed upon the existing competences of the European Commission. But if in addition "our" local politicians could only give just a little support to the entrepreneurs who are eager to bring investment and employment to our region, would such influence not be worth their

[17] See Commission (2002c).
[18] For details see Commission (2003a).
[19] This is the title of O'Neill und Hymel (1994).

efforts and would it not be public money well spent? It is such contradictory thoughts and motivations which constantly incite the member states' administrators to violate the self same rules which they agreed upon *in principle*.

In terms of budgetary arrangements there is now a rather paradoxical situation: although forbidden "in principle", transfers to individuals and firms, i.e. state aid in many forms, amounts to approximately a third of national budgets in many member states.[20] Indeed, the budget of the European Community itself is mostly concerned with state aid in some form: about half of the budget goes into agricultural aid. In addition, a third goes into financing structural and regional policy measures, mostly justified with attempts to boost competitiveness of regions and sectors in Europe. Thus about 80 % of the EU's budget are "state aid" in a loose sense of the word. They are subsidies granted because of lacking competitiveness – either in order to compensate for that lack (as is the case in important parts of agriculture), or in the attempt to *do away* with lacking competitiveness (as is the case in structural policy).

There can be doubts whether this volume of spending is really warranted by the aim of competitiveness. These doubts have been repeatedly addressed at meetings of the European Council, the gathering of the EU's heads of state resp. governments. Thus the Stockholm European Council meeting on 24 March 2001 came to the conclusion that "the level of state aids in the European Union must be reduced and the system made more transparent" (see Commission 2002b, p.1). About one year later, at Barcelona, the

[20] In the regular "State Aid Scoreboard" the European Commission gives a far lower figure of about 1% of GPD going into state aid in the member states of the EU on average (Commission, 2003e, p.11, graph 1). But it should be realised that this figure is based on a very narrow definition of state aid: "The [State Aid] Scoreboard covers State aid as defined under Article 87(1) EC Treaty that is granted by the fifteen Member States and has been examined by the Commission. Accordingly, general measures are not included in the figures. For example, a general tax break for expenditure on research and development is not considered as State aid although it may well appear in Member States national budgets as public support for research and development. Furthermore, Community funds and instruments are also excluded." (*ibid.* p.8)

European Council renewed this appeal and called for a change in the rationale of giving state aid so that in future it will be directed more to "horizontal" objectives like environmental and social policy. Since the European Council has the statutory role of giving the guideline for the general development of European integration, some fundamental reorientations are to be expected. Thus, coincidental with enlargement, we have now an increased awareness of the problematic aspects of "competitiveness policy" *via* state aid.

6 The 'Lisbon strategy' and enlargement

On the occasion of the Lisbon European Council in March 2000 the heads of government of the EU put the present decade of European integration under the motto of competitiveness, declaring (Council (2003), p.5):

> "The Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world ..."

Based on this declaration, a "Lisbon strategy" was developed which involves among other measures "stepping up the process of structural reform for competitiveness and innovation" and "completing the internal market" (*ibid.*). From 2004 on the "Lisbon strategy" involves also the new members of the European Union, of course, and there is the question whether the ambitious aims of the Lisbon declaration fit together with the particular problems of the new members.

One of the reasons for concern about "competitiveness" in the EU in general stems from the observation that for decades the EU15 countries were on average about 30%

below the USA as far as GDP per capita is concerned (see Sapir *et al.* 2003, p.21, fig.4.1). A plausible reason for this superiority of the US economy seems to be a better integration of her goods and factor markets and a more dynamic research and development sector. Therefore it also seems plausible to insist on finalising the completion of the internal market in the EU and on structural economic reforms. But with economic performance being an important concern in the EU, what contribution towards these aims will come from enlargement? Out of the ten new members are predominantly only

Especially as far as the new members of the EU are concerned we have the problem that the GNP as expression of regional economic performance is way under the EU average, as table ... shows.

7 Concluding remarks

In the introduction we quoted the view that "in terms of economics" even the particularly problematic eastward enlargement is "yesterday's news". The considerations of this chapter should have shown that that is most likely too optimistic a view. Quite to the contrary: even the founding members of the Common Market still have remarkable problems with fulfilling their self-imposed aim of market integration. There is considerable apprehension among economic commentators that these well known difficulties will be particularly topical after the new round of enlargement. The "Lisbon Process" now under way is supposed to address these problems in a renewed spirit of dynamism and innovation. Whether its high aim of Europe becoming the most dynamic economy in the world will come true by the targeted year 2010 only the future can prove. But whatever the outcome of the "Lisbon Process", the already achieved progress in the freedom of movement for goods, persons, services, and capital is without any reason-

able doubt very considerable and in this form and extent it is without any historical precedent.

Although in the end mostly driven by economic concerns, the European Union has by no means a purely economic agenda. It propagates and defends high social values and fundamental human rights. But the concrete way forward in these directions was based in the past and will be also based in the future on a "customs union" and on the operation of the internal market within its area. In quoting relevant passages from the Treaty establishing the European Community, we saw that her foundations are of a predominantly economic nature.

The ambitions associated with the enlargement of the European Union go far beyond such narrow confines, however: "Enlargement can only succeed if it is a social project involving all citizens and not just an elite" as the (Commission, 2000b, p.5) stated in one of her strategy papers leading to the recent enlargement. But this all embracing involvement cannot just be based on the equality of market access. There is no guarantee that this by itself will lead to the equitable results which an impartial union must offer to all of its members and to their citizens. The special situation of most of the newly acceding countries may well require that for quite some time to come a special effort of integration must be made – in the form of good neighbourly intentions and in the form of finances. The good functioning of the internal market will require a persistent commitment to the aim of its completion from *all* the members of the EU25 "club".

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