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The European Single Market – How Far from Completion?

In 2012, the European Single Market will celebrate its 20th anniversary. Thanks to the May 2010 Monti report and the release of the European Commission's "Towards a Single Market Act" six months later, renewed scrutiny is being given to the market's achievements and failings over the previous two decades. In this issue's Forum, our authors analyse this progress from diverse viewpoints and draw different conclusions as to the future path to be taken.

Jacques Pelkmans

Single Market: Deepening and Widening over Time

The single market is back! Or was it ever gone, actually? Following the Monti report of 2010 and the 50 suggestions by the European Commission for a Single Market Act, the single market has returned to the Union's list of high priorities. Does that mean that the internal market had been forgotten for two decades? What progress was made in this period? How can one appreciate the accomplishments so far and hence the integration deficits which ought to be overcome for EU economic growth and productivity as well as for its legitimacy with citizens, workers and consumers?

When Mario Monti came out with his insightful and strategic report on 9 May, it was overwhelmed by the enormous attention being paid to the financial rescue of Greece's sovereign debt at that time. The ambitious Grech report endorsed by a very large majority of the European Parliament[1] suffered more or less the same fate. Earlier in 2010, the new European Commission had published its EU2020 strategy[2], and despite Barroso's request to Prof. Monti to write a strategic single market report, the internal market did not figure prominently in EU2020.[3] Everything seemed to militate against the single market becoming a renewed priority for EU political leaders. Meanwhile, this might have changed with the European Commission's 50 suggestions[4] and the active consultation which followed. The proposed Single Market Act is now expected late in the spring of 2011. The judgment is still out, however. The European Council will have to turn away from its almost obsessive exercise of repairing the Stability and Growth Pact with a Pact for the Euro (combined with the Stability Fund), meant to pre-empt or minimise a future sovereign debt crisis, but doing little to improve the underlying EU framework and incentives to return to a (higher) growth path. A revival of a credible and ambitious single market strategy is a painstaking undertaking and it requires a firm and relentless commitment from political leaders in order to make significant progress over several years. Without this commitment, if leaders only pay lip service, progress is bound to be little different from the splintered and haphazard low-key approaches we have seen ever since 1993. Moreover, EU political leaders must be seen as standing just as firm as they do in domestic politics when it comes to internal market questions.

This article will take stock of the internal market accomplishments of the last 25 years, as a backdrop to the current single market debate. The main reason for doing this

1 Report on delivering a single market to consumers and citizens, Rapporteur Louis Grech, 3 May 2010, A7-0132/2010.

2 European Commission: Europe 2020, A strategy for smart, sustainable and inclusive growth, COM (2010) 2020, 3 March 2010.

3 In fact only a small section appears in the text, almost as an afterthought and under the misnomer "Missing links" in section 3.1. Four of the seven "flagships" comprise single market elements but they are not presented as such. For more details, see e.g. Jacques Pelkmans: Single Market Revival, CEPS Commentary, 17 March 2010, at www.ceps.eu.

4 European Commission: Towards a Single Market Act, for a highly competitive social market economy, COM (2010) 608, 27 October 2010. Note that the Commission issued the EU Citizen report 2010, Dismantling the obstacles to citizens' rights, COM(2010) 603, on the same date, with another 25 actions, presumably in response to the Monti report's insistence on improving legitimacy with EU citizens.

is that most EU observers and practically all citizens have lost track of where the single maket is today. Indeed, many are wondering why the once proudly announced "completion" of the internal market (the title of the famous 1985 White paper for EC1992) is called into question time and again. Why does the EU regularly come back with new "strategies" to deepen and widen the internal market and why should the Single Market Act be a top priority today?

What EC1992 Accomplished: a Reminder

In order to appreciate what was realised under EC1992, one first needs to recall the starting point in 1985. The EU at the time was little more than a "customs-union-plus".[5] One also needs to remember what the 1985 White paper comprised and what was actually accomplished from the list of nearly 300 proposals. Whereas normally in EU affairs there tends to be a lot of difference between ambition and realisation, that is not the case for EC1992. By late 1992, some 95% of the proposals had been adopted. Much less known is that a lot more was tackled than announced in the White Paper. Table 1 sketches what EC1992 accomplished.

EC1992 is so famous for three reasons. First, the sheer ambition of the programme was reflected in the large number of intra-EU liberalisation and EU regulation measures: in fact, far more than 300 in the final analysis. Second, a series of extremely hard issue areas were tackled successfully. This point is worth noting because memories are fading quickly. Assertions, heard in the current debate on the Single Market Act, that EC1992 was not really so difficult after all, constitute a curious instance of circular reasoning. True bastions of protective national regulation (like insurance and securities or airlines) had to be demolished. Removing inner frontiers was initially regarded as unfeasible. Arriving at common regulations and mutual trust in veterinary and phyto-sanitary rules (some 160 SPS directives and regulations in highly sensitive areas such as foot and mouth disease, etc.) was most controversial. A common merger control had been flatly refused by three big EU countries for 16 years. The abolition of national quotas of selected third countries' clothing products and cars – one of the many items accomplished but not mentioned in the White Paper – turned out to be a painful struggle implying the abolition of the

Table 1
What EC1992 Accomplished

GOODS	Harmonisation under "old" approach (e.g. tractors, etc.) + 160 SPS measures
	Approximation under "new approach" (large markets, e.g. machinery)
	Global approach of conformity assessment (based on European standards)
	Common customs code and removal of inner frontiers
	No inner fiscal frontiers for goods trade (new VAT + excise duty system)
	Abolition of national quotas for selected third countries' goods
SERVICES	Liberalisation & regulation of six modes of transport (rail symbolically)
	Free movement of financial services (banking, insurance, securities)
CAPITAL	Removal of exchange controls
LABOUR	New, more general mutual recognition approach in qualifications
HORIZONTAL	Open, competitive public procurement/public works tendering
	Competitive conditions: (i) EU merger control; (ii) tightening state aids regime (e.g. steel); (iii) stricter conditions for national public R & D funding and for national regional aid
FLANKING	Economic cohesion policy with much larger funding
	Common R & D + technology funding

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5 Summarising, free movement of goods was tariff and quota free, but regulatory barriers were numerous and permanently increasing. There was a common external trade policy but again mainly for goods and restricted to border issues. Free movements of services, capital (six out of the ten EU countries at the time still had exchange controls) and workers were severely restricted. In 1985 the CJEU condemned the Council of Ministers for a "failure to act" on a common transport policy. The CAP was so distorted that intra-EU trade in agricultural goods was subject to "green exchange rates" and numerous specific interventions. EU competition policy was reasonably credible but merely concerned goods markets, lacked a merger control policy and still had no teeth in state aids control. For extensive analysis see J. Pelkmans: Completing the internal market for industrial products, Luxembourg 1986, Office for Official Publications of the European Community.

Multifibre Arrangement (linked to the Uruguay Round but only fully completed by 2005) and doing away with the voluntary export restraints (and the Italian quotas) for Japanese cars much later in the 1990s.

Third, the innovativeness and originality of EC1992 is yet another reason for its fame. The new and global approaches, based on what can be called "regulatory mutual recognition", constitute early examples of "better EU regulation". Turning away from the heavy-handed and extremely detailed old approach of regulating literally everything concerning a good and its components, often even its design, as well as testing details and inspection or approvals, the new approach only defines common regulatory objectives of safety, health, environment and consumer protection, and possibly some further refinements if the scope is very large (e.g. the machines market covers more than 40 000 types), and recommends that technical details for (voluntary) European standards be written in full conformity with these objectives. This makes sense because what the EU legislator ought to do is no more than overcome market failures (by adhering to these objectives) and ensure a robust system for reference to standards and the associated conformity assessment (i.e. the global approach) so that free movement of these goods is guaranteed for producers and traders. This type of "co-regulation" has proven far less costly and rigid, whilst facilitating fairly rapid agreement on a range of directives with a huge number of goods and allowing innovation, too.[6] The approach in banking (with home country control of banks, mutual recognition between national authorities of this control and an EU passport for subsidiaries) and to some degree in insurance (for example, distinguishing "mass risks" of groups of consumers, subject to asymmetry of information, and "large risks" of enterprises) was entirely novel. It should also be noted that the long postponed free movement of transport services, called a "common transport policy" in the treaty, was accomplished without heavy-handed regulation or other interventionism.[7]

6 For details, see J. Pelkmans: The demise of intra-EU technical barriers?, in: M. Bulterman et al. (eds.): Views of European law from the mountain, 2009, Liber Amicorum Piet Jan Slot, New York/Alphen ad Rijn, Wolters/Kluwer, pp. 59-72.

7 In road haulage, all that was regulated were safety requirements (e.g. total driving hours per day; the equipment requirements were harmonized, e.g. max. weight on axles) and some social provisions to protect drivers. Cabotage was granted, be it only after some delay. Of course, the abolition of fiscal and customs frontiers was also critical for road transport. In air transport, the intra-EU regime is similarly "light" and monopolies were quickly removed. Safety inspections of aircraft, already strict, were Europeanised. The lingering problems after 1992 consisted mainly in state aids and bilaterals with third countries, see below.

What Internal Market Does the EU Want?

The ambition and success of EC1992 in deepening and widening notwithstanding, the EU internal market was not "completed" in 1993. One can wax philosophical about what a "completed" internal market would actually look like. When comparing the contemporary internal markets of the USA, Canada, Australia, Switzerland (all federal countries) and the EU, which are all "deep" and have a wide scope, the differences are striking.[8] A benchmark for the EU can be defined, however. The crux is in Art. 26, TFEU.[9] A full analysis cannot be provided here, but the principal weaknesses of this Article are the following:

- Art. 26/1 should replace "or" with "*and*" in "establishing or ensuring the functioning". This is not a trivial matter; better still, the article should specify "proper functioning" because it is only the "proper functioning" of the internal market which will best serve the socio-economic goals of the treaty. The internal market is the "workhorse" of the treaty in promoting growth and productivity increases, insofar as the EU level can do that. Proper functioning refers to the optimal working of markets in the EU so as to induce reallocation and dynamic effects. The term "proper functioning" would induce greater discipline by not allowing all kinds of soft, half-baked solutions.

- Art. 26/2 should include (besides goods, services, persons and capital) "codified technology", usually encapsulated in intellectual property rights (IPRs). The treaty is still saddled with a major drafting flaw from the Rome treaty and this solution would remove it immediately. Art. 345, TFEU says that the treaties "shall in no way prejudice the rules in Member States governing the system of property ownership". It underlies the absurd veto of the European patent. The original article should have distinguished a national system of ownership (e.g. land, state-owned enterprises, etc.) from issues of IPRs. There is no sound reason why almost

8 For a detailed comparison of those five internal markets, see G. Anderson (ed.): Internal markets and multilevel governance, Toronto 2011, Oxford University Press, forthcoming. In 1988 the Cecchini group attempted to come to grips with the notion of an internal market in a detailed study of the internal markets of Canada and of the USA, comparing them with the implicit notion of EC1992. See J. Pelkmans, M. Vanheukelen: The internal markets of North America, fragmentation and integration in the US and Canada, Research on the Cost of 'non-Europe', Basic Findings (background reports), Vol. 16, Luxembourg 1988, Office of Official Publications of the EC.

9 It reads as follows. Art. 26/1: "The Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market, in accordance with the relevant provisions of the treaties". And Art. 26/2 : "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the treaties".

all vetoes on progress on free movements have disappeared but not those concerning codified technology. A European patent does not take away or endanger any private "ownership", but it is critical to enjoy free movement of codified technologies, so crucial for innovation and growth.

- Another weakness is entrenched. The innocent phrase "in accordance with the (relevant) provisions" of the treaties becomes problematic if sections of the TFEU are still more or less as they were in the Rome treaty, although long proven to be inadequate. This is the case for services and to some extent labour, and it severely hinders the accomplishment of a fully fledged internal market in these two submarkets. Moreover, there are several other weaknesses in the treaty, including problems concerning the conferral of powers (for example, the Meroni doctrine, blocking the option of having independent regulatory agencies at EU level) and subsidiarity, which tend to be protected by this phrase. If indeed a "completed" internal market were wanted, some of these provisions would have to be either redrafted or reinterpreted by the EU Court of Justice in the light of the overriding importance of "completing" the internal market, including its proper functioning.

Given these weaknesses, a "completed" internal market is a *fata morgana*. Nevertheless, one can proceed far beyond the status of early 1993, even though in services and labour some integration deficits are likely to remain and problems concerning the insufficient conferral of powers to the EU level will continue to plague certain submarkets.

The Single Market Accomplishments up to 2010

In the 18 years since EC1992, much has been achieved in terms of the deepening and widening of the internal market. With the political leadership paying far less attention than before, and lacking a vision as well as a firmly agreed upon benchmark, the progress has been fragmented over many areas, frequently only known well by specialists. At the same time, with further deepening, the treaty weaknesses specified above have become more pronounced, and complicated suboptimal solutions have had to be tried out.

In order to appreciate progress to date, it is useful to distinguish the deepening of the acquis from a *widening of scope*. Although the line cannot always be sharply drawn, the widening of the scope of the internal market was required even after EC1992. Examples of widening include the opening up (and regulation of) network industries, the Europeanisation of IPRs other than the patent, the EU (carbon) emissions trading system and the prudent liberalisation and facilitation of intra-EU exchange in military goods, beyond dual purpose goods. Given the text of the Maastricht treaty, especially the Social Dialogue, one may include a series of minimum requirements directives in labour markets as well. Deepening refers to the EU acquis, which is somehow not leading to sufficient market integration due to shortcomings or gaps (or remaining distortions), and these inevitably induce pressures to complete (deepen) that part of the EU acquis. Often, this is combined with modernisation for all kinds of reasons.

In Figure 1 a summary is provided of progress to date. A few comments might be helpful. Deepening typically comes in "generations" of EU legislation for certain markets or activities. A prominent example is financial services markets, where Figure 1 indicates a 3rd and a 4th generation of regulation. The 3rd generation was the Financial Services Action Plan using the Lamfalussy procedure, from 2000 to 2005. It built on the second generation originating from the EC1992 process. The idea was to radically liberalise securities trade (at first still suffering from significant host country control which tends to maintain fragmentation) in the Markets in Financial Instruments Directive and otherwise upgrade and refine the banking and insurance directives as well as deal with accounting standards, corporate restructuring and selected supervison issues. The driving forces included the euro, Basel II, and gaps and omissions in the second generation, against the backdrop of rapidly consolidating equity markets.

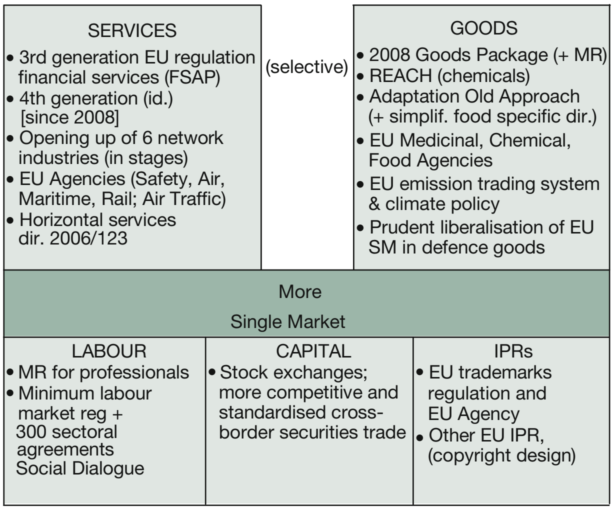
However, the financial crisis which broke out in 2008 demonstrated that, despite the improved and more complete texts, the underlying solvency (e.g. capital requirements) and risk management standards were hopelessly weak, whilst supervision was both failing and insufficiently coordinated in the EU as a whole. Much has been analysed but one recent paper stands out as particularly interesting. Barrell et al. show empirically that large banks, perhaps "too big to fail", may take greater risks than smaller institutions, thereby aggravating systemic risks still further. For a sample of no less than 713 OECD banks, the authors show that size is indeed related to risk-taking and that banks with high proportions of Tier 2 capital are particularly vulnerable to adverse incentives.[10] This prompted the fourth generation of financial services regulation and supervision, which is now approaching its final stages.[11]

10 See R. Barrell, E. Davis, T. Fic, D. Karim: Is there a link from bank size to risk taking?, NIESR Discussion Paper No. 367, London 2010.

11 Since the FSAP was also highly technical, one improvement, initiated around 2000, was actually adopted only in 2009, when the 4th generation was in full swing. It is the sophisticated Solvency-II directive for insurance. The extremely detailed so-called level 3 (of Lamfalussy) implementation questions, which might eventually add up to far beyond 10 000 pages of methodology of risk assessment, etc., will have to be available by 2013.

Figure 1

Internal Market Accomplishments: 1993-2010



Notes: 1. Modernisation of EU competition policy; 2. RIAs (since 2003) and better regulation; 3. Better inter-MS horizontal/adm. cooperation; 4. Public procurement, 2nd generation.

Similar remarks can be made of the 2008 goods package (second generation of the global approach and improved protection of mutual recognition), the REACH regulation on chemicals (second generation overhaul, with an EU Agency and far-reaching risk assessment) and the 2004 second generation of public procurement rules (indicated as one of the four horizontal forms of deepening at the bottom of Figure 1).

Figure 1 shows that a lack of strategy does not mean that nothing happens. The widening to the six network industries (telecoms, post services, gas and electricity, and the two networked transport sectors, rail and airlines, none of them in the 1985 White paper) has been a major instance of progress. Still, these dossiers, too, were opened up in stages. Thus, telecoms (eComms) has now gone through three generations, beginning in 1998, and the beneficial economic effects have been enormous. Yet, even today, the competition is essentially "national" and an internal eComms market is simply absent.[12] The fundamental reason is the flawed EU governance model, including the legal (and political) difficulty of setting up a genuine EU regulatory Agency given the Meroni doctrine. Interestingly, the postal, gas, electricity and rail sectors have all gone through three generations. Another instance worth noting is the horizontal services directive 2006/123 (once proposed as the Bolkestein draft) which has led to the far-reaching screening of thousands of national and regional laws and significantly improved market access for establishment (the critical mode for services provision). It is predictable that it will be followed by another generation of revision; the question is when. Furthermore, a number of EU Agencies for safety (in transport), for risk assessment (e.g. EFSA for food, ECHA for chemicals) and for a still wider technical assessment (EMEA for medicines) have been founded. Though not fully independent, their expertise provides the space to depoliticise such issues in the general European interest (except, so far, the touchy issue of genetically modified organisms). Finally, the four horizontal improvements (bottom of Figure 1) improve the quality of internal market regulation and implementation, whilst reducing the costs of both EU regulation and EU competition policy.

Conclusions

The core economic business of the Union is its internal market, and for good reason. It is the principal route, at the EU level, for promoting the socio-economic goals of the EU, and it forms the essence of the E of EMU, crowned by the euro. After the ambitious and successful EC1992 programme, another two decades of haphazard but nonetheless significant deepening and widening of the "single market" has taken place. In 2011, the internal market is no longer comparable to the status quo of 1993. But the lack of strategy and vision or benchmark has a price: political attention becomes fragmented over many separate markets or activities and the overall economic purpose of the EU economy gets lost.[13] It required a strategic and yet detailed report by Mario Monti to lay down the foundations of a new strategy, both key for enhancing economic growth and careful to improve legitimacy with citizens and others in Europe. It creates fertile soil to make the case for more internal market once again, building on achievements already made since 1993.[14] EU lawmakers and the political leaders of the Member States should give it the highest priority, now.

12 As is shown, with ample empirical evidence, in J. Pelkmans, A. Renda: Single eComms market? No such thing..., CEPS Policy Briefs, No. 231, January 2010, see www.ceps.eu.

13 For a critical analysis of the lack of strategy and its consequences, see J. Pelkmans: More internal market without strategy?, in: H. Guimaraes, A.P. Faria (eds.): Product market integration, a multi-faceted approach, 2010, Emerald Publishers.

14 See also J. Pelkmans: The Case for "More Single Market", CEPS Policy Briefs, No. 234, February 2011, see www.ceps.eu.

Monique Goyens*

Will the European Single Market Finally Become a Reality for EU Consumers?

Lessons to be Learnt from Two Decades of Hesitations

In 2012, the Single Market will celebrate its 20th anniversary and undergo a relaunch, which was kicked off by the Monti report.[1] However, an impetus just as important, though less prominent, was the European Parliament report devoted to "Delivering a single market to consumers and citizens"[2], followed by the Commission Draft Single Market Act published in November 2010[3], which opened a public consultation combined with a hearing and conferences intended to identify the priority measures the EU must take to complete the Single Market.

It is therefore a perfect time to assess the results of the Single Market policy from the consumer perspective and to analyse the ongoing consultation process with a view to optimising the impact of this policy on consumer welfare.

A market finds its substance in its customers. Therefore, it is crucial that any policy aimed at improving the functioning of a market, be it local, national, European or international, gives proper consideration to the consumer perspective of a properly performing market. This is why this article will briefly define the initial consumer expectations of the EU Single Market as created in 1992, then turn to identifying its current shortcomings and finally suggest an assessment of the present Commission approach as reflected in the Single Market Act.

From the outset, it is important to stress that the Single Market has indeed already delivered to consumers in specific areas: this is especially true for telecommunications, passengers' rights or the consumer acquis (based on the principle of minimum harmonisation). In the area of financial services, recent developments indicate that the EU is also on the right track here in promoting the consumer interest in a single financial market.

However, the recent experience and major disappointment on key consumer issues such as collective redress, consumer rights and European contract law do not give us a lot of hope that the Barroso II Commission will have the political will to finally put consumers centre stage.

The Announced Benefits for Consumers of a European Single Market

Back in 1992, the announced benefits that consumers would draw from the creation of a European Single Market were fully inspired by neo-liberal economic theories: the opening of borders would boost markets through enhanced competition and would offer to consumers the combined benefits of increased choice among better quality products at lower prices.

As from the beginning, the underpinning concept was that of *indirect consumer welfare deriving from increased business mobility*: it was anticipated that the benefits gained by the industrial and retail sectors – especially by the SMEs – through the enlargement of their hinterland by promoting freedom of establishment, free movement of goods and services and of capital would spontaneously enhance consumer welfare.

This script has however failed to materialise, for several reasons.

Consumer Welfare as a By-product of Increased Business Mobility

The initial single market approach – still predominant today – *per se* presents an incomplete view of consumer markets and an incorrect reading of neo-liberal theory, as it views the consumer as a passive recipient of products and services and does not pay sufficient attention to

* This article was partly drafted with reference to the position prepared by BEUC, the European Consumers' Organisation, in response to the public consultation launched by the Commission on its proposal for a Single Market Act. This position is the result of collective thinking and evidence gathered by the policy officers from the BEUC secretariat and the experts from BEUC member organisations. For more information, visit www.beuc.eu.

1 "A new strategy for the single market at the service of Europe's economy and society", Report to the President of the European Commission José Manuel Barroso by Mario Monti, May 2010, http://ec.europa.eu/bepa/pdf/monti_report_final_10_05_2010_en.pdf.

2 European Parliament report on "Delivering a single market to consumers and citizens". Rapporteur: Louis Grech, May 2010, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2010-0132+0+DOC+PDF+V0//EN&language=EN.

3 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, "Towards a Single Market Act for a highly competitive social market economy. 50 proposals for improving our work, business and exchanges with one another". COM(2010) 608 final/2. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0608:REV1:EN:PDF#page=2.

the aspects linked to *consumer mobility*, which is a main condition for a market to be truly competitive. A genuine EU Single Market policy would have verified whether the conditions for consumers to move freely between offers of products and services, whatever the location of the company, do effectively materialise and would, where needed, have addressed market failures in this respect. One can therefore regret a lack of vision for the consumer's role in the market and therefore a lack of vision for the EU's consumer policy.

The most prominent among the few proactive expressions of the right that should be granted to consumers to move freely within the EU market is to be found in Article 20 of the Services Directive[4], which provides for the prohibition of discrimination based on grounds of residence or nationality. The Services Directive, however, had to be implemented at the national level only by December 2009, and it is thus not yet possible to assess its impact on commercial policies that aim at territorial segmentation.

The overwhelming number of other policy initiatives taken under the Single Market umbrella have concentrated on enhancing the mobility of undertakings without granting sufficient attention to the parallel need to promote consumer mobility, nor to the risk of re-segmentation of markets through private behaviour.

The Myth of the Rational and Mobile Consumer (the Prosumer)

Numerous initiatives taken by the EU under the Single Market policy rely on a similarly classical conception of the rational consumer: according to this perception, when a consumer receives adequate information, he will be able and willing to make the most appropriate choice and will use his mobility to engage in the best deals.

In recent times, this optimistic vision of the empowered consumer has begun to face major criticism with the emergence of behavioural economics evidence indicating that consumers rarely act in their best interests, even if well informed, for numerous reasons linked to behavioural and cognitive biases.[5] While acknowledging these biases, and even supporting research in the area of behavioural economics[6], the European Commission still fails to apply the findings of these studies to the policies that it implements, overestimating the role of information in consumer empowerment.

It is essential that the future initiatives taken by policy-makers in the area of consumer policy take due account of the lessons learnt from behavioural economics. These lessons have to be given due consideration when engaging into any impact assessment that precedes policy measures relevant to EU consumers.

The Limitation of the Single Market Concept to its Cross-border Dimension

In a genuine single market, the notion of borders should be redundant. The European territory should be considered as a single jurisdiction, which means, from both a business and a consumer perspective, that the same rights and opportunities should be granted, irrespective of whether one engages in a cross-border relationship or not. The Single Market is relevant to consumers in their daily life, be it when engaging in cross-border purchases and activities or when shopping at home. A legal framework that is intended to provide consumer confidence in a market should make it possible for consumers to enforce their rights regardless of the geographic scope of their activity.

Against this approach, too many of the measures taken to implement the Single Market have sought their justification in its cross-border dimension and have consequently concentrated on eliminating territorial hurdles without taking into account the more global and fundamental challenge of creating consumer confidence in the markets concerned. They have not engaged in an ambitious pursuit of promoting consumer welfare in the EU market by providing consumers with strong rights against potentially unfair and deceptive market behaviour on behalf of enterprises.

The Single Market: a Far from Finished Symphony

In spite of the promotional messages that have surrounded the completion of the single market, the EU itself has not seen the effort through to the end. Several major components for a genuine market without borders have not been finalised. Indeed, when companies, and more specifically SMEs, are asked to identify the major obstacle that they face in cross-border trade, they most often mention as a priority concern the discrepancies in VAT. These discrepancies lead to a refusal to sell to consumers cross-border.

4 Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006L0123:EN:NOT.

5 Behavioural economics demonstrates for example that people always tend to postpone to "tomorrow" stopping smoking, eating healthily, working out... For more inspiration: Richard Thaler, Cass Sunstein: Nudge: Improving decisions about health, wealth and happiness, Penguin Books, 2008.

6 http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/748&format=HTML&aged=0&language=EN.

The EU and the governments of its Member States might have good reasons for not engaging in a more in-depth harmonisation of their legal systems on VAT. However, EU policymakers should then abstain from advertising the Single Market as being integrated and should not create false hopes of such a market delivering to its companies and its consumers.

The Risk of Instrumentalisation of Consumer Policy to Boost Cross-border Trade

The EU is characterised by a multiplicity of consumer cultures: consumer attitudes and expectations vary considerably among the Member States and these variations are reflected in the consumer policy approaches that are taken by their governments. While the EU has done a lot, as of 1975, to define and add substance to fundamental consumer rights, their implementation and their application to concrete market developments vary, sometimes significantly, among the Member States.[7] In order to respond to this variety, the EU legislator has adopted in the past the dynamic concept of minimum harmonisation: according to this concept, EU legislation setting consumer protection standards will not prevent Member States from maintaining or adopting in the future more protective consumer provisions.

From a market integration perspective, minimum harmonisation, as opposed to full harmonisation, is an imperfect tool, as it will still not phase out divergences in national legislation. Consequently, companies that wish to engage in cross-border trade have to abide by different rules.

From the point of view of consumer policy, however, this concept leads to a win-win situation: on the one hand, consumer protection is boosted in those Member States where it traditionally lags behind, and on the other hand, those Member States that champion consumer protection can keep their stronger levels of protection. Minimum harmonisation is a tool to make national legislation more uniform while respecting national cultures.

More fundamentally, minimum harmonisation is a less dogmatic tool allowing Member States to react more adequately to local or national market developments and to maintain national authority over such developments, with a possibility for national authorities to share their experiences in the Consumer Protection Cooperation network.[8]

7 For a description of the state of consumer policy and consumer movement in the EU27, please refer to the 5th Consumer Market Scoreboard, published by DG SANCO on 4 March 2011.

8 See Regulation 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws (Consumer Protection Cooperation), OJ L 354, 9.12.2004, p. 1.

More globally, the concept of minimum harmonisation implies a political message that the protection of the consumer is a fundamental European value that should take precedence over any potential facilitation of cross-border trade. On the contrary, with full harmonisation and the underlying risk of mitigating national consumer protection standards for the sake of finding political agreement between all decision-makers that intervene at the EU level, the message becomes that of consumer policy being instrumentalised for the sake of increased cross-border trade.

The recent EU trends, however, show a move towards a more systematic application of the principle of full harmonisation in consumer law. It must be stated very clearly that this is not an adequate and fine-tuned consumer policy tool, but rather a disguised instrument to promote trade interests.

Where the Single Market Concept Ends: Enforcement of Consumer Rights

Consumer confidence is key for a market to function. This implies confidence in the products and services to be purchased as well as in respect of the rights granted to consumers by the product and service suppliers. This moreover implies confidence that if those rights are not respected spontaneously by the supplier, the consumer is able to enforce them in an easy, effective and cheap way. The Single Market concept, as implemented over the last 20 years, simply collapses when it comes to enabling economic operators, and notably consumers, to enforce their rights across borders within the EU: when facing a dispute with a "foreign" supplier, the consumer, already confronted with many difficulties in obtaining access to justice in local situations, has to overcome such significant hurdles to obtain redress that he simply gives up. The European institutions have been very reluctant to acknowledge this major weakness of the Single Market concept, and they are still hesitating, after so many years, to introduce those tools that have long ago been identified as the most effective in terms of consumer access to justice, most notably collective redress mechanisms.

The Single Market Reality Check: Consumer Frustrations Due to Inconsistency

The above-mentioned shortcomings are embedded in the Single Market concept of the past. On top of these, it has to be questioned whether the concrete implementation of the Single Market benefits that were anticipated for consumers, such as access to more and better products at cheaper prices, have materialised.

In a Single Market, consumers should be able to buy cross-border almost as easily as they can buy at a distance within their own country. Yet this is far from being the case in the EU at present. Compared with buying "at home", consumers buying cross-border face big uncertainties.

Private Re-segmentation of Defragmented Markets

Undertakings have been given the right by the EU to establish wherever they wish in the EU and to offer their products and services in the entire EU territory, subject to a limited number of restrictions. There is, however, currently no straightforward right for consumers not to be discriminated against when wishing to purchase a product or a service from any supplier within the EU.

Indeed, especially in the online world, consumers who wish to shop cross-border often face restrictions that have been decided by companies: some of these restrictions are legitimate and understandable, such as the decision for a small company not to engage in cross-border deliveries upon the request of a single or a limited number of consumers because of the hassle that this can bring for small potential outreach. Some other restrictions, however, are the consequence of commercial policies by undertakings that are intended to segment markets with a view, for instance, to adopting different pricing policies in different countries. Among those restrictions, the following can be mentioned:

- Exclusive distribution arrangements by suppliers cause the Single Market to be divided into separate territories. Copyright holders often limit the authorisation for distribution of their works to a specific country, and this then prevents consumers in other countries from purchasing certain types of products or services[9]: a more pro-European attitude would be to contractually accept the multi-territorial distribution of copyright protected works.

- Selective distribution arrangements by manufacturers often limit the ability of retailers to sell online. The recently revised Commission regulation in this area[10] failed to address the challenges inherent to the online environment by maintaining the "brick and mortar" requirement even for those products for which no objective justification applies.

- Many companies that are present in several EU countries often refuse to sell cross-border. Online suppliers that are present in different countries often apply different prices for the same goods while refusing to deliver those goods other than domestically.[11] Companies redirect you automatically to their domestic website (and its pricing policies) once they have identified your place of normal or supposed residence (most currently via the identification of your credit card number).

- Discriminatory conditions are often applied to foreign consumers. When it is possible for a consumer to purchase cross-border from a company that is present in different EU countries, it happens that the delivery costs are related to the country of delivery and not to the effective costs linked to the delivery and related, more objectively, to the distance and the means of transport used.[12]

- When paying online consumers face different problems, including the lack of different means and the existence of discriminatory charges, the lack of interoperability between the means offered and, finally, security problems.

Beyond the online experience, consumers who wish to engage in cross-border transactions in the offline world can also face major obstacles:

- Access to financial services in cross-border situations can be a daunting challenge. Opening up a bank account abroad, let alone taking a consumer credit or a home loan, is for most consumers a most disrupting experience. The most prominent international credit cards are often not accepted by foreign ticket machines.[13]

- The management of copyright levies also gives rise to numerous difficulties. Companies may decide to withdraw specific types of equipment from a national market due to a complex system of reporting and reimbursement. Furthermore, copyright levies vary considerably among Members; nevertheless the equipment is sold by companies at similar retail prices. This means

9 For example, Spotify, a website where you can legally download music, is not, or only partially, available in all European countries because of the territoriality of licensing agreements; see the explanation on their website: http://www.spotify.com/int/about/music-catalogue-info/.

10 Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. OJ L 142, 23.4.2010, p. 1; Commission notice - Guidelines on Vertical Restraints, OJ C 130, 19.05.2010, p. 1.

11 There are many such examples; just to mention one: www.3suisses.fr.

12 The Amazon UK website indicates for certain goods that delivery is free in the UK. However, from an objective point of view, it could in some instances be less costly to deliver to Ireland than to the UK.

13 Based on personal experience, at London St Pancras you cannot buy your Underground ticket with a foreign credit card from a ticket machine. You have to queue and then pay with your (foreign) credit card. The same troublesome experience also appears at Madrid Barajas airport and probably in many other locations.

that the consumers in a country where there are no, or reduced, copyright levies end up subsidising the copyright holders and their collecting societies from another country.

Lack of Proactive Solutions for the Active Consumer

While rules are established or proposed at the EU level to facilitate cross-border trade by companies, there seems to be a lack of political will to provide for similar rules to promote active cross-border consumer attitudes.

One should mention in this context the absence of a global recognition of producers' liability for a lack of contractual conformity: when a consumer buys a good across the border, e.g. when travelling or via the Internet, she is supposed to turn to the retailer in case of incident to benefit from the legal guarantee. This can be difficult and cumbersome for the consumer, who has to send the good back, even when the producer of that good might have a branch in the consumer's country of residence. Some companies have understood the marketing advantages of providing worldwide commercial guarantees, but at the EU level, this should be considered a straightforward consumer right in the field of legal guarantees. This would be a strong signal to consumers that they are provided with adequate tools to actively benefit from the Single Market across the borders.

There is also a need to promote interoperability and compatibility between systems, particularly for electronic equipment as well as in terms of access to online services, such as e-government and e-health, in order for consumers not to be locked in with a particular provider.

These are examples of active consumers being prevented from grasping single market benefits. More fundamentally, however, the benefits of increased competition between national and foreign companies for passive consumers have not dramatically materialised: in some sectors, such as retail financial services or energy, the potential benefits of increased competition linked to the liberalisation of these markets have been outweighed by the fundamental restructuring and oligopolisation of these sectors.

How to Save the Single Market for Consumers

In 2011, the Single Market is at a crossroads: the relaunch of the Single Market could be a unique opportunity to redesign its centre of gravity so as to ensure that consumers are the focus of the Single Market policy and that priority is granted in policymaking to consumer-friendly initiatives. It is therefore important to add to the initiatives currently listed in the Single Market Act those that are needed to achieve a consumer-friendly market.

Proposals of the Single Market Act to Be Prioritised

Among the 50 proposals contained in the draft Single Market Act, several have potential to boost consumer confidence in an EU integrated market.

One can particularly welcome the initiatives announced by the Commission in the area of electronic commerce and its intention to concentrate on *problems faced by consumers in the digital economy*, including those linked to the right not to be discriminated against because of nationality or place of residence (proposal 5).

The announced intention of the Commission to make the *standardisation framework* more effective, efficient and inclusive and to extend the scope of the procedures from goods to services is crucial for European consumers and is closely linked to the proposals concerning an Action Plan for *European Market Surveillance*. Indeed, the increased participation of consumer representatives in the setting of standards for consumer goods and services constitutes a major assurance of their compliance with consumer needs and expectations; additionally, increased cooperation by supervisory authorities on the safety of products that are marketed in the EU represents a major factor of consumer confidence in a market where goods move freely across borders (proposals 6 and 39).

The announcements made by the Commission in the Single Market Act on improved *access to justice*, with reference to Alternative Dispute Resolution mechanisms and consideration given to collective judicial redress (proposal 46), deal with a previously mentioned major loophole of the Single Market, and it is essential that this is being addressed.

The intention of the Commission to better *involve civil society* in the preparation and implementation of its policies (proposal 48) represents an important commitment to improved consumer engagement in policymaking.

For these proposals to deliver to EU consumers, however, they now need to be given substance by being effectively drafted and implemented in a consumer-friendly way. This is where a continuous space for dialogue between EU policymakers and consumer representatives is to be established in order to ensure the EU does not miss its main target in terms of delivering welfare to consumers in the Single Market.

Additional Measures to Be Considered

The Single Market Act does not list in an exhaustive way those measures that are needed in order to deliver a consumer-friendly environment within the EU market. Beyond the initiatives that are listed, areas have been identified in which there still are a lot of discrepancies among national legislations, to the detriment of both businesses and consumers, and in which, simultaneously, a lot can be done to improve consumer protection and the balance of rights between the different market operators. This is notably the case in the area of copyright legislation (scope and exemptions, levies), data protection rules and rules related to investor protection. In order to earn consumer confidence, the Single Market policy also has to address these elements.

Initiatives Listed in the Single Market Act that Are Biased Towards Consumers

There are initiatives in the Single Market Act that reflect the biases to which the Commission may be submitted when deciding its policy priorities. This is especially the case in the areas linked to intellectual property and copyright law. In this context, proposal 3, which proposes an action plan against counterfeiting and piracy, falls short of distinguishing the issue of counterfeiting of physical goods from the issue of copyright infringements online. The harm caused by the selling of counterfeit medicines is not the same as the one caused by a teenager downloading a single music file for his private use. Before engaging in any wide-reaching action in this area, the Commission should first undertake an assessment of the economic impact of file-sharing on the basis of independent and objective data, which it has thus far fallen short of doing.

Furthermore, the intention of the Commission to strengthen intellectual property rights enforcement should only be done once it has finalised the analysis of the impact of such an initiative on fundamental rights, innovation and the development of an information society. Due consideration must be given to avoiding consumer detriment and to the need to promote creativity. Strengthening of IPRs cannot go on ad infinitum to the detriment of both creativity and access to knowledge.

Political Moves Beyond Words

Consumers are often referred to in EU speeches by President Barroso and his college, and consumer welfare and empowerment are regularly mentioned in EU documents. Indeed, consumer policy is one of the very few EU policies which have the clear potential to reach out to the European people, to directly impact their daily lives and to reconnect them to the currently not very popular EU by delivering tangible benefits.

It is obvious, however, that beyond these words, consumer welfare is only considered to be a by-product of growth, the creation of jobs and the reduction of burdens on business. While the pursuit of these goals is quite obviously legitimate, it is essential to acknowledge that the specificity of the consumer interest must, in certain conditions, lead to amending these economic policies in order to privilege consumer welfare in terms of access to safe and high-quality goods and services, information, protection against unfair commercial practices and contract terms and the enforcement of rights. To do this, decision-makers should engage with consumer representatives to better understand consumer expectations, needs and difficulties and refrain from considering consumer policy, as some of them indeed do, as a negligible element of the Union's decision-making.

Only with this effort will the Single Market deserve the confidence of its consumers.

Hans-Peter Burghof

Uniformity or Diversity – What Works Better for a European Banking System?

The European Commission has strong views on the German banking system[1]: its three pillar model of private, cooperative and state-owned savings banks is obsolete and has to be changed. Germany should be able to sustain more than one global player in the banking sector, like Spain or the Netherlands. The high relevance of institutions that are not listed on capital markets seems to be an obstacle to the development of a modern banking system. This is believed because, firstly, many of these banks are owned by a public constituency and the general experience with regard to the efficiency of state-owned banks

1 Most outspoken in this regard was the former competition commissioner Nellie Kroes in June 2009, interestingly starting from the observation that the German banking system is completely different from others.

is extremely negative. Secondly, these banks, public or co-operative, cannot be taken over by an arbitrary third party. Thus, the positive effects of the market for corporate control on efficiency seem to be absent. And thirdly, Germany, with its many strongly regionally based banks, has not been very attractive for entrants and thus limits the degree of European market integration.

It is not the task of this article to discuss these arguments in detail, although much could be said on the topic which is not in line with this reasoning. The fundamental point is that the European institutions, or at least some of their outstanding representatives, seem to entertain a rather precise idea of how a banking system should be organised and, from this perspective, which developments are deemed bad and should be hampered and which are good and should be supported. Given the power of the European institutions and the lack of democratic control at the European level, this should strongly influence the development of banking systems in Europe, whether with or against the will of the European people. The result could be a rather homogeneous European banking system in which similar, preferably pan-European and thus rather large institutions follow similar business concepts – the ideal of an integrated European banking market?

Developments in banking regulation after the financial crisis point in the same direction. For many years, the international regulatory community mainly paid lip service to the principle: "Same business – same risk – same regulation". Large players like Germany and, in particular, the United States, forced the international community to accept exceptions that suited the particularities of the respective banking system or business interests, peaking in the non-acceptance of the Basel II agreement by the United States. The willingness of the United States to comply remains doubtful, even after the crisis. However, it seems that the problem could at least be solved at the European level. The introduction of a central European banking regulator is already an important step in this direction. One motivation for such a supranational regulator could be to improve the control of the few large and internationally active financial groups. However, its actual task is a different one. It has to guarantee a uniform application of the regulatory framework in Europe. This might be helpful to avoid areas of diminished banking security and thus reduce the possibility of regulatory arbitrage, at least between banking locations inside the European Union. It could also lead to a more homogeneous European banking system.

Every banking system in the different countries of the European Union has developed under the special economic conditions of the respective country. If Europe grows closer together, should the banking systems consequently not also become more alike? And further, if it is the task of the European Union to improve the economic situation of Europe, should it not also help the European countries to create an optimal banking system like, for example, it helps them to overcome obstacles to competition to create an optimal market for products? Some might have doubts that the representatives of European institutions (or anyone else) know what this optimal system might be. All the different banking systems in Europe have shown both good and bad performance in the past. I will argue in the following that we do not need to know which system is best, because the diversity of the systems is itself valuable. In this discussion, diversity refers both to the differences among the national banking systems and to the existence of considerably different types of financial intermediaries inside each system. I will scrutinise the question both from the perspective of systemic risk and efficiency.

The Stability of Banking Systems

The financial crisis made apparent what was forgotten for many years: banking systems are inherently unstable. This instability cannot be mended as long as we need the banking system as a central liquidity pool for our economy and therefore cannot totally exclude runs on this liquidity. Therefore, banks must be regulated to reduce the probability of such runs. And the regulator must have means to stop runs if they occur nonetheless. A homogeneous banking system makes this task easier for the regulator, especially if we consider a supranational regulator that often does not know enough about the special institutions of a particular country but wants to apply his standardised methods that worked well in other countries. He could, so to say, create economies of scale if the banking system was the same everywhere. However, the problems he has to face might be much more severe than the ones a decentralised regulator has to solve in a diverse banking environment. The fundamental (and in other fields of finance very well established) concept is diversification. How does it apply to the institutional setting of financial systems?[2]

As we might expect and are able to observe in reality, a particular crisis hits some types of financial intermediaries harder than others. In Spain, it was mainly a certain group of large public banks (*cajas*) that suffered badly, whereas the large international banks did fairly well. In Germany, many banks smaller than Deutsche Bank and larger than the local banks were damaged substantially,

2 The following is an extension of ideas from the last chapter in H.-P. Burghof, B. Rudolph: Bankenaufsicht, Wiesbaden 1996.

amongst them many public *Landesbanken*, whereas Deutsche Bank was soon back on its feet and the local public *Sparkassen* and co-operative *Volksbanken* remained nearly untouched. In Switzerland, the crisis mainly reached the two global players. Countries like Ireland or Iceland where the banking market is dominated by a few very similar institutions got into very deep trouble. Reasons for these different degrees of affliction might be both the differences in the business model of the respective institutions and the stochastic process of regulatory failure that, e.g., allowed large German banks to engage in certain activities on the international markets for securitised credit risk that their counterparts in some other countries were not able to pursue. Thus, a homogenous banking system might experience banking crises less often, but when it did, there would be almost no remedy because most of its financial institutions would be affected simultaneously.

At first sight, this is only an argument in favour of diversity inside the national banking systems. However, the economic consequences of a systemic failure in one banking system are less severe if other countries are, due to different banking system structures, not afflicted, and positive spillover effects can help the weakening economy of the afflicted country. This happens in the most straightforward way if investors from still economically healthy countries are able to provide the urgently needed equity to offset the losses of banks in the afflicted countries. During the current crisis, some banks, e.g. the Swiss UBS, were able to receive large capital inflows this way. However, the demand for goods generated by thriving economies can also help the economies that are depressed from a banking crisis to recover much faster. The precondition is that the different countries are not hit by a banking crisis at the same time. Thus, the downside of too much homogeneity is a domino effect in both the banking sector and the general economy.

One of the most positive experiences from the current crisis is the degree to which countries (both in and out of the European Union) were able to avoid popular protectionism and were willing to support each other. This is in stark contrast to the situation during the global economic crisis beginning in 1929 and might make the difference – at least if we are able to solve the incentive problems of such support that remain unresolved up to now and are still being debated on a European level. One precondition for the effectiveness of such co-operative behaviour is a multipolar global economy, something which was conspicuously missing in the 1930s after the disasters of World War I but which has been evolving with impressive speed since the turn of the century. A second precondition is that not all the relevant countries are hit by the crisis at the same time with the same severity. Institutional diversity in the banking system can reduce the likelihood that no government is able to provide support because its own state of affairs does not permit such essential luxury.

Institutional diversity in the banking system might also help to create solutions to the problems that become apparent during financial crises. It serves both the generic and intellectual process. Business might choose the system that served best its needs in and out of the crisis. And politicians and administrators might draw new ideas on how things can be organised and regulated not from abstract considerations but from existing institutions that proved their strengths and weaknesses in reality. In this sense, it is the competition of different institutional settings that generates new and creative solutions to the question which banking system works best, rather than a level playing field with cloned players, however hard these might compete and however beneficial this competition might be for the consumer of bank services in the short run.

The last mentioned concept can be seen as a travesty of the true intentions of the European Union with regard to competition in the European banking sector. The difficulties arise from the fact that many of these different institutional solutions require a special legal, in particular regulatory, setting. They might need a special charter and protection from free riders that abuse the respective name without delivering its true economic content. The European Union regards such special rules with great suspicion. They might function as barriers to market entry and could contain elements of unwanted subsidies. The ideal of a level playing field, which is understood as the fundamental prerequisite for the creation of a single European market in banking, would then be violated. The chosen solution is to regulate different types of financial contracts instead of institutions, which leaves every competitor the freedom to offer the respective products or to abstain. However, in the following I will show that a level playing field is an illusion as long as these contracts are offered by different types of financial intermediaries and that an efficient banking system is marked by a greater diversity of such types.

Efficiency and Incomplete Contracts

Not only regulators can achieve economies of scale through the creation of a greater degree of homogeneity. Bank managers themselves face less complex problems, auditors and rating agencies can employ standard procedures and models, both investors and potential debtors have to acquire much less institutional knowledge, and even business schools can concentrate on a single banking system and few types of financial intermediaries.[3] Everything gets simpler. But does it get better?

It is an unpromising venture to try to measure or compare the efficiency of banking systems.[4] The financial system of a country consists of many different elements that might be complementary to each other and provide different tradeoffs. Due to complementarity, switching from one regime to another is time-consuming and costly as many of these elements would need to be changed to reach a new local maximum.[5] Determining the best system depends on what we want to achieve, and even a result based on such an appraisal might be only temporary due to changes in society, economy or technology. A crude method used sometimes by political decision makers to get a result despite all these obstacles is to compare the prices of certain standardised financial products. From a consumer perspective and for the politicians representing the consumer interest, the best system is one in which he or she can get these products the cheapest. However, this only holds if the contracts implied in these products are really the same, independent of the kind of institution offering them to the clients. According to practical experience, this is obviously not the case.

Surprisingly, economic theory is not unanimous on this point.[6] Many economic models imply that contracts are comprehensive in the sense that they contain, either explicitly or through legal provisions filling the gaps, remedies for any potentially relevant future state of the world. Thus, the contracting parties will never have to renegotiate, and firms are nothing else but, to use the phrase of Jensen and Meckling, "a nexus of contracts". The contracts generate certain incentive effects that hopefully lead to a second best behaviour of the individuals. How the contracting parties themselves are organised and what kind of institutions they represent does not matter. Although we cannot know from an outside perspective what really drives the European decision makers, here at least they can find a justification for the concept of product-oriented regulation to implement a level playing field for the European banking market.

The discussion on the theoretical foundations of incomplete contracts, i.e. contracts that leave relevant points open to debate and therefore have to be renegotiated in some states of the world, has been at best inconclusive. However, in reality, most contracts require renegotiation in at least some states of the world, and many complex financial contracts are marked by almost permanent renegotiations, often from the very beginning. Some financial contracts even contain the creation of special institutions to renegotiate, and what else is a shareholder meeting but a renegotiation of the original financial share contract. Thus, contractual incompleteness and renegotiations are definitely among the most important elements of financial contracting, and it matters with whom one renegotiates.

In a two-period setting, it is important to know if the counterparty has invested in any capacity to renegotiate at all or is simply relying on the legal provisions.[7] In the case of a corporate loan, this might be the difference between a disastrous bankruptcy and a successful reorganisation. The efficiency effects of a potential renegotiation both from an *ex-post* and an *ex-ante* perspective also depend on the threat points and distribution of bargaining power.[8] German banks backed by the creditor-oriented German insolvency law and well experienced in renegotiations might receive very different results in a private workout than, e.g., US banks threatened by Chapter 11 and without the respective experience and close customer relationship. Thus, American bank loans tend to be much softer and therefore provide very different incentives to debtors, a discrepancy German bankers were seemingly unaware of when they bought large amounts of American credit risk before the financial crisis. To put it succinctly, both contracts are corporate loans, but their implicit content and economic performance are very different.

The relevance of institutions becomes still more apparent if we regard a setting with a greater or even infinite number of periods. The longer time horizon allows more efficient contracts than are available in a short-term setting, even if, as the well known folk theorem proves, these contracts are very incomplete.[9] Both parties might have

3 Given the dominance of the Anglo-Saxon banking model in business schools, one is tempted to say that they already did even before reality followed.

4 The well known collection of papers of F. Allen and D. Gale: Comparing Financial Systems, Cambridge, MA 2001, MIT-Press, should be mentioned here, although it does not solve the problem and is sometimes misleading with regard to the description and understanding of non-Anglo-Saxon financial systems.

5 To my best knowledge, the idea of complementarity in financial systems was put forward by Andreas Hackethal, see e.g. A. Hackethal, R.H. Schmidt: Finanzsysteme und Komplementarität, in: Kredit und Kapital, special issue No. 15, 2000.

6 In the following, terminology and arguments on incomplete contracts are obviously greatly influenced by O. Hart: Firms, Contracts, and Financial Structure, 1995, Oxford University Press.

7 See D. Schäfer: Restructuring Know How and Collateral, in: Kredit und Kapital, No. 4, 2002, pp. 572-594, for a respective model.

8 Arguments along this line can be found in H.-P. Burghof: Bankkredit und Kreditrisikotransfer, Frankfurt a.M. 2005.

9 An application on bank loans is S.A. Sharpe: Asymmetric Information, Bank Lending, and Implicit Contracts. A Stylized Model of Customer Relationships, in: Journal of Finance, Vol. 45, 1990, No. 4, pp. 1069-1087.

expectations about what kind of equilibrium is played and what behaviour is in line with this. The multi-period setting allows for punishing the counterparty effectively if he does not act in accord with his so defined reputation. However, both parties must be able to signal what kind of equilibrium will be played, which is equivalent to saying what kind of persons or institutions they are. A special institutional setting and regulation can help to define such equilibria and thus make long-term financial contracts available to the consumer that would otherwise not exist. We achieve a richer set of potential financial contracts if regulators allow institutions with very different reputations and they are supported in their differences through the respective legal framework.

A fundamental economic justification for the creation of derivatives is that they help to overcome market incompleteness. Thereby, they enable market participants to achieve better risk sharing and increase their utility, which is equivalent to saying that they make markets more efficient. This is argued in an Arrow-Debreu framework where contracts are taken to be comprehensive. Apart from the conventional doubts whether most derivatives are really created for this reason and not for rent seeking, we might also ask ourselves how we can achieve a higher degree of market completeness in a world with incomplete contracts. In this world, the payoff structures are not only defined explicitly in the contracts but also depend on the outcomes of renegotiations and thus on the characteristics of the contracting parties. Thus, financial markets with incomplete contracts should become more complete if financial intermediaries exist that differ with regard to the way they renegotiate. As stated above, financial markets consequently become more efficient.

Conclusion

The new efforts in banking regulation are important to overcome some of the problems that caused the ongoing financial crisis. More equity and a restriction on leverage (as proposed in Basel III) will certainly increase the stability of the financial system (although the latter regulation in particular could also lead to a more homogeneous banking market). A common caveat is that such activities tend to fight the last crisis rather than the next one. Systemic stability is not only a question of the regulatory framework in a narrow sense and its competent implementation, which were both found to be deficient in the course of the current crisis. It also has to do with the financial system as such and its resilience against systemic failure. One relevant aspect not discussed in this article is the size structure of financial intermediaries, and "too-big-to-fail" certainly remains on the agenda. As discussed above, the systemic vulnerability of European banking also depends on the degree of diversity both among and inside the different national banking systems. More diversity should not only enhance systematic stability against any potential future crisis. It might also contribute to the efficiency of banking in Europe, offering a richer set of financial contracts to the clients. The current policy of the European Commission follows different ideas on efficiency and competition and therefore tends to threaten the still existing diversity in European banking. In the long run, this might not be a change for the better. And it is a break with long European traditions, as Europe for many centuries profited from sharp competition among very different kinds of institutions. This might still be a valuable concept for the European future, as long as it is happens under the umbrella of a peaceful and united European community.

Stephan Leibfried

The European Single Market – How Far from Complete Is It or How Complete Can It Ever Be?

Markets are innately social institutions. There is no such thing as a "free market", since all social institutions are based on society-wide rules and on mutually expected behaviour: all social institutions are inherently regulated ones. Historically, a really functioning market was always part and parcel of some political entity. The market of the *Hanse* in the Middle Ages worked well as long as the *Hanse's* political structures were strong enough to secure the trust in the contracts made "under it". When the political structure was seen as having been weakened, the *Hanse's* economic force was also sapped.

The first political entities which really created territorially defined markets were the territorial states of the late 16^{th} and early 17^{th} centuries. For the first time a new political entity enforced contracts, harmonised weights and measures and promoted exchange through investments in infrastructure. Even then it took until the late 19th century to fully harmonise just the legal base – as we can gather from the example of Prussia which, for most of the 19th century, was divided into at least three zones of civil law: the *Gemeine Recht* in the east, the *Allgemeine Landrecht* in most of the central provinces and the Napoleonic Code Civile in the Western provinces. A truly common market was created only when the German Reich introduced the *Bürgerliche Gesetzbuch*, the BGB, in 1900.

Yet, markets did develop over time as social institutions. Expectations of efficiency and trust increased but so did the perceived requirements to regulate issues such as environmental concerns and consumer protection. And markets expanded early on into hybrid territories, into the condominium of economics and politics – the *Daseinsvorsorge,* the public services – that is, into administratively provided public goods like electricity, water or telecommunication. They were seen as natural monopolies important enough to warrant strong political influence and, especially, the "political production" of the good itself.

And when most observers in the 1960s and 1970s considered national markets to be complete – or even over-complete, i.e. over-regulated – globalisation again changed the surrounding landscape and the demand for market-making and for market regulation. On the one hand, regional and global markets developed in some sectors in such a way that they essentially cast doubt on most national sectoral regulation. In a global financial market, national regulation of financial intermediaries becomes less effective. For many observers this was advantageous because it reduced cumbersome "over"-regulation in some national markets. On the other hand, the perceived loss of autonomous national political influence was regarded as a major problem for democratic legitimacy since the different sets of national regulation represented the outcome of decades of political struggle over embedding financial markets in democratic national societies.

Basic Considerations

Seen against this backdrop, the question "How complete is the Single European Market?" prompts six considerations:

1. *The Single European Market will never be "complete"*. Defining what is complete rests either on some normative idea of *Ordnungspolitik* or on the perceptions of market participants. The normative problems are obvious: you can tell people a thousand times that the current level of social security guarantees is too expensive and cannot be financed any more in a sustainable fashion. They will, nevertheless, persist in calling on the state to meet the risks of the day and to provide more social security. So, at the end of the day, it is the perceptions and demands of the people which guide the development of the market. This holds true for the given demand and supply of goods and services on the market and also for the necessity to regulate or subsidise its subsectors.

   A small but telling example: until the late 1950s, Article 180 of the German Penal Code forced hotel owners to rent double rooms to married couples only. Today such a provision would not only meet with surprise about what the state in those days deemed a social problem important enough to be regulated via the penal code, but any hotel owner would also meet fierce resistance if he were to inquire about the marital status of his prospective guests. Then, however, it is obvious that the social institution of the (hotel) market thrives in a dynamic social and political environment which leads to new or different demands for less or more or other regulation and for less or more or other subsidies. New market sectors will develop which again will call for regulation and, if only initially, subsidies.

2. *The sheer complexity of today's extremely segmented, functionally differentiated and professionalised markets prevents markets as a whole from reaching an "optimum" in any sense of economic theory*. Markets as social institutions are always inherently unstable and, hence, in dire need of regulation. However, political regulation is a source of instability of its own. Political time horizons normally do not exceed the average legislative term of four or five years, and politicians answer to electoral majorities. The government might, thus, do what is economically "optimal" but would nevertheless lose the next election. In democratic societies, elections and referendums are just the other side of the markets' social embeddedness. This creates mutual interdependence: while markets are in dire need of supporting political regulation and subsidies, they also heavily influence the electoral prospects of political actors.

3. *Due to the cumbersome and inescapable requirements of democratic legitimacy or to its short-term horizons, political decision-making will always lag behind market developments*. Only in rare instances are political institutions really avant-garde in developing new market segments. Markets are normally faster in

developing new ideas. This, however, leaves politics with the constant task of re-embedding new commercial and economic developments, be it by supporting and subsidising new technologies so that they can overcome structural barriers to market entry or by regulating new market segments to avoid a distribution of chances, incomes or risks that is deemed socially harmful. Actual political decision-making normally looks backwards and draws on past experience even when future markets are to be regulated. Politics regulates the past – the last crisis, not the next one.

4. *Market opportunities and political interference with markets result in, or are part of, an oscillation of basic economic parameters: economic growth, inflation and unemployment*. Such ups and downs are the inescapable effects of decisions made by diverse interdependent actors. But these ups and downs sometimes affect actors very differently: unemployment, for example, is mostly a burden on employees and the state, while employers carry only a part of the costs and also benefit from the reduced power of the trade unions. Moderate inflation normally does not hurt lower class employees too much, and the same can be said of industry. But it sharply reduces the purchasing power of the middle class, which usually does not invest in stocks but relies on savings in bank accounts or in bonds. Hence, even seen from a market perspective, there is no obvious and stable preference for any kind of market development or market intervention.

5. *Nevertheless, there is no better alternative to a regulated market econom*y. A planned economy loses most of its dynamism as the administration and its planning staff have neither all the necessary information nor the capacity to guarantee the distribution of scarce goods and services as effectively as any form of market economy could. But it is also true that a "free market" without any regulation is no market at all, just a grand anarchy in which cartels and monopolies fill the power vacuum and exploit the less powerful market participants.

6. *The problem of the Single European Market is that while markets evolve all over the world and political systems try to catch up with their most recent developments, Europe is simultaneously creating a political system of its own*. This means that the tastes of constitution-making and problem-solving for the daily issues at hand must be performed simultaneously. Since John Rawls published his concept of a "veil of ignorance", we know that, for the sake of fairness and equity, constitution-making and everyday problem-solving should be dealt with *separately*, that they should be in two different universes. If I know where I'll end up after I've solved my daily problems, I'll be inclined to bend the constitution in favour of my expected position. This is exactly what happens in the EU: if I know that I'll be a net contributor to the EU budget, I'll try to contain the budget authority of the EU. If I have a highly regulated national market, I'll have an incentive to strengthen the regulatory authority of the EU and to make the EU accept my regulatory concept as an example for all to follow and to extend it to the European market as a whole. Rawls' "veil of ignorance" is difficult to preserve even in national constitution-making, and so, a fortiori, it cannot be "taken" in the constant, uninterrupted mix of constitution-making and daily problem-solving in the European multi-level system. To take the "veil of ignorance" is a transformative experience that needs to move in its own universe.

Ensuing Effects

In this complex situation, the Single European Market and the European Union are confronted with at least three effects:

1. The political and social "bed" does not (yet?) really exist in which the Single European Market could and should be implanted. This allows the variety and the velocity of change in the different social and political demands to persist. And to complicate matters even further, different segments of the Single Market vary in their territorial reach: the three freedoms – the free movement of goods, services, and capital – extend to the 27 member states of the EU, to the three member states of the EFTA (Norway, Iceland, Liechtenstein) via the European Economic Area Agreement, and to Switzerland via a special bilateral treaty. European trade policy even extends to a 32nd state, since Turkey entered into a customs union with the EU in 1995. EU regional policy reaches out to 29 member states, including Norway and Switzerland, both net contributors to the EU's Regional Funds. And the EU's monetary policy focuses on 17 member states, the members of the euro area. Hence we see a functionally differentiated, fragmented embedding of different market segments, and we see a territorial inclusion of some states, without them having – or even wanting – the attendant political influence. Switzerland, for example, is part of most dimensions of the Single Market, but it can hardly influence EU regulation, at least not by participating in EU decision-making.

2. Such a multi-level and multi-actor situation opens multiple avenues for interference in both directions. Market participants with enough political clout have various points of access to lobby for regulation or to "self-regulate" certain market aspects – and hence to determine the regulatory density in their field of interest. At the same time, a multitude of political actors at various levels have access to numerous regulatory instruments. In a centralised nation-state, the government and the administration are hierarchically structured and occupy the commanding heights of both decision-making and implementation. In the multi-level system around the Single Market, these powers are distributed amongst various actors. Decision-making is partially commandeered by the WTO, by EU supranational bodies (such as the Commission, the European Parliament, the Council and the European Court of Justice), by national decision-making bodies, by independent agencies (such as the European Central Bank) and also by (transnational) private organisations like the International Standard Organisation (ISO) or CEN and CENELC (the European bodies for technical norms). In most cases such decisions are not self-implementing but in need of implementation by agencies and administrations which have some firm territorial grounding. That brings to the fore mostly national and regional authorities, like national ministries and administrations or regional administrative bodies in national federal systems. It usually also increases the leeway of the European Commission as it monitors implementation and since it naturally has some degree of discretion in the process. But it also occasionally entails "self-regulation" by market actors or the enforcement of certain regulations by large multinational corporations via their supply chains. While the traditional national hierarchical "command and control" perspective had reached its limits already in the 1960s and 1970s and had to embrace more horizontal mechanisms of social participation, this multi-level market regulation involves a much larger number of actors and hence an, at least potentially, much wider disparity in interests and demands.

3. Any attempt to solve the political problems of the day may also bring about a redistribution of competences and powers. Not only do the perennial treaty revision exercises and the debates on the European Constitution in the last two decades indicate that the European Union is an attempt to develop a political system in a piecemeal fashion. The EU goes down this road while at the same time tackling the problems of the day. Our sense that we live in a permanent crisis of European integration is also fed by these parallel and interdependent processes. The EU might have been the best level for regulating the financial markets in the global crises of 2008/2009. But regulation by Brussels would have required more political competences at the supranational level. Here problem-solving and power distribution collide. The effects: the EU seems incapable of coping with the regulatory needs of many market participants. But if people are asked whether more political competences should be supra-nationalised, a majority is very reluctant to grant the supranational level more powers. European gridlock in action.

Lost in Complexity

One might argue that these are all transitory problems which will dissolve once all European states have become EU member states and codetermine all aspects of their Union. But that is wishful thinking. There is no reason to believe that the governance structure of the 21st century will eventually mirror the government structure of the nation-state of the 1960s and 1970s, albeit on a larger scale. Rather, in the EU and globally, we will have to live "in the times to come" with:

- functionally highly segmented, yet more and more interdependent markets;
- the varying territorial reach of their respective regulations;
- the different social "beds" in which these market segments are socially and politically implanted or "embedded".

This, to be sure, is part of the thus far remarkable success story of the Single European Market. But it also means that this market, even less than any traditional national market, will never be complete in any sense of the traditional notion of "completeness": It will not be so in terms of:

- possible economic, social or political demands made on the market;
- the market's political regulations;
- normative economic "optimality".

Even worse, at least when seen from the perspective of proponents of some sort of "optimality", any discussion of "completing the market" is inevitably marred by the underlying question of the *finalité européenne*. Once this *telos* has sucked us in, we'll get lost in complexity pure. So, we must avoid the traps of presumably "easy solutions" advocated by standard economic theories, though they do attract us because we all long for a manageable and hence low degree of complexity. That low degree of complexity cannot be attained today – and I am not even sure that it is worth aspiring to.