OECD Economic Surveys
EUROPEAN UNION

MARCH 2012



OECD

OECD Economic Surveys: European Union 2012



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Please cite this publication as:
OECD (2012), *OECD Economic Surveys: European Union 2012*, OECD Publishing.
http://dx.doi.org/10.1787/eco_surveys-eu-2012-en

ISBN 978-92-64-12733-3 (print)
ISBN 978-92-64-12751-7 (PDF)

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

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

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

The economic situation and policies of the European Union were reviewed by the Committee on 14 February 2012. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 7 March 2012.

This Survey of the European Union has been prepared back-to-back with the Survey of the Euro Area, which was discussed and approved on the same days as this document. The Surveys are being released together.

The Secretariat's draft report was prepared for the Committee by Sebastian Barnes, Charlotte Moeser and Jon Pareliussen under the supervision of Piritta Sorsa. Research assistance was provided by Isabelle Duong.

The previous Survey of the European Union was issued in September 2009.

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BASIC STATISTICS OF THE EUROPEAN UNION 2010

	EU15	EU12	EU27
LAND AND PEOPLE			
Area (thousand km^2)	3 316	1 088	4 404
Population (million)	391.4	102.3	493.7
Number of inhabitants per km^2	118.0	94.0	112.1
Population growth (2000-10, annual average % rate)	0.5	–0.1	0.4
Labour force (million)	259.5	71.6	331.2
Unemployment rate (%)	7.1	6.6	7.0
ACTIVITY			
GDP (billion EUR, current prices)	11 311	945	12 256
Per capita GDP (current PPS)	27 399	14 975	24 824
In per cent of GDP:			
Gross fixed capital formation	18.4	21.1	18.6
Exports of goods and services	39.4	56.0	40.7
Imports of goods and services	38.4	56.2	39.8
PUBLIC FINANCE (per cent of GDP)			
General government:			
Revenue	44.5	37.8	44.0
Expenditure	51.1	44.2	50.6
Balance	–6.6	–6.4	–6.6
Gross public debt (end-year)	83.0	45.2	80.1

EXTERNAL TRADE IN GOODS
(main partners, % of total flows)

	Exports	Imports
United States	18.0	11.3
Other Europe (incl. Russian Federation)	32.8	36.9
China	8.4	18.7
Japan	3.3	4.4
Other Asia	21.6	20.4
Other	24.4	27.1

Executive summary

The EU needs to tackle the economic crisis and move to stronger, fairer and cleaner growth. *The EU27 economy is in a serious downturn driven by the euro area sovereign debt crisis and on-going weaknesses in the wake of the financial crisis as set out in the* Economic Survey of the Euro Area. *Longer-term prospects are for growth to be weaker than over the past twenty years, influenced by population ageing and sluggish productivity gains. Structural weaknesses in labour and product markets contribute to low productivity and employment, as well as slow growth. Higher growth would help to make current debt levels more sustainable and create more space to deal with social and environmental challenges.*

An ambitious programme of structural reforms is needed. *Removing policy obstacles to growth requires a broad range of measures to raise productivity and employment rates. The EU has set itself ambitious targets with the Europe 2020 strategy. Many of the necessary reforms require changes in national policies and institutions. EU policy instruments can make a strong contribution to growth by creating the right conditions and incentives to support national reforms. Improving EU and co-ordination of national innovation policies, as well as continued opening of EU markets to trade, would also help support sustainable growth.*

Strengthening the Single Market should be at the centre of EU policy action to boost growth. *The EU's internal market remains fragmented in terms of trade and financial integration. The main obstacles are market regulations at national level and poor implementation of existing Single Market requirements. The Commission sought to re-launch the Single Market project with the 2011 "Single Market Act" Communication. The twelve key legislative actions it identifies should be passed by the end of 2012 as planned. Greater political commitment is needed to the Single Market project, which would be encouraged by a stronger evidence base and more innovative approaches to decision-making. Implementation of the Single Market, including the Services Directive, should be improved and more actively enforced by the Commission and within countries. The framework conditions for cross-border business should be improved, including by addressing cross-border corporate and indirect tax issues, and stronger implementation of competition policies and consumer protection at the national level. Further integration efforts are required on a sectoral basis for government procurement and the network industries, including through developing cross-border regulators and investment in infrastructure.*

Labour market reforms would create more and better jobs. *Large differences in labour market outcomes across EU countries suggest that performance could be improved. High unemployment, particularly among young people, and low labour mobility coexist with skill and labour shortages in other regions. Internal migration within the EU can help to meet labour market shortages. However, mobility is hindered by barriers stemming from restrictive domestic labour market and pension policies, and by weak enforcement and implementation of legal rights under the Single Market. The recognition of professional qualifications across the EU should be further developed and the access to public sector jobs improved. Reforms at national level to pension systems*

and housing policies, which would be beneficial in their own right, are an opportunity to tackle disincentives to worker mobility.

EU migration policy needs to be further developed to better respond to shortages of workers. *With demographic changes underway, most EU countries expect growing shortages of skilled labour or workers in specialised activities. This should be mostly dealt with by making better use of the existing population and providing them with the right skills. The EU should develop policies to ensure that migration responds more directly to labour market needs. The Blue Card should be used effectively to make it more attractive to high-skilled workers.*

Assessment and recommendations

The EU needs to tackle the economic crisis and reach a stronger sustainable growth path

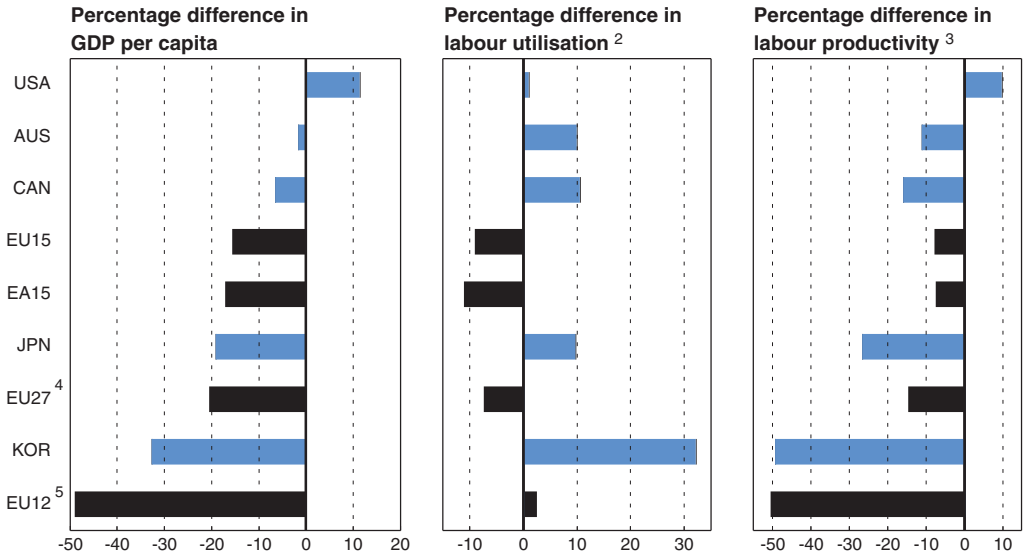
The EU economy is in a serious downturn as the protracted sovereign debt crisis has lowered confidence, against the background of underlying economic, financial and fiscal weaknesses and imbalances. The economy will contract in the short run, but longer-term growth prospects are also dim. The origins of the crisis lie in inadequate financial oversight, insufficiently prudent and disciplined fiscal policy, and weaknesses in structural policies during the upswing of the credit cycle that gave rise to serious imbalances. Weaknesses in the design of regulatory, labour market and a range of other policies have impaired growth and labour market performance, while hindering necessary economic adjustments.

The crisis has left many countries with weak banking systems, poor public finances and high rates of unemployment. In the euro area, there is a need to rebalance activity after the build-up of excessive imbalances over the past decade, as described in the *Economic Survey of the Euro Area*. The ensuing crisis in the euro area could have a significant negative impact on the European economy as a whole, through close trade linkages and the financial system. These effects are having a dampening effect on growth in the United Kingdom, where the recovery is also subdued due to continued fiscal and financial retrenchment, while Sweden is growing only moderately. Despite strong linkages to the euro area, central and eastern European countries (EU12) are likely to maintain stronger growth on average than the EU15 economies but some continue to face large fiscal deficits and financial fragilities, as well as high unemployment. The crisis in the euro area must be resolved as pre-condition to returning to growth as set out in the *Economic Survey of the Euro Area*: severe financial vulnerabilities and fiscal weaknesses must be reduced in many euro area countries, which requires an adequate response to the crisis, rebalancing of overall demand and supportive monetary policy settings.

Even before the crisis, economic performance in most EU countries was weaker than in the best-performing OECD countries in terms of GDP per capita and underlying growth was fairly weak (Figure 1). Indeed, the income gap for the EU21 (OECD EU members) *vis-à-vis* the best performers has widened slightly over the past decade. This weak growth performance is partly the result of population ageing and diminishing gains from rising female participation. However, unfavourable policy settings in labour and product markets have also contributed. This is particularly true in countries with very poor growth performance, such as Italy and Portugal, which grew at an average annual rate of just 0.3% over the past decade. By contrast, some central and eastern European countries with sound policies have managed to achieve vigorous catch-up growth (Figure 2). Overall, growth in Europe is anticipated to slow over the coming decades under current policies:

Figure 1. **Sources of real income differences**

Relative to benchmark,[1] 2010 data

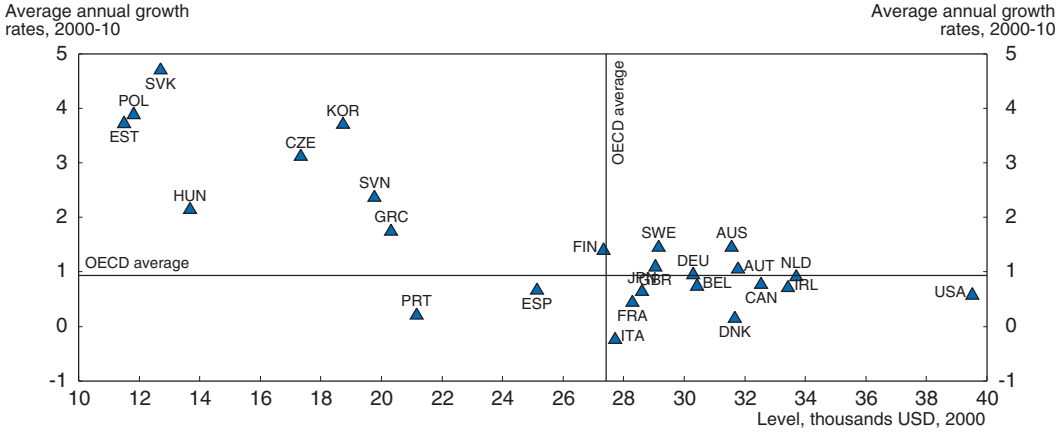


1. Benchmark is the simple average of the highest 17 OECD countries in terms of PPP-based GDP per capita. The population of Luxembourg is augmented by cross-border workers and Norway GDP refers to the mainland.
2. Labour utilisation is measured as total number of hours worked per capita.
3. Labour productivity is measured as GDP per hour worked.
4. EU27 refers to the 21 countries that are OECD members.
5. EU12 refers to the 6 countries that are OECD members.

Source: OECD (2011), *Productivity Database*.

StatLink http://dx.doi.org/10.1787/888932590038

Figure 2. **Convergence in GDP per capita**[1]



1. At constant prices and constant 2005 PPPs.

Source: OECD, *National Accounts Database*.

StatLink http://dx.doi.org/10.1787/888932590057

potential growth is projected at an annual rate below 2%. The main driver of the growth slowdown is the ageing of the population, both in EU15 and EU12 countries, which would lead to an overall reduction in the working-age population in the absence of major pension reform or large immigration flows. Labour productivity is difficult to predict but there are downside risks to projections which extrapolate forward recent growth rates, notably if the

trend slowdown over past decades continues as discussed in the *Economic Survey of the Euro Area*.

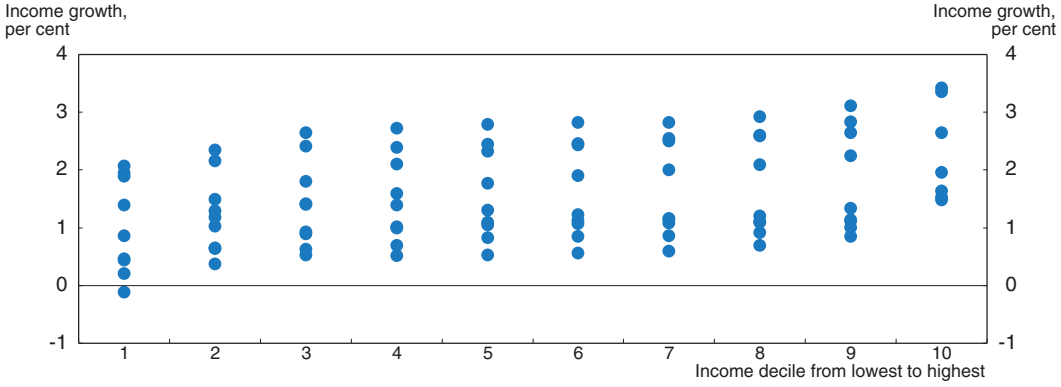
An ambitious programme of structural reforms is needed to achieve a sustainable improvement in growth prospects. This could help to restore confidence in the near term and, over time, improve the sustainability of public and private finances as well as substantially raising long-term living standards. Some countries have especially strong structural problems to overcome and the necessary reforms there would help to tackle the underlying causes of economic and financial imbalances. An important factor for future growth will be the ability of EU countries to reap the benefits of globalisation. This depends on the good functioning of labour and product markets, the innovation framework and the education system, and a fair sharing of the costs and benefits of globalisation. The need to adapt to sustain growth is likely to increase as emerging countries move up the value chain and become more likely to compete directly with a wider range of products currently produced in European economies.

The new growth model should support a fairer and greener economy

Growth and a better functioning of the EU economy are needed to meet major social challenges. The weak growth performance in the EU has been accompanied by growing social problems and rising inequality. This reflects in part high unemployment, the development of dual labour markets and detachment from the labour market of vulnerable workers, such as young people with little work experience, older workers or those with low skill levels. The redistribution of wealth as the result of developments in financial markets also contributed to the increase. Inequality in the EU as a whole has risen because income convergence among EU countries has not offset growing income inequality within countries (Fredriksen, 2012). The richest tenth of the population in most EU countries has been capturing a growing share of national income over time, while those in the lower half of income distribution have tended to gain less. Many Europeans have seen only very slow growth in real incomes over recent decades (Figure 3). Higher growth would create space to make current social systems more sustainable, while better functioning markets would help to address some of the underlying causes of joblessness and falling real incomes.

Figure 3. **Inequality and income growth**[1]

Average annual change between mid-1980s and mid-2000s



1. Dots correspond to observations for Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Sweden and the United Kingdom.

Source: OECD, *Income Distribution and Poverty Database.*

StatLink http://dx.doi.org/10.1787/888932590076

Boosting the accumulation of human capital and making educational outcome less dependent on social background, as well as improving the labour market by reducing dualism and facilitating integration of women, immigrants, older and young workers, are among the set of policies that would both increase GDP per capita in the long run and reduce income inequality (Koske *et al.*, 2012).

Achieving sustainable growth requires management of the environmental consequences, although this challenge also creates opportunities to build a new growth model as set out in the OECD Green Growth Strategy (OECD, 2011c). These issues form an integral part of the EU 2020 strategy, which includes the "20-20-20" objectives to reduce greenhouse gas emissions, increase the share of renewables and increase energy efficiency. The EU has developed a comprehensive agenda on resource efficiency, a green economy and sustainable development. The EU has taken an important leadership role in international efforts to combat climate change by pressing for all countries to negotiate a legally-binding agreement under the UN Framework Convention on Climate Change (UNFCCC, 2011). Furthermore, the creation of EU Emissions Trading System (ETS) in 2005 was a major step. The functioning of the ETS is being improved and extended, as recommended in the 2009 *Economic Survey of the European Union* (OECD, 2009a): free allocations of permits have been reduced and the ETS is being extended to air transport in 2012 and to the petrochemicals, ammonia and aluminium industries and additional gases from 2013. The European Union is well on track to meet its target of a 20% reduction in emissions by 2020 relative to 1990, which has been assisted by the sharp drop in emissions due to the weak economy. As a result, ETS carbon prices have been depressed in recent years and there was a further sharp fall during 2011. While this partly reflects success in reducing emissions, it is important that the resulting over-supply of allowances does not unnecessarily reduce incentives to invest in reducing emissions and improving energy efficiency. Measures could be taken to reduce the supply of allowances, such as a percentage reduction or set-aside of Phase III allowances. There should be a further strong move away from giving allowances for free. Overall, meeting emissions reduction targets and securing energy security goals in a cost-effective way and without compromising growth remain a challenge given the multiple mechanisms and targets involved in the EU. Policy targets should be better prioritised. If demanding targets are to be met, it is essential that cost-effective policy mixes are used. Further efforts are needed to tax emissions from all non-ETS sources appropriately, reduce tariffs on imported biofuels and to ensure that the 10% renewable transport fuel target is met in an efficient way (OECD, 2009a). All options for technology choice should be kept open during the transition phase to a long-term sustainable energy system and policies should be technology-neutral (OECD, 2012b).

The Europe 2020 strategy sets out ambitious EU reform targets, but will they be achieved?

An ambitious programme of structural reforms would contribute to higher sustainable growth prospects, as well as achieving key social and green objectives. The Europe 2020 strategy, adopted in 2010, responds to this challenge by setting out five high-level policy objectives at the EU level (Table 1) with a system of corresponding national goals. The objectives of Europe 2020 strategy are set so as to support economic recovery in the near term, and boost growth and job creation in the medium term. This strategy of identifying long-term structural reform goals, while recognising their contribution to exiting from the crisis, is similar to the role of structural reforms in the OECD *Strategic Response* to the

Table 1. **Europe 2020 objectives for a smart, sustainable and inclusive growth**

	2000	2010	2020 target
Population aged 20-64 employed	67%	69%	75%
Share of GDP invested in R&D	1.9%	2%	3%
Education:			
Share of early leavers from education and training	17.6%	14.1%	10%
Share of tertiary educational for age group 30-34	22.4%	33.6%	40%
Climate change and energy:			
Greenhouse gas emissions relative to 1990	91%	83%	80%
Share of renewable in gross final energy consumption	9%[1]	11.7%	20%
20 million reduction in number of people at risk of poverty	124 million[2]	116 million	96 million

1. 2006.
2. 2005.

Source: Eurostat.

financial crisis (OECD, 2009b). Country-specific recommendations are issued by the Council in the context of the European Semester to reach the overarching Europe 2020 strategy's goal of smart, sustainable and inclusive growth. These are highly correlated with the five policy priorities set out in the OECD *Going for Growth* exercises (OECD, 2011b) and OECD *Economic Surveys* of individual countries.

For the Europe 2020 strategy to succeed, the EU needs to improve on its mixed track record of achieving European objectives through changes in national structural policy settings. The Europe 2020 strategy is the successor to the renewed Lisbon Strategy for growth and jobs (2005-10). Although it led to some reforms that might not otherwise have been achieved, the Lisbon Strategy fell well short of reaching its objective of making Europe "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion" (Presidency Conclusions, Lisbon European Council, 23-24 March 2000). The main problem is that most of the policy instruments to achieve the EU objectives are in areas of national competence, making it hard at the EU level to ensure that the necessary reforms are undertaken. The EU has historically not been able to achieve either sufficient national ownership of the EU objectives nor has the peer-review process provided sufficient pressure for domestic policymakers to act. Under the Lisbon Strategy, various approaches were tried, including both a broad and a narrow set of objectives, but neither was able to deliver fully on them.

The key question is whether the Europe 2020 will be any more effective than the Lisbon Strategy, despite relying on the same basic design and institutional architecture. Ownership may be higher because of the focus on a limited set of specific EU-level objectives and because countries set their own national targets in these areas. Moreover, the Europe 2020 strategy includes targeted and precise policy recommendations to national authorities, against which implementation can be monitored. Peer pressure could be stronger than in the past to the extent that peer reviews of structural policies are now linked through the EU Semester process to other high-profile policies on budgetary and economic stability. Furthermore, surveillance of structural policies in the context of macroeconomic imbalances has been significantly reinforced as described in the *Economic Survey of the Euro Area*. A euro area country could even in principle be required to undertake structural policy measures in the context of the new Macroeconomic Imbalances Procedure, which is backed by financial sanctions. However, it remains to be seen how

effectively these mechanisms will be enforced, notably with respect to structural policies. So far, the experience with the first European Semester in 2011 has been positive in that the Commission made more precise recommendations with more clearly articulated deadlines for policy action than in the past, making it more difficult for countries to avoid taking action. In addition, the difference between the Council recommendations and those proposed by the Commission was quite narrow and smaller than in the past, perhaps indicating a lower collective tolerance to inaction on structural reforms by other countries in the wake of the crisis and higher awareness of spillovers. It will be important during the second round of the EU Semester and with new economic governance measures in place for the Commission and Council to follow through effectively on the recommendations made in 2011, if the new regime is to establish a strong reputation. It is not encouraging as a signal of commitment to the Europe 2020 strategy that the sum of national objectives, even if these were met, would not reach the EU-wide targets in all areas (European Council Conclusions, 23-24 June 2011).

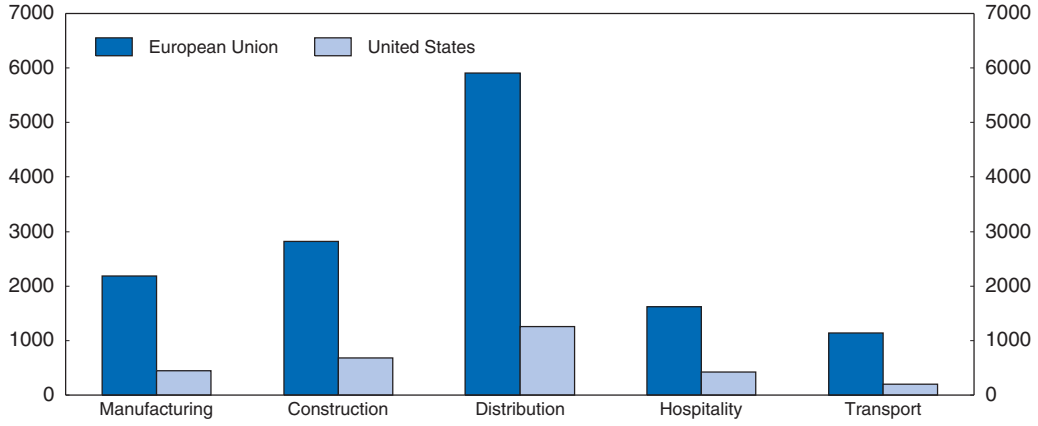
The completion of the Single Market is a strong EU-level tool to boost growth

One of the European Union's strongest tools to boost growth is the binding instruments and *communautaire* approach that underpin the Single Market project. These cover major responsibilities to foster internal competition and trade in goods, services and capital market integration (Chapter 1) and labour mobility (Chapter 2). Completing the Single Market using these instruments could have a substantial impact on boosting growth by increasing competition and the scale of economic activities in Europe. This potential is recognised in the Commission's 2011 "Single Market Act" (SMA) Communication, setting out twelve key legislative actions to boost growth. This should be implemented with a high level of political commitment within the Europe 2020 Strategy.

Significant progress has been made towards achieving a Single Market but more remains to be done, especially in services. The potential of a market of 500 million consumers is being held back with many markets remaining organised largely on national lines, where the median market size is less than 10 million. The high degree of integration in goods and services activities through trade and through cross-border companies is a significant achievement, but further progress appears to have stalled over the past decade (Chapter 1). The crisis may have slowed progress further. Trade integration, while higher than between most countries, is lower than within a large federal economy such as the United States and price differences across countries remain high. The fragmented market contributes to keeping average firm size low in Europe (Figure 4). The microeconomic costs of remaining trade and capital market fragmentation are difficult to assess, but there are likely to be substantial costs from the failure to use the full gains of specialisation, the lack of competition and limited consumer choice. Greater integration is needed to boost productivity and avoid excessive macroeconomic imbalances, as argued in the *Economic Survey of the Euro Area*. While there are some inherent barriers to integration in Europe, notably distance, culture and language, policy obstacles to the development of cross-border activity remain a significant problem. Given some of these inherent constraints, EU countries may need to make greater efforts than in federal economies to achieve the same gains from integration.

Figure 4. **Number of enterprises by sector**

Thousands, 2006



Source: OECD, *Structural Business Statistics Database*.

StatLink http://dx.doi.org/10.1787/888932590095

Despite legal progress, implementation at the national level remains deficient

The legal framework for an integrated single market has progressed substantially over the past decades. The core legal framework establishes the basic freedom of cross-border movement. Under laws and extensive case law, explicit discrimination in economic transactions by nationality has largely been removed. The EU applies the basic standards necessary to underpin efficient economic activity across a range of areas, such as product safety. EU competition policy and state aid rules help to ensure a level playing field and have been important during the crisis in ensuring that national authorities resisted the temptation to apply protectionist policies.

The main policy obstacles to economic integration are now regulations at national level (Chapter 1). Product market regulations in many EU countries remain relatively restrictive by OECD norms, although considerable progress has been made during the past decade. Although not inherently discriminatory by nationality, these restrictive rules are likely to confer an advantage and protection to domestic firms relative to competitors from other EU countries. The diversity of regulations introduces transactions costs for companies looking to develop new business in another EU country. Many aspects of the basic economic institutions of EU countries, such as corporate governance, tax systems, financial oversight and consumer protection, are largely designed and operated at national level. This allows for disparities across countries and can fail to take into account the implications in terms of creating *de facto* obstacles to cross-border activity. Although many large federal economies have some variation across sub-federal levels, the differences across EU states may be greater in some areas, notably product market regulations, taxation and banking supervision, and add to some of the inherent obstacles to developing cross-border activities in Europe.

A major problem with the EU Single Market is the chequered implementation of existing requirements. While many national laws and practices have been adapted to comply with EU law, some directives are not even transposed at all into national law in all countries or only poorly, and implementation deadlines are sometimes ignored. Although ultimate responsibility for this failure rests with national authorities, the Commission

should be more active in ensuring that possible infringements of EU law are challenged and if necessary pursed through the European Court of Justice, as complaints by individual workers or firms suffer from a collective action problem. The Commission should allocate more resources to identifying and resolving obstacles to integration, including within individual countries. There should be a clear annual report on the implementation of the Single Market for each country, both in a legal and, more importantly, in a practical sense. More rigorous political and economic sanctions could be used for failure to make sufficient progress in opening markets, including loss of access to EU funds. National authorities should also give greater priority to making sure that domestic obstacles to integration are removed. The development of closer co-operation between national regulatory authorities in some sectors, such as network industries, and more effective EU bodies to facilitate this process could help to overcome co-ordination problems and lack of trust between the competent authorities at national level, so that regulatory decisions are more coherent across countries and support the development of economic activity across borders.

Stronger policy action is needed to deal with remaining barriers to cross-border business

As well as improving implementation, stronger policy action is required to tackle remaining barriers to economic integration and realise the potential benefits of integration. Progress continues through a combination of major initiatives and incremental progress as the existing legal framework is applied and developed in practice. The 2007 EU Services Directive is the most recent landmark legislative programme. While this takes important steps to extend existing freedoms in the services area and make this effective on the ground through "one stop" shops for administrative procedures and a mutual screening process for national regulations, the Directive was much less ambitious than the original proposal. At present, it remains too early to assess how effective this measure will be. The 2011 Commission "Single Market Act" Communication sets out twelve "levers" of growth and areas of legislative proposals with the aim that all measures will be passed by the end of 2012 (EC, 2011e). A high level of political commitment will be required to ensure that these important measures are all adopted by that deadline. EU and national leaderships need to be willing to act against protected vested interests and make genuine efforts to encourage progress towards more cross-border activities. To move the Single Market forward more rapidly, a more innovative approach to decision-making could be used to avoid it taking many years to make material progress in some areas. This was discussed more widely at the EU level in the past but little progress has been made in making the decision-making process more reactive. The political commitment to advancing the Single Market from EU governments and the European Parliament could be stronger if the efforts were better directed to clearly identified *ex ante* priorities and if the tangible benefits from proposed integration measures were more clearly presented. More extensive and high profile *ex post* assessment of the gains already achieved would make the case more compelling and help to identify priorities for further action.

A more favourable business environment for cross-border trading and investment is needed to deepen economic integration and boost productivity (Chapter 1). There is a need to achieve greater convergence and coherence in the basic features of the business environment across countries, including regulations around corporate governance, product markets and competition. In many respects, the Single Market lags well behind the coherence of institutions found in large federal economies, such as Canada or the

United States, although there are also larger linguistic and cultural barriers to cross-border activity in Europe. The current heterogeneous system of cross-border corporate and indirect taxation may raise costs of doing business in other countries and could distort some incentives in terms of trade and investment, although it may also promote some useful forms of competition. Although these are complicated areas, the interaction between the benefits and costs of different approaches towards more common ground on taxation needs to be further considered. The Commission has proposed an optional Common Consolidated Corporate Tax Base scheme, which according to the Commission's analysis would significantly reduce the incentives for profit-shifting. Simplifying the administration of corporate and indirect taxes across countries and ensuring a more similar approach could also significantly lower transaction costs and encourage cross-border activity, notably by small and medium-sized enterprises for which these fixed costs are likely to be a more important barrier.

Several other reforms areas would enhance cross-border activities. More emphasis on competition policy at the national level, including ensuring that the potential of the Single Market to boost competitive pressures is fully used, would also help create better conditions for the development of cross-border activities. More effective and consistent consumer protection across countries would improve consumer confidence when buying in another country and would help boost cross-border sales. The improvement of overall framework conditions in the Single Market should be complemented by sector-specific measures, where there remain particular obstacles to developing cross-border activities. Significant barriers remain in sectors including government procurement, energy, telecommunications, transport and postal services. Specific measures are required in each sector, such as simplifying tendering procedures for government procurement and full ownership unbundling in power generation and transmission. The "Digital Agenda for Europe" strategy, proposed by the Commission in May 2010, would provide a coherent legal framework for the integration of economies online, including a pan-European licensing for online rights management, strengthening EU data protection rights of consumers, updating the e-Signature directive, and ensuring interoperability of secure e-authentication systems.

Integration of the financial system has advanced well in some areas but remains patchy so far in others, reflecting among other factors the lack of unified cross-border banking and financial supervision. While considerable progress appeared to have been made in terms of cross-border activity in the run-up to the crisis, some of this appears to have been unsustainable and driven by unstable economic developments and allowed by weak regulatory oversight (Barnes *et al.*, 2010). The EU financial architecture has been substantially over-hauled following the financial crisis across a wide range of areas. In addition to strengthening financial regulation, significant efforts have been made to achieve more consistent regulation across countries and to improve supervision of cross-border financial activities. New European Supervisory Authorities (ESAs) have been created in banking, securities markets and insurance to strengthen microprudential oversight of cross-border institutions, and colleges of national supervisors are required for all large cross-border institutions. The European Systemic Risk Board (ESRB) has been created to oversee macroprudential risks. However, there could be advantages to a more co-ordinated approach to the supervision for large cross-border institutions, for example in managing prudential risks from cross-border flows from large foreign banks to small countries. This issue will be considered again at the EU level in 2013. At the same time, a wide range of

different legal requirements, such as different property laws, tax systems and consumer protection laws (as discussed above) may pose barriers to the development of cross-border retail financial institutions. As discussed in the *Economic Survey of the Euro Area*, the new Single Rule Book approach being set out in legislation currently under consideration will support a better managed form of financial integration by reducing the scope of national discretion. This will help to ensure that the Single Market develops further and on a more sustainable basis. The Single Rule Book approach should nevertheless allow some flexibility to the national authorities to impose stricter requirements in limited and duly justified cases, in the context of a macro-prudential regime to foster greater financial stability and address systemic risk. This use of national discretion should not weaken the gains from a large EU financial market, create negative spillovers within the Single Market, nor create additional risks in the underlying stability of the financial system in Europe as a whole.

Box 1. **Main recommendations for strengthening the Single Market**

- Produce a step change in the political priority to encouraging economic integration through the Single Market. Passing the proposals in the "Single Market Act" Communication by the end of 2012 would be an important step.
- Improve the implementation, enforcement and follow-up of Single Market rules at national level, including through more rigorous enforcement by the Commission. There should be an annual country-specific report on the state of the Single Market with clear indicators and recommendations.
- Improve the elaboration of Single Market policies through a stronger evidence-base to prioritise and motivate reforms.
- Further enhance the framework conditions for doing business across borders and setting up in another country, including through effective competition and consumer protection policies at EU and national level.
- Make further progress with the sectoral approach to market integration by fully implementing the Services Directive and measures aimed at boosting competition in services, and further efforts on network industries, including closer co-operation among regulators and investment in cross-border infrastructure.

Europe needs to innovate more and better

Innovation is essential to supporting long-term growth. Europe continues to lag behind the United States in terms of innovation performance, while some emerging countries are rapidly increasing their capabilities in innovation-related higher education and research. Too few businesses are created in new technologies and services, while new enterprises face difficulties in accessing capital and gaining market share. Although the number of new firms created in Europe is comparable to that in the United States, these firms grow by much less than firms in other parts of the world (OECD, 2009a). Academic research in Europe is not enough connected to business activities (EIB, 2009). A key contribution of policy to supporting innovation on the demand side is in creating appropriate framework conditions, in terms of fostering competitive markets, a skilled and adaptable workforce, a financial system that is prepared to support risk-taking, and a tax system that leads to good incentives for innovation. These include a competitive and

integrated Single Market in products and working towards EU capital markets that are deep and able to finance innovative projects (OECD, 2009a).

Nevertheless, policies to stimulate innovation, especially on the supply side should also play an important role as recognised in the OECD *Innovation Strategy* (OECD, 2010). Although innovation policies remain largely at national level, the EU is pursuing an ambitious agenda and its Innovation Strategy sets out a broad set of actions to ensure that ideas are translated into innovative goods and services that create growth and jobs. In 2011, the Commission proposed a substantial reorientation of EU support for innovation as part of the "Innovation Union" and with a single strategic framework, Horizon 2020, to fund spending. These would lead to wide-ranging changes in innovation policy, its implementation and monitoring, and the interplay between these policies and other closely related areas such as support for small and medium-sized enterprises (SMEs), regional policy and the Single Market (OECD, 2009a). The largely national system of patents at present creates high costs for firms wanting to seek and enforce patent protection across the EU, reducing innovation incentives. An EU-wide system of patents and patent litigation is needed (OECD, 2009a) and is progressively taking shape (Chapter 1).

Box 2. **Main recommendations on innovation**

- Pursue the introduction of a unitary patent protection and a unified patent court to reduce the costs of patenting in Europe.
- Simplify the cost of research grant applications to the Commission, consider synergies between the existing schemes for funding for innovation and ensure that all national research grants are open to all EU-based researchers. Improve ties between academia and the private sector.

Further progress in trade liberalisation and agriculture would boost growth and raise living standards

The growth of trade between the EU and the rest of the world has weakened since the crisis and there is a risk of rising protectionist pressures and growth consequences. During the crisis, the EU has largely maintained the overall openness and transparency of its trade and international investment policies. Policy intervention has mainly focused on the financial sector, although other sectors, notably automobiles, construction and tourism, received support within the context of the EU state aid rules. To promote further trade integration, efforts should be stepped up to advance the Doha round to strengthen the multilateral system. The EU played a significant role in the renegotiation of the plurilateral Government Procurement Agreement (GPA) in the WTO concluded in December 2011.

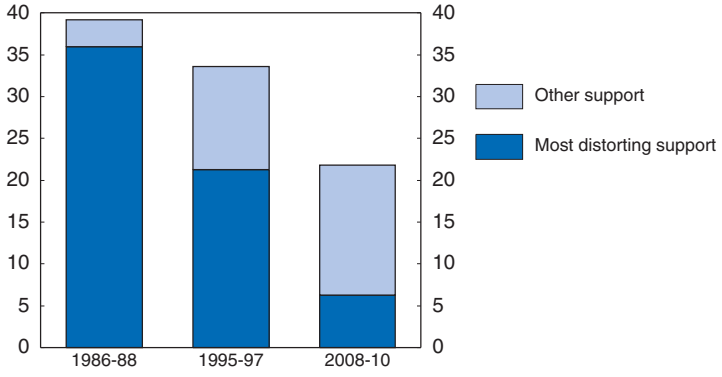
The EU's use of the main trade policy instruments has remained largely unchanged in recent years and it remains a user of anti-dumping measures, although 43% of these measures are applied to a single WTO member (China) and their use is less intensive than by some other economies. The EU continues to pursue its policy of comprehensive bilateral free trade agreements, which are second-best but make some important progress pending a multilateral deal and are designed to contribute to further liberalisation at the multilateral level. The EU has recently signed a free trade agreement with Korea and negotiations are well advanced with Canada. Least developed countries are granted duty- and quota-free access under the Everything But Arms (EBA) initiative in the framework of

the EU's Generalised System of Preferences (GSP). Other developing countries benefit from preferences under the overall GSP, and further preferences under GSP+. More flexible rules of origin for products imported under GSP countries were introduced in 2011. The relaxations cover all goods and are particularly significant for products processed in the least developed countries.

A significant reduction of trade distorting agricultural support in the EU has already taken place over the past decade through successive reforms, constituting an important contribution of the EU to multilateral trade negotiations. Further reduction in protection of the EU agricultural sector that may result from a successful WTO Doha Round would yield benefits in terms of prices for consumers. This may also impact the productivity of the agricultural sector. The efficiency of the Common Agricultural Policy (CAP) has improved over the past decade as payments have become increasingly decoupled from production (OECD, 2009a; OECD, 2011d; OECD, 2011e). However, imports of agricultural products remain lower than for many other goods. Reforms of the CAP have focused on reducing export subsidies and trade-distorting domestic support, but average MFN agricultural tariffs remain relatively high at 15%. Total support remains considerable in both absolute and relative terms. OECD indicators of support show that market price support represents a declining share of transfers to producers, which has fallen from 87% in 1986 to 15% of transfers in 2010. In the period 2008 to 2010, the level of support to producers was reduced to 22% of gross farm receipts compared to 39% in the period 1986 to 1988. The EU has also reduced the forms of support that most distort production (Figure 5). The level of price distortions has been significantly reduced, while the share of payments granted with no requirement to produce has increased. As payments have become increasingly decoupled from production, the CAP has come closer to being a system for delivering public goods and responding to a set of other rural and environmental objectives. However, efforts should be made to better target support to specific objectives: for example, around three-quarters of CAP funding is allocated to direct income support without any conditions on farm income, while direct payments are only linked through cross-compliance instruments to environmental and other production standards objectives (OECD, 2011a).

Figure 5. **Producer support estimate**

Share of most distorting support in percentage of gross farm receipts[1]



1. Most distorting support: price- and production-linked support measures that increase commodity production the most above the market equilibrium level.

Source: OECD (2011), *PSE/CSE Database*.

StatLink http://dx.doi.org/10.1787/888932590114

The combination of high world food prices, which boosts farm earning power, and the need for fiscal consolidation, creates a window of opportunity for reform. Current proposals from the Commission would introduce a new system of direct payments which would change the distribution within and between countries with little impact on production and trade (EC, 2011c; EC, 2010). However, the CAP post-2013 agenda should make efforts to shift the focus away from direct support payments and towards further improving the spending efficiency under CAP and contribute to improving productivity and profitability in the agricultural sector (OECD, 2011a). Single payments remain skewed towards relatively large and wealthy recipients. Furthermore, despite introducing innovation as a core element of reform and removing production quotas, under the current Commission proposals market deficiencies would remain. Market access to some products will still be restricted by very high quota tariffs, although opportunities exist for lower tariff rates via tariff rate quotas.

Box 3. **Main recommendations on trade and agriculture**

- Continue efforts to secure further multilateral trade liberalisation through the Doha round and, in the absence of agreement, continue to pursue bilateral and regional trade agreements while ensuring that these are trade-creating and supportive of broader trade and development goals.
- Continue to reduce trade barriers and distortions in agriculture in the context of broader trade measures.
- Pursue a far reaching reform of the CAP in the context of the 2014-20 framework to create a stronger link to environmental and productivity objectives. Move further away from unconditional direct income support and market measures.

Labour market reforms and removing barriers to intra-EU labour mobility would boost employment, growth and ease adjustments

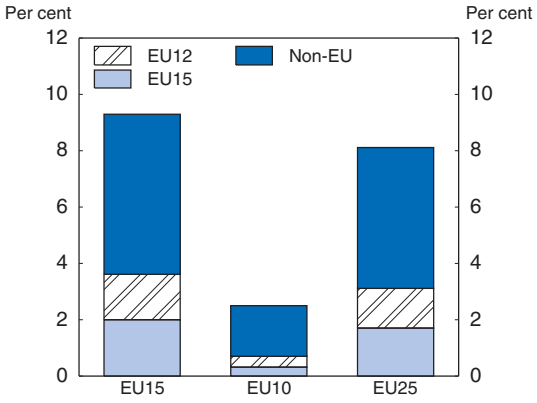
Boosting growth requires removing obstacles to employment. EU labour markets have structural weaknesses that hinder job creation. There are large imbalances of supply and demand of labour between and within countries. Overall employment rates are low due to modest participation rates and persistently high unemployment rates in some countries. Groups with weak attachment to the labour force, such as women, immigrants, older and younger workers are most affected, especially in Southern and Eastern Europe. In particular, youth unemployment in the EU rose to an unprecedented 21% in 2011, even though the size of the labour force is beginning to recede due to ageing. Many of the weaknesses in EU labour markets reflect the poor functioning of national labour market institutions, such as excessively strong employment protection legislation, labour market dualism, ineffective wage bargaining, and social protection or taxation systems that weaken incentives to work. The differences in policy settings across countries are reflected in a wide range of labour market performance. Labour market regulations and tax-benefit systems fall largely outside EU competences and require reforms at national level. However, removing obstacles to labour mobility within Europe and achieving a coherent framework for labour migration would help to make the labour market work better and require policy action at the EU level (Chapter 2).

Greater mobility between EU countries would help meet imbalances in demand and supply, as well as making it easier for workers and firms to make the right job matches.

Labour mobility in the EU remains low: only 3% of working-age EU citizens live in a different EU country (Figure 6). Indeed, migration from outside the EU is much larger than migration within the EU, accounting for around 5% of the working-age population, although this most likely partly reflects larger income differentials. EU enlargement has, however, resulted in a substantial increase in labour migration flows in Europe since 2004, despite many EU15 countries applying transitional restrictions on access to their labour markets. Migrants within Europe are on average substantially younger than the average worker. Moreover, many migrants are over-qualified for their jobs, reflecting among other things difficulties in obtaining recognition of professional qualifications in some areas.

Figure 6. **Share of foreigners[1] in working-age population**

2010 data



1. Foreigners are foreign nationals living in a country.
Source: Eurostat, *Migration Statistics* and *Labour Force Survey*.

StatLink http://dx.doi.org/10.1787/888932590133

Europe's linguistic and cultural diversity constitute an obstacle to labour mobility that is hard to avoid. But, there remain many administrative obstacles to mobility in the EU and legal rights under the Single Market are often not implemented in national laws or effectively enforced. Furthermore, the cost of migration for individuals is increased by policy-induced barriers to mobility, such as the loss of pension entitlements, differences in national regulations of professional qualifications, inaccessibility of some public sector jobs and housing market frictions. For pensions, people moving jobs between, and often even within, EU countries may lose part of the value of their existing rights. Indeed, long vesting periods can mean that no entitlement is received for shorter periods of work. Also, EU nationals often cannot contribute adequately to occupational and supplementary pension schemes in their home countries while working in another EU country. Efforts to promote pension mobility are hampered by the diversity of systems and the weak funding positions of many public and private schemes after the crisis, which could be further complicated if more workers could withdraw existing contributions. However, steps can be taken to improve the portability of public and private pension entitlements to avoid losses in pension value when moving between countries, including through shorter vesting periods and allowing workers to contribute for some time to schemes in a home country while working abroad. There remain risks of double taxation for pensioners and discriminatory treatment of cross-border transfers of pension capital, which should be removed.

Difficulties linked to the efficiency of professional recognition procedures reduce incentives to move. Automatic recognition applies only to seven out of more than 800 professions. However, mutual recognition is now at the heart of ensuring recognition in other professions, which allows professionals to obtain the recognition of their qualifications. At the same time, it gives some leeway to countries to ensure that the qualifications correspond to national requirements. Between 2007 and 2010 and for all professions, more than 90% of professionals requesting the recognition of their qualifications in another country received a positive decision, although the number of applications was only around 25 000 per year on average. In contradiction to existing EU legislation and ECJ rulings, EU nationals or other citizens are often excluded explicitly or implicitly from public sector jobs. Workers trying to get a job in the public sector face problems with the recognition of professional experience and seniority, recognition of professional qualifications, and disproportionate language requirements. Large housing transaction costs, particularly in some continental and southern European countries, make it harder for owner-occupiers to move to other countries, while other housing rigidities can also make it hard for renters, who tend to be young, to move. Better information about job vacancies in other countries or regions would facilitate migration. Information sharing should be improved, mainly through co-operation between national employment agencies and by upgrading the EURES system. Removing these obstacles would help workers to find jobs and make it easier for firms to recruit from outside their locality, both within the same country and elsewhere in Europe.

An EU-level immigration policy could ease skill shortages due to demographic changes

Immigration from outside the EU has a larger impact on labour markets in European countries than migration within the EU. Twenty-seven million foreign-born immigrants live in the European Union. Most of them live in the EU15 countries, although good growth performance is turning some EU10 countries into destinations for non-EU immigrants even if overall numbers still remain low. Although net inward migration rates are positive for most EU countries, emigration rates from European countries are substantial in some cases, particularly for high-skilled workers. For Ireland, Italy or the United Kingdom, the outflows of their own high-skilled citizens broadly cancel out the inflow of skilled workers.

With demographic changes underway, most EU countries expect growing shortages of skilled labour or workers in specialised activities. In principle, labour market shortages should be reduced mainly through increasing labour participation and the employment rates of women, young and older workers and immigrants already living in the country. In addition, education and training should be improved to make sure that they match skills requirements by employers. Policies at the EU level should be developed to ensure that migration responds more directly to labour shortages, particularly for specific types of high-skilled workers. Managing labour flows at the EU level is important to attracting high-skilled migrants because of the sensitivity of their choice of location to obstacles such as the still fragmented nature of EU labour markets. The recent Blue Card – an EU-wide work permit, allowing high-skilled non-EU citizens to work and live in the EU – should be used effectively in order to make it more attractive to high-skilled workers.

Box 4. **Main recommendations on mobility and immigration**

- Improve portability of public and private pension entitlements to avoid losses in pension value when moving between countries. Pension reforms should be designed with a view to facilitating movements both between employers and across borders. As proposed by the Commission, a vesting period of no more than one year across the EU should be ensured when transferring into pension schemes across borders. Allow workers to pay into occupational and supplementary pension schemes in their home countries while working in another EU country.
- Eliminate double taxation of cross-border pension benefits and discriminatory taxation of cross-border transfers of pension capital.
- Develop recognition mechanisms aiming to ensure more automaticity in the recognition of professional qualifications.
- Open public sector employment as far as possible to all EU citizens in national laws and procedures. Public sector employment practices should facilitate labour mobility, including through recognition of seniority and qualifications acquired in other countries.
- Pursue a reform of EURES enabling greater European mobility, and enhancing placement and matching between labour supply and demand. The EURES network and portal should be upgraded, and co-operation and information-sharing between national employment services should be improved.
- Policies at the EU level need to be developed to ensure that migration responds to labour needs, such as expected shortfalls in labour supply and skill shortages.
- Use the Blue Card scheme effectively to make it more attractive to high-skilled workers.

Regional policy can contribute more to growth

EU cohesion policy has contributed to raising economic performance in regions by promoting economic convergence and helping to reduce disparities in living standards. The objectives of EU regional policy have moved increasingly from providing transfers to poorer regions to supporting endogenous growth with a primary focus on small and medium enterprises (SMEs), the environment, innovation, infrastructure and R&D. Achieving these objectives with a budget of less than 0.5% of EU GDP is difficult, although cohesion funds can amount to a much greater share of GDP in some of the poorer recipient regions and are one of the main sources of investment in some cases during the fiscal consolidation efforts. The record of EU cohesion policy so far is somewhat mixed: regional disparities have been falling at the EU27 level since 2000 (EC, 2011d), but not all lagging regions have been able to boost their performance. The challenge is to get the maximum benefit from the available funds by making sure countries focus on activities that support productive investment and growth. Achieving this has been a long standing problem. Currently, further concrete reforms are being debated for the next financial framework (EC, 2011a). Previous trends to decentralise the management of cohesion funds may get reversed, by attaching conditionality requirements to the use of cohesion funds – supported by more and better indicators of policy impact – and reducing the freedom of EU countries and regions to decide where to spend funds. *Ex ante* conditions, based on previous project performance, could target the key weaknesses in implementation that have often led to ineffective use of funds in the past. Administrative burdens associated with cohesion funds for countries and regions should be further lowered (OECD, 2007).

Box 5. **Main recommendation on regional policy**

- Attach *ex ante* conditions to the use of cohesion funds without creating an additional layer of bureaucracy. These should target the key weaknesses in past implementation.
- Further lower administrative burdens associated with cohesion funds for countries and regions.

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Chapter 1

A Single Market for Europe

The creation of a more integrated Single Market is one of the EU's main policy levers to boost growth and job creation. Despite major progress with integration of EU goods and services markets over the past decades in terms of cross-border trade, it remains lower than within the United States. In recent years, trade has increased mainly from Central and Eastern Europe, while intra-EU15 cross-border economic activity has stalled and some of the progress of financial integration over the past decade now appears to have been unsustainable.

The remaining fragmentation of the Single Market prevents Europe from fulfilling its full growth potential and important gains in terms of scale and competition. Product market regulations at national level and their diversity are key obstacles to a more effective Single Market. Many of the institutions and regulations that govern and facilitate integration among EU countries are still organised on national lines. While enormous progress has been made over past decades in building the Single Market, including the landmark Services Directive, weak implementation of the framework has undermined its effects on growth.

A step change is required in the priority devoted to achieving a true Single Market in Europe. This should include better identification and more rapid adoption of policies required to make markets more integrated, as well as better implementation and stronger enforcement of Single Market requirements. Product market regulations at national level should be more friendly to cross-border activities. The Single Market needs more effective basic economic institutions for cross-border activity in areas such as taxation, competition policy and patent protection. Specific measures are needed to ensure that there is more cross-border competition and integration in some sectors, particularly network industries such as telecommunication, energy and transport.

The crisis and the weak long-term growth outlook in Europe need to be tackled through ambitious structural reforms to raise the performance of the economy. At the EU level, one of the main opportunities is the creation of a more integrated European economy through the Single Market. Despite substantial progress over many decades, many EU markets remain fragmented and integration has advanced only slowly. This reflects some inherent barriers to trade, but also insufficient progress in removing policy barriers to cross-border economic activity and widespread remaining differences in basic economic institutions across countries. A range of major reforms aimed at creating a real Single Market would bring major benefits to European consumers, workers and businesses and create a wide range of new opportunities. This would raise living standards, improve economic stability and help the economy return to sustainable growth.

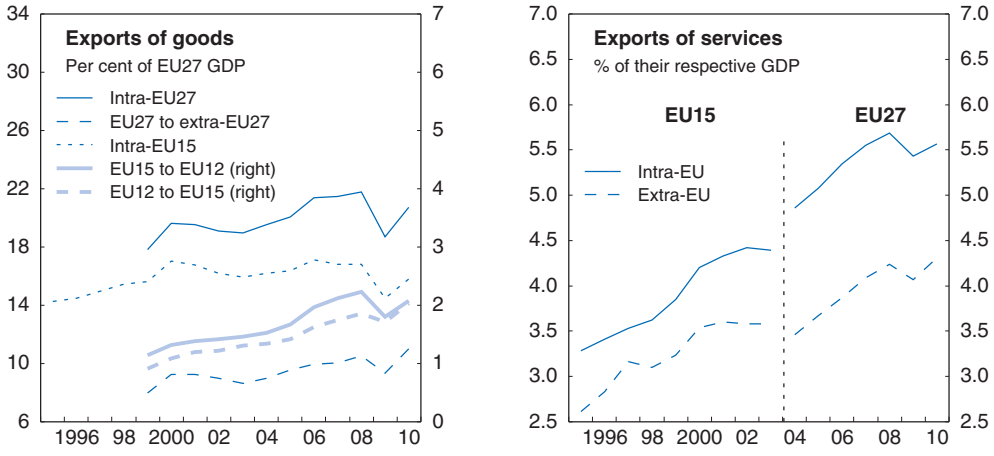
The first section of the chapter sets out how integrated the goods, services and capital markets of EU countries have become. Labour mobility is considered in Chapter 2. The second section considers the costs of an incomplete Single Market and the main barriers to a more integrated and larger economy. The third section considers the effectiveness of policy measures being taken to complete the Single Market, including the landmark Services Directive and the Commission's 2011 "Single Market Act" Communication. The fourth section considers the need for a more unified set of basic economic institutions as the framework to support the development of cross-border activities. The final section sets out measures that are needed to boost cross-border competition in some specific markets, including public procurement and network industries.

How far is the Single Market a single market?

EU economies gain from a high degree of integration in terms of cross-border trade. The share of goods and services exports in GDP is above 40% of GDP for the European Union, well above the trade shares of other major OECD economies. A large majority of this trade occurs within the EU itself, with extra-area trade lower than in other large OECD countries: intra-EU exports account for around 26% of EU GDP compared with 15% for extra-EU transactions (Figure 1.1). From an economic perspective, trade in intermediate goods is a useful indicator of how integrated production processes are across borders. It reveals the amount of trade that is driven by reducing production costs, rather than satisfying diverse preferences for consumption. In the machinery and equipment sector, around half of all intermediate and final consumption of goods is sourced from other EU countries with only a tenth from outside the EU.[1]

Although the process of trade integration within the EU is well advanced, further progress has stalled in many areas in recent years. Over the past decade, the share of intra-EU trade in goods as a share of GDP has remained roughly unchanged, while goods trade within the EU15 has declined somewhat as share of activity. This performance is all the more striking against the rapid growth of trade at the global level and growing trade with countries outside Europe. Trade volumes have yet to recover to their pre-financial crisis

Figure 1.1. **Exports of goods and services**



Source: Eurostat.

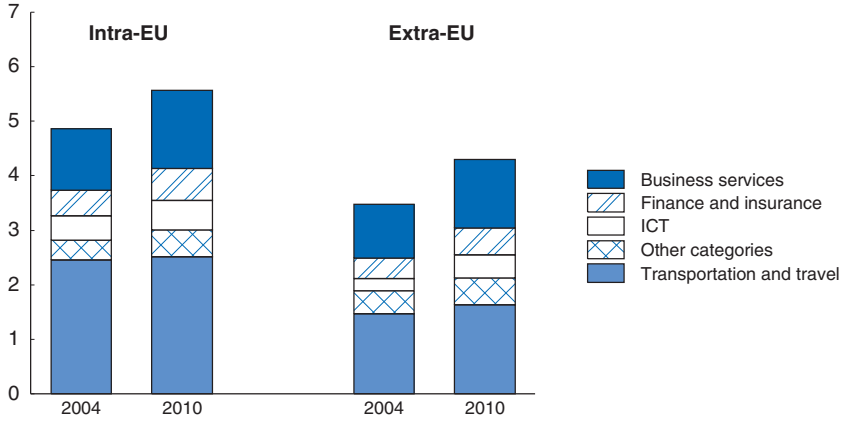
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levels and there is a risk that trade integration could be impaired in a lasting way if firms have to exit foreign markets or inappropriate policies are pursued. A major exception to this trend of the past decade has been the rapid growth of goods exports to and from Central and Eastern Europe, encouraged by EU accession and large differences in factor costs. These trade flows have increased by almost 30% in volume terms over the past decade.

Trade integration in services remains far lower than for goods, accounting for only around one quarter of intra-EU trade. Measured in terms of imports as a share of value-added in each sector, the degree of integration for the services sector is even lower relative to goods because the sector as a whole is much larger. Over a long period of time, the trend growth of trade in services within the EU has considerably outpaced GDP (Figure 1.2). The rapid growth of intra-EU trade in services is encouraging, but it is barely in line with global trends towards larger cross-border flows of services. The similarity of the trend within the

Figure 1.2. **Composition of services exports**

Per cent of GDP



Source: Eurostat.

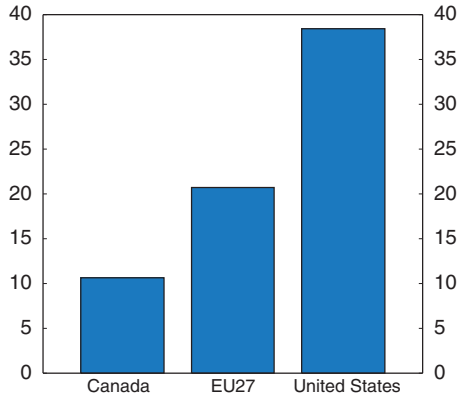
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EU to global trends suggests that there is little by way of EU-specific growth in trade in services. Over the past decade, a large part of the increase in services trade was driven by contributions from business services, finance and transport. Given the distorting effects of the credit cycle on these activities, growth in services trade may be weaker and start from a lower level following the crisis.

A high level of trade integration in Europe could be expected, even in the absence of Single Market policies because EU countries are geographically close to each other and many national economies are small. However, the consensus of model-based empirical analyses strongly supports there being additional trade as a result of the Single Market and that these gains are larger for the European Union than for free trade areas such as ASEAN, MERCOSUR and NAFTA (Bosquet and Boulhol, 2009). Despite this, intra-EU trade in manufactures remains much lower than interstate trade within the United States, although it is higher than in Canada (Figure 1.3). Based on a comparison of the share of domestic goods over total consumption, the "home bias" in trade in product markets in the European Union appears to be far greater than in the United States, even taking into account the role of the distance between markets (Delgado, 2006).

Figure 1.3. **Inter-state trade in manufactured goods**

Per cent of GDP, 2010 or latest available data



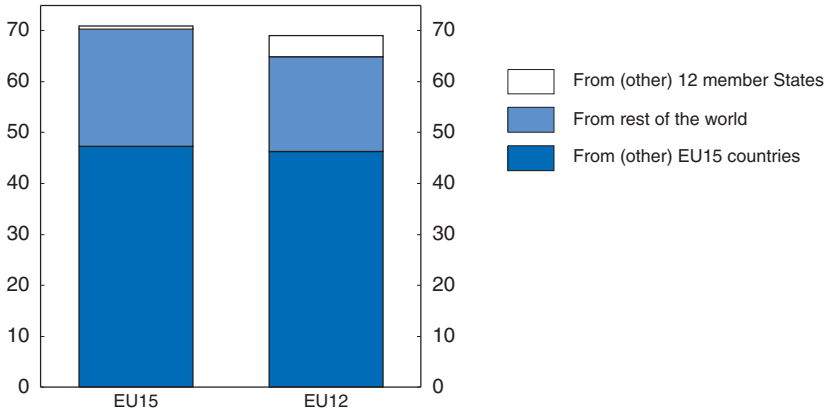
Source: Eurostat; US Bureau of Transportation Statistics, *Commodity Flow Survey 2007*; Statistics Canada, *Interprovincial Trade Flows*.

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The mobility of capital and labour can contribute to better economic performance in the same way that trade in goods and services do. Movements of finance and people can contribute to cross-border economic integration and help achieve a similar efficient allocation of economic resources and use of the opportunities. In countries where capital is scarce, flows of financing and the relocation of production to the domestic market can be equivalent to imports of capital-intensive goods. Many of the characteristics of foreign-produced goods can just as well be made available through implantation of foreign firms as through imports. Firms investing in other countries or establishing themselves abroad are a key part of the integrated economic space. Foreign direct investment (FDI) amounts to a large share of GDP and capital stocks in both EU15 and EU12 countries (Figure 1.4). Around two-thirds of FDI in EU15 countries comes from other EU15 countries, and investors from Western Europe account for a large majority of foreign investments in Central and Eastern Europe. Cross-border investment is likely to bring important knowledge and

Figure 1.4. **Inward foreign direct investment in EU countries**

Per cent of GDP, 2009



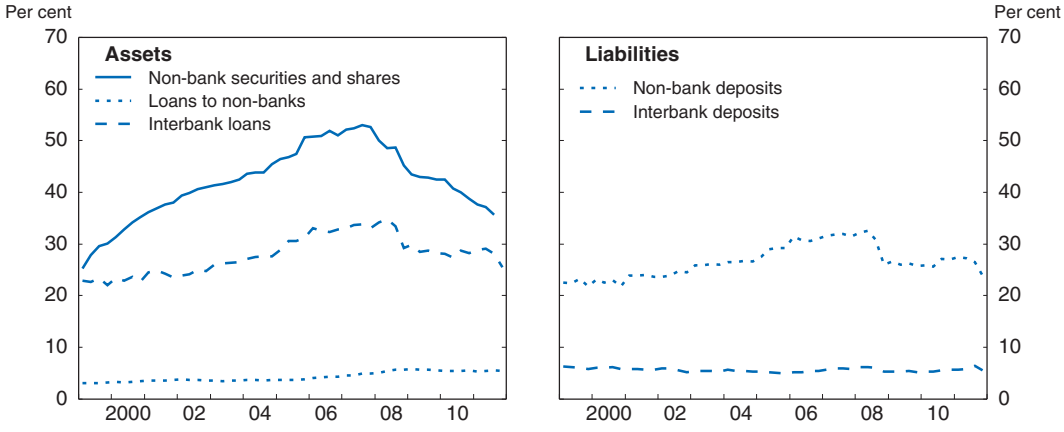
Source: Eurostat.

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productivity spillovers to the wider economy. FDI across EU borders rose rapidly during the five years up to 2006, from 30% to 48% of GDP. However, there is a risk that such activity may be reduced as a result of the financial crisis and the wider rebalancing of capital flows within Europe, as set out in the *Economic Survey of the Euro Area*.

Financial integration advanced rapidly over the past 20 years as markets were liberalised and financial innovation took advantage of the opportunities created by the Single Market. However, cross-border financial activity has fallen particularly sharply since the crisis (Figure 1.5). This suggests that some of the gains in financial integration over the past decade may have been unsustainable, stemming from the global credit cycle rather than from long-term integration of the European financial system. While cross-border financial integration is likely to resume as the financial system recovers from the crisis, some of the loss of cross-border activity since 2008 is likely to be permanent given that earlier cross-border activity was in part driven by excessive and unsustainable risk-taking.

Figure 1.5. **Cross-border provision of financial services in the euro area**[1]



1. Cross-border activity as a percentage of the total provision of financial services in the euro area.

Source: ECB (2010), *Financial integration in Europe*, April, updated with online data.

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Market integration reached high levels in parts of the wholesale banking system, encouraged by the single currency as well as the development of the EU regulatory framework for financial services. However, integration at the retail level has remained weak: households and most firms are still largely served by domestic institutions (Barnes *et al.*, 2010). This patchy form of integration created inherent risks and is likely to have contributed to the retrenchment of banks on national lines, encouraged by national systems of bank support during the crisis (see *Economic Survey of the Euro Area*).

The Single Market framework has contributed to economic integration

The process of the creation of a single European market has made huge progress in deepening cross-border economic integration. Since the Treaty of Rome, through to the 1992 Single Market programme and more recently, an extensive legal framework has been put in place to ensure that cross-border economic activity is allowed to flourish. The core legal framework established freedom of movement for goods, services, capital and workers. Laws and extensive case law have largely removed explicit regulations that discriminated by nationality or by unnecessary residency requirements. More widely, the EU applies the basic regulatory standards necessary to underpin efficient economic activity across the Union through common rules on food and consumer goods and labelling, mechanisms to avoid inconsistencies in cross-border taxation, consumer rights and advertising standards (OECD, 2007). At the same time, EU competition policy and state aid rules ensure a level playing field between firms operating in the Single Market.

Rigorous application of these standards during the crisis helped to avoid an unravelling of the level playing field that could have occurred as the weak economy increased the temptation to cede to protectionist pressures (EC, 2011c). For the non-financial sector, a temporary framework was put in place to manage the crisis lasting to the end of 2011. This included raising the "de minimus" threshold for aid being deemed not to distort competition from EUR 200 000 to EUR 500 000. Around EUR 21 billion (less than 0.2% of GDP) of state aids were committed, although take up was ultimately much lower. The financial sector itself posed special challenges given the need to react quickly to circumstances and the potentially systemic impact of the treatment of some institutions. The Commission was able to deal with these cases rapidly and put in place a system of principles setting out the approach. The principles imply that, following a rescue, there is a six-month restructuring phase to bring the institution back to a position of viability, ensuring that sufficient costs are carried by the shareholders (including through divestment and suspending dividends) and that competition is safeguarded, including through preventing acquisitions by supported firms and other measures. The Commission, as competition authority, has played a useful role in keeping markets open and fair during the crisis.

Deeper integration would have a large impact on growth and living standards

The remaining fragmentation of the Single Market holds back economic performance

The remaining fragmentation of today's Single Market prevents the European economy from fulfilling its economic potential. Economic theory suggests that there would be large benefits in terms of productivity and consumer welfare from greater market integration. *Firstly*, deeper market integration would allow the full benefits of comparative advantage to be achieved with each economy specialising in the goods that it is best placed to produce and overall production being efficiently allocated across the European Union.

Secondly, a better integrated Single Market would increase competition between firms in different countries, putting downward pressure on margins, encouraging firms to raise the quality of products and to invest in innovation. *Thirdly*, consumers would benefit from the greater choice of goods available at lower cost. *Fourthly*, by lowering production costs and encouraging firms to be more efficient, an integrated market would help to raise the competitiveness of European products on world markets.

The limitations of the current state of integration are well illustrated by the telecommunications sector. This is a sector where market liberalisation is relatively advanced, and where prices have been falling and there has been strong innovation. However, price disparities within the EU are still large and widespread (Pelkmans and Renda, 2011). The difference in telecommunications prices for businesses across EU countries contrasts with almost identical costs, for example, in California and New York State. At the same time, the penetration and performance of broadband services varies widely across EU countries. In a truly integrated and competitive market, prices would have largely converged to those of the lowest and new technologies would be available everywhere.

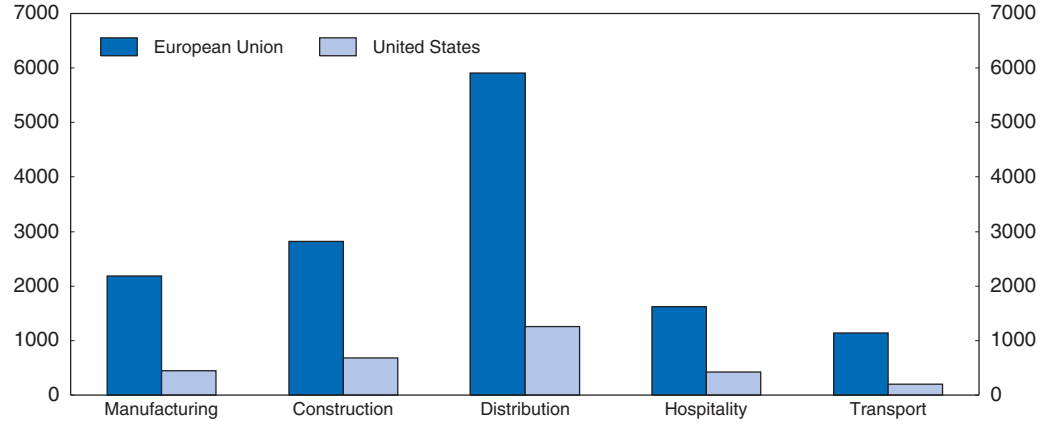
The costs of trade and capital market fragmentation in terms of productivity and growth are hard to assess, but are likely to be substantial. The major difficulty in terms of identifying the gains is assessing the counterfactual of how integrated EU economies would be if the right policies were pursued, taking into account inherent obstacles including distance, language barriers, culture differences and slow adjustment of historical patterns of economic organisation. Furthermore, the benefits of the Single Market have a network property in that their value depends on the degree of compliance across the system as a whole. Very limited empirical evaluation of the benefits of the Single Market and the potential gains from further integration has been carried out in recent years. The main recent assessment concluded that the first two decades of the Single Market raised EU GDP by 2% and boosted employment by 1.5% (Ilkovitz *et al.*, 2007), well below what had been hoped for at the time. However, this estimate is based on taking the results from a small number of limited microeconomic studies and drawing their implications through a standard large-scale macroeconomic model, and is therefore likely to be very imprecise.

The failure to fully exploit the potential economies of scale of an internal market of 500 million people may be one of the main costs of the Single Market. Many products and services are still largely provided along national lines, even though the median market has a population below 10 million. The lack of scale in European businesses is reflected in the large number of enterprises (Figure 1.6): the overall number of firms in the European Union is far larger than in the United States, despite a much smaller difference in the relative size of the two economies. This gap with the United States is apparent across many sectors, including manufacturing and key services sectors. While small firms play an important role in the economy, the very large number of firms is likely to have contributed to low productivity and weak innovation and investment: low investment in capital and low productivity growth in distributive trades and business services have driven a slowdown in productivity growth in Europe (Timmer *et al.*, 2011).

The degree of price convergence gives an alternative perspective on how welfare gains from economic integration have been realised. This measure can be difficult to interpret because of developments in relative living standards and economic catch-up: price convergence has continued in the EU as a whole over the past decade but this has largely

Figure 1.6. **Number of enterprises by sector**

Thousands, 2006

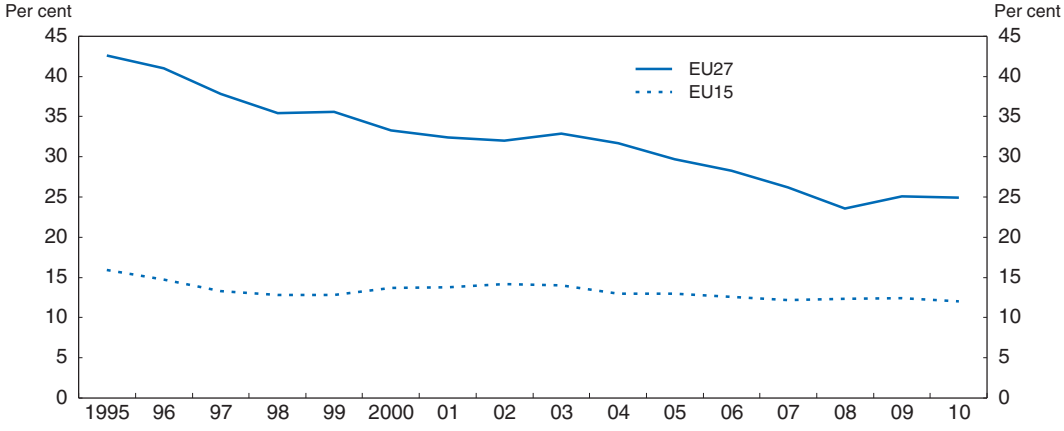


Source: OECD, *Structural Business Statistics Database*.

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been driven by the catch-up of prices in EU12 countries towards EU15 levels (Figure 1.7). Nevertheless, for the EU as a whole, price differences remain wide and price convergence within the EU15 over the past decade has been very limited. Consumers are facing different prices for the same goods in different countries and are missing the benefits of purchasing at lower prices. Price differences are likely to remain far larger than within the United States (Rogers, 2002).

Figure 1.7. **Price convergence indicator**[1]



1. Coefficient of variation of comparative price level index for final household consumption.

Source: Eurostat.

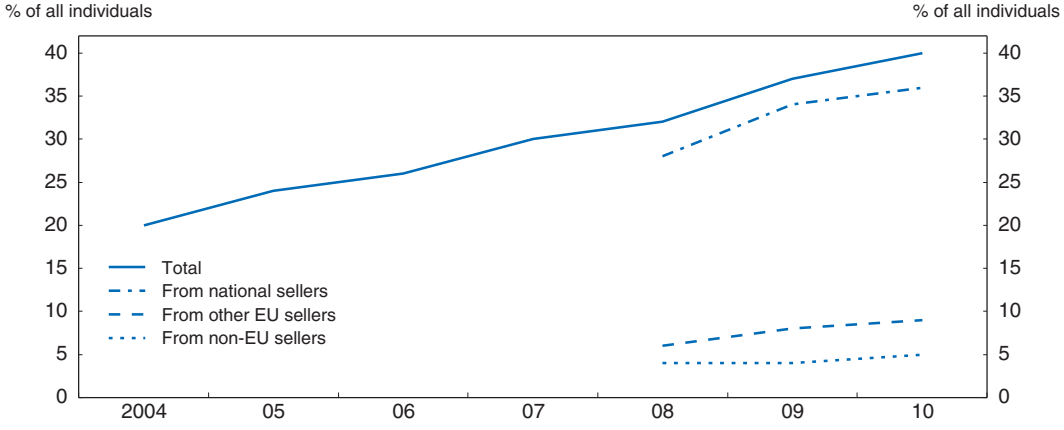
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Many obstacles remain to achieving a fully integrated Single Market

Many of the obstacles to creating an integrated and efficient European market reflect inherent features of the European economic landscape such as physical distance, differences in language and culture. The broad pattern of integration in the economy mirrors these features: integration tends to be lower in those parts of the services sectors where physical proximity between the client and the supplier is important and goods are

less standardised, depending more on the reputation of the provider. Activities that tend to be dominated by smaller businesses are typically less integrated given that many of the costs have a fixed element, which is more difficult for a small business to overcome than for a larger enterprise. All this may suggest that the EU has to work harder in some respects to achieve the same integration as other major economies, which for example do not present the same degree of language diversity. The impact of these inherent obstacles may be falling over time, for example, as new technologies such as the internet make communication easier and cheaper. Internet shopping provides an interesting case study (Figure 1.8). The internet should render geographic distance less relevant and the standardisation that web-based services brings should make it easier to overcome language barriers and other transactions costs. But, four times as many individuals use the internet to order goods and services from domestic providers than from vendors in other EU countries.[2] Survey evidence suggests that consumers are much more likely to trust domestic businesses and that concerns about fraud, delivery and redress in the event of problems were high with regard to cross-border internet shopping (EC, 2011a). This suggests that other factors are important alongside basic social and geographic structures.

Figure 1.8. **Internet purchases in the EU**[1]



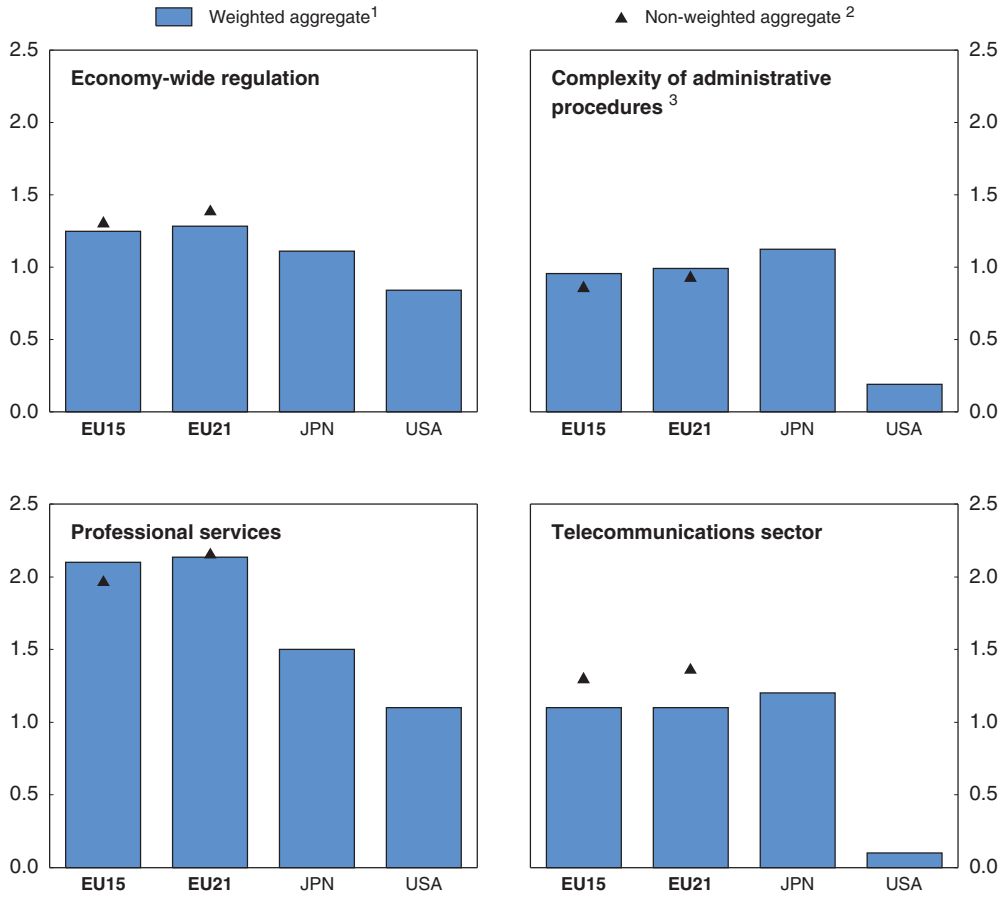
1. Individuals who ordered goods and services over the internet for private use in the last 12 months.
Source: Eurostat.

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National product market regulations can be excessive and the range of approaches creates barriers

The main policy obstacles to the development of more cross-border activities are product market regulations at national level. While these are not explicitly discriminatory by nationality or residency, the need to comply with different regulatory systems in different countries when entering local markets is a burden on the development of cross-border economic activity. The barriers to entry created by inappropriate regulation hinder the entry of foreign as well as domestic firms. The OECD indicators of product market regulation (PMR) indicate that, in some aspects and sectors, the average regulatory barriers in EU countries are high by OECD comparison (Figure 1.9). This suggests that the burden of regulation in Europe is higher than necessary and less favourable to competition and market entry than in the best performing OECD economies. This is a particular problem for

Figure 1.9. **Product market regulation**
Index scale of 0-6 from least to most restrictive, 2008



1. The aggregates EU15/EU21 were calculated using 2008 GDP weights.
2. The aggregates EU15/EU21 were calculated as simple average.
3. Covers complexity of government communication of rules and procedures, as well as of licences and permit systems.

Source: OECD, *Product Market Regulation Database* and *OECD Economic Outlook Database*.

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professional services, which are important for the economy as a whole because of the inputs they provide to other sectors. Many countries maintain a wide range of regulated professions, even if regulation of these activities is not considered necessary in some other EU countries. There is a clear link at the level of national economies between excessively tight regulation and economic performance (Bourlès *et al.*, 2010).

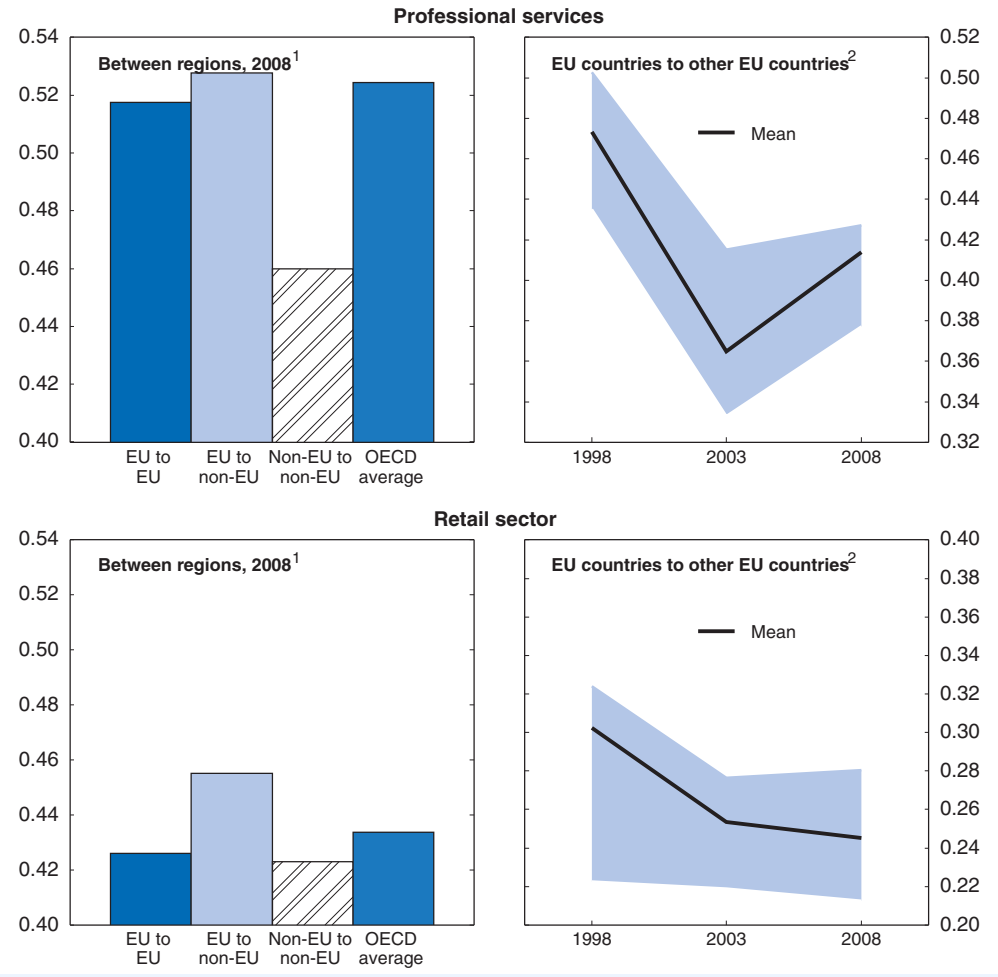
The diversity of regulations is likely to hinder the development of trade and cross-border establishment of firms, as well as the nature of the regulations themselves. Local specificities introduce transactions costs for a company looking to develop new business in another EU economy. Language barriers are likely to compound these costs. Indigenous firms gain a competitive advantage through understanding the local procedures. These obstacles are likely to be most binding on small and medium-sized companies that lack the capacity or the financial incentive to overcome the fixed regulatory costs of doing business in other countries. Analysis of bilateral trade in services shows that these differences in regulation have a negative impact on trade (Kox and Lejour, 2006). An indicator of

differences in product market regulations suggests that the diversity in regulations among EU countries is generally less than the differences between EU and non-EU countries (Box 1.1). For professional services, these differences are fairly closely related to the overall

Box 1.1. **Cross-country differences in product market regulation**

Restrictive product market regulations can be a barrier to new firms, including foreign companies, from entering a local market and to developing new activities. However, differences in regulations – not just their overall level – can be an obstacle to cross-border activity, especially for small and medium-sized enterprises for which the cost of complying with different sets of regulations is particularly burdensome. Based on the OECD system of indicators for product market regulation (PMR), an indicator of the differences in regulations in the retail sector and in professional services between countries can be derived based on whether this is a difference between a pair of countries in their response to the underlying surveys (Figure 1.10).*

Figure 1.10. **Indicators of differences in regulations**



1. Scaled from 0 to 1, where 0 indicates no differences and 1 no similarities.
2. The shaded area denotes the area between the 25th and 75th percentiles, GDP weighted.

Source: OECD, *Product Market Regulation Database* and OECD calculations.

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Box 1.1. **Cross-country differences in product market regulation** *(cont.)*

The professional services indicators cover the legal, accounting, engineering and architecture professions. Restrictions within the EU are less similar than between EU countries and other OECD countries and somewhat less similar than between OECD countries in general. Within the EU, differences in the regulation of professional services have declined since the mid-1990s. Italy, Luxembourg and Portugal have regulations for professional services that are most different from other European countries. Ireland, the Netherlands, Sweden and the United Kingdom have regulations that are likely to cause the fewest problems to outside entrepreneurs. Regulations tend to be more different from elsewhere in countries where they are also the strictest.

The differences in regulations in the retail sector have narrowed over time and are somewhat lower in the EU than between average OECD countries. Without weighting, the differences are still large and increasing over time for a number of countries. Denmark, Hungary, Ireland, Luxembourg and Portugal stand out as having relatively large differences with other countries in terms of their retail regulations. However, given that regulations are generally fairly strict across countries, some such as Sweden that have largely deregulated their retail sectors come across as being relatively different but in this case it is because they are more attractive as locations for cross-border business. There is not a clear positive correlation between the overall level of PMR and the level of differences in retail regulation in individual countries. In most EU countries, there is still significant scope for further deregulation in the retail sector, including relating to planning, and enforcing competition policy more vigorously.

* The method used is similar to the paper "The Effects of the Services Directive on Intra-EU Trade and FDI" by Kox and Lejour (2006). For the retail sector, the PMR data covers the years 1998, 2003 and 2008. For professional services, the PMR data cover the years 1996, 2003 and 2008. The analyses have been performed on available data, where all countries which are currently EU members are defined as EU members for the full analyses.

level of regulations, although this is less clear cut for the retail sector. Some countries, such as Greece and Portugal, partly isolated their domestic economies from the benefits of the Single Market through having sharply different policy settings in some areas, which led to some of the macroeconomic consequences discussed in the *Economic Survey of the Euro Area*.

A factor in creating an unfavourable environment for the development of cross-border activities is that many of the institutions that govern and facilitate the market economy in EU countries are insufficiently co-ordinated. Many aspects of the corporate governance, tax systems, financial oversight, consumer protection and economic regulation are still designed and operated at national level. Furthermore, much of the thinking about their functioning takes place in a national context. The diversity of regulatory situations is likely to lead to substantial transactions and information costs, both for cross-border trade and establishment in another EU country, compared with the situation in a unified system. Comparison with large federal economies shows that, almost by definition, all such economies allow for some differences in the economic institutions at the sub-federal level (Box 1.2). However, the gaps between EU countries appear to be greater in some areas, notably product market regulations, taxation and banking supervision. Given higher inherent barriers related to language and culture, Europe may need to make a stronger

Box 1.2. **Market institutions in large federal economies outside Europe**

Many large economies are organised along federal lines with responsibility for different parts of economic management allocated to different levels of the political system. In many areas, the economies of Australia, Canada and the United States are regulated on a more integrated and homogenous basis than across the states of the European Union. However, it is worth noting that some of the institutional features within these economies create similar obstacles to those in Europe. *OECD Economic Surveys* have highlighted the need to dismantle these barriers, such as residency-based policies affecting occupational mobility and provincial product market regulations in Canada (OECD, 2004).

Internal trade barriers. There are typically no explicit barriers to selling goods or providing services across state lines. Canada is an exception, where there are restrictions on selling certain goods (alcohol, and certain dairy and agricultural products). In Brazil, taxes are levied on interstate trade.

Taxation. There is usually a mix of federal and state taxes collected by the corresponding authorities. Canada has an unusual system as the federal administration collects taxes for both levels of government.

For state-level ***consumption taxes,*** sales to residents of states where the vendor does not have a presence are tax free with the customer expected to pay the sales tax in their state. This assumption is largely technical in some cases and non-compliance is likely to be widespread in countries such as the United States. By contrast, state sales taxes in Brazil are applied on an origin basis.

Market regulation. Product market regulations are usually determined at the federal level with some exceptions. This is the case in Australia and the United States, where state regulations apply only in very specific areas. In Canada, broader sectors are regulated at provincial level such as the electricity market, retailing and professional services.

Recognition of professional qualifications. There is a wide range of arrangements and qualifications are often not recognised across states. Many countries such as Australia, Canada and the United States are making efforts to achieve wider mutual recognition of qualifications.

Organisation of network industries. In Australia, there is a mix of federal and state funding for network industries and there is a tendency for regulation to be transferred from state to federal level (for example, for the electricity market and transport). US electricity networks are organised on a multi-state regional basis, while the system in Canada is essentially provincial.

Banking supervision. Supervision of banks takes place at national level in Australia, Canada and the United States. Other financial services, such as insurance, are in some cases also at national level, while in other countries these are subject to state level oversight.

effort than these federal economies in terms of the coherence of institutions across countries to achieve the same gains from a larger integrated economy.

EU policy to complete the Single Market is moving forward, but slowly

The Commission's "Single Market Act" (SMA) Communication of 2011, which sets out twelve legislative measures to boost growth, is the latest in a series of initiatives to reduce the remaining barriers (EC, 2011c). At the same time, incremental progress is continually

occurring as the existing legal framework is applied: competition and state aid decisions help to create a more level playing field, while infringement actions lead to a step-by-step implementation of outstanding legal requirement to complete the Single Market.

Box 1.3. **Milestones in the creation of the Single Market**

1956: The Treaty of Rome puts in place a common market through a customs union; eliminating quantitative restrictions on trade and measures with equivalent effect; and establishes freedom of movement of goods and services, employed persons and (to some extent) capital.

1970: Deadline for creation of the common market. While the customs union and removal of quotas were achieved alongside measures for free movement and introduction of VAT in all countries, incomplete progress was made in many other areas.

1985: The Commission White Paper sets out 300 legislative measures to remove all internal economic frontiers, using new legislative methods. This was implemented in the 1986 Single European Act (SEA).

1993: 90% of the targets for 1992 set out in the SEA had been approved including full liberalisation of capital markets, removal of border checks on goods and major progress on freedom of establishment and to provide services through harmonisation and mutual recognition.

1997: Action Plan for the Single Market, including a series of 62 actions with precise deadlines and six-monthly monitoring of progress.

1999: Strategy for Europe's Internal Market – a five-year plan of targeted measures with an additional review and further measures in 2003.

2000/01: E-Commerce and Copyright Directives.

2007: EU Services Directive aims to tackle barriers in a key sector through a range of measures to ensure that existing freedoms are effectively applied and to lower the regulatory burden.

2011: The Commission issues a "Single Market Act" Communication setting out twelve "growth levers" and corresponding legislative proposals.

The EU Services Directive is a major step forward but implementation has been slow

The most recent landmark legislative step in completing the Single Market is the EU Services Directive, passed in December 2006 and due to be implemented fully by the end of 2009 (OECD, 2007). The final Directive, which generated huge controversy during the legislative process, was less ambitious than the original proposal. The initial concept had at its core the application of the rules in the country of origin to three modes of service delivery: services provided from across the border, temporary movement of the service provider to another country to perform a service there and where the service recipient goes to another EU country to buy services there.[3] While this approach was considerably modified, the Services Directive nevertheless marked a significant step forward in removing barriers to services integration and clarifying the legal framework. The Directive does not cover all parts of the services sector, although the free movement provisions of

the EU Treaty does also apply in many of those areas.[4] The main elements of the Directive are:

- ***National requirements on incoming service providers must be non-discriminatory, necessary and proportional*** under the provision entitled "freedom to provide services". The standard of necessity is met only if the requirements are justified for reasons of public policy, public security, public health and protection of environment. This is narrower than the justifications accepted by the European Court of Justice in its case law on Article 56 of the Treaty.
- The ***requirement to ensure freedom of establishment*** is more clearly defined than in Article 49 of the Treaty. For example, national requirements cannot duplicate home requirements or discriminate against non-nationals. The Directive contains a "black" list of prohibited requirements and a "grey" list of requirements that have had to be evaluated by EU countries in terms of their compatibility with the principles of non-discrimination, necessity and proportionality.
- The ***regulatory burden*** is reduced by the adoption of the "silence is consent" rule, subject to some conditions. In addition, economic need or market demand tests were outlawed.[5]
- The ***administrative burden*** is eased by the creation of single points of contact ("one stop shops") for administrative formalities. Formal requirements such as presentation of original documents or certified translations should be limited to strict necessity. It should be possible to complete all formalities by electronic means and at a distance, except for the exceptional cases provided for in the Directive.
- A ***process for the review of national regulations*** through a mutual screening process is put in place. In addition, there is a review clause for the Commission to evaluate the Services Directive.

Passing the measures in "Single Market Act" would be a major step forward

The aim is for all "Single Market Act" measures to be legislated by the end of 2012. These measures span a wide range of policy areas (Table 1.1), including many long-standing issues such as greater tax harmonisation and patent protection. Adopting all these measures would be a significant step forward in terms of economic integration, although some measures would appear to offer little growth potential. The SMA relies heavily on new or revised Directives in key areas, which is a form for legislation that should provide the best guarantee of effective harmonisation.

To support the objective of a real Single Market in digital services, the EU Digital Agenda for Europe includes pan-European licensing for online rights management, strengthening EU data protection rights of consumers, updating the e-Signature directive, and ensuring interoperability of secure e-authentication systems. The gains from a Digital Single Market could be substantial, both in terms of increased productivity of the existing infrastructure and in terms of new large-scale investments. The opportunity cost of the lack of a Digital Single Market is estimated to be 4% of EU GDP (Copenhagen Economics, 2010a).

Single Market initiatives need to be more ambitious

While passing and implementing the measures set out in the "Single Market Act" Communication would be a major step forward, there are wider questions about whether the growth gains offered by greater economic integration are being pursued rapidly or vigorously enough. Building on earlier progress has become more difficult as the easiest

Table 1.1. **Key elements of the "Single Market Act" Communication**

Growth lever	Key action	Principal other legislative actions
Access to finance for SMEs	Legislation designed to make it easier for venture capital funds established in the EU to invest freely in other EU countries	Revision of market directives
Mobility for citizens	Legislation modernising the system for recognising professional qualifications	White Paper on pensions Reviews of IORPs directive
Intellectual property rights	Legislation setting up a unitary patent protection and a unified patent litigation system	Upgrading of systems for granting copyright and trademarks
Consumer empowerment	Legislation on Alternative Dispute Resolution	Revision of product safety directive Review of passenger rights measures
Services	Revision of the legislation on the European standardisation system to extend it to services and make standardisation procedures more effective, efficient and inclusive	
Networks	Energy and transport infrastructure legislation serving to identify and roll out strategic projects and to ensure interoperability and intermodality	White Paper "Roadmap to a Single European Transport Area" Radio spectrum policy programme
Digital single market	Legislation ensuring the mutual recognition of electronic identification and authentication and revision of the Directive on Electronic Signatures	
Social entrepreneurship	Legislation setting up a European framework for social investment funds	
Taxation	Review of Energy Tax Directive	Common consolidated corporate tax for business (CCCTB) Revised VAT system
Social cohesion	Legislation aimed at improving and reinforcing the transposition, implementation and enforcement in practice of the Posting of Workers Directive and legislation aimed at clarifying the exercise of the freedom of establishment and the freedom to provide services	
Business environment	Simplification of Accounting Directives	European Private Company Statute Optional EU contract law instrument Regulation on debt recovery
Public procurement	Revised and modernised public procurement legislative framework	

barriers have already been removed. Some of the measures in the SMA, including on taxation and intellectual property, have been discussed and even been subject to proposals from the Commission for many decades: such a delay is costly in terms of the economic opportunities foregone. This slow progress reflects a number of factors. A lack of political commitment on the side of the EU countries to achieving the Single Market reduces the progress that can be made. A number of elements in the SMA are not new but were already on the policy agenda and well advanced through the legislative process and were included in the SMA as they needed additional momentum.

A more innovative approach could be taken to streamline the decision-making process so that faster progress can be made. This must balance the ease of reaching agreement with ensuring effective regulation and a coherent approach across countries. The Lamfalussy process that has been used successfully in financial markets – opting for flexibility rather than prescriptive rules – could be applied more widely. The "new approach" applied to regulations in the goods market, based on legislation setting out only

essential requirements and allowing standard bodies to set up voluntary technical standards, should be applied more widely. The proposed extension of the standardisation process to the services sector would be a useful step in this direction (EC, 2011c), although it may take a long time to achieve progress through this approach. There remains scope to make greater use of the extension of comitology procedures in terms of delegating implementation powers to the Commission and giving a greater role to formalised networks of national regulatory authorities. The potential to make greater use of recommendations and opinions, as well as self-regulation and co-regulation instruments (such as Codes of Conduct) should be more systematically considered. Although some measures have been taken through this approach such as legislation on consumer access to basic bank accounts, its use has been rather limited.

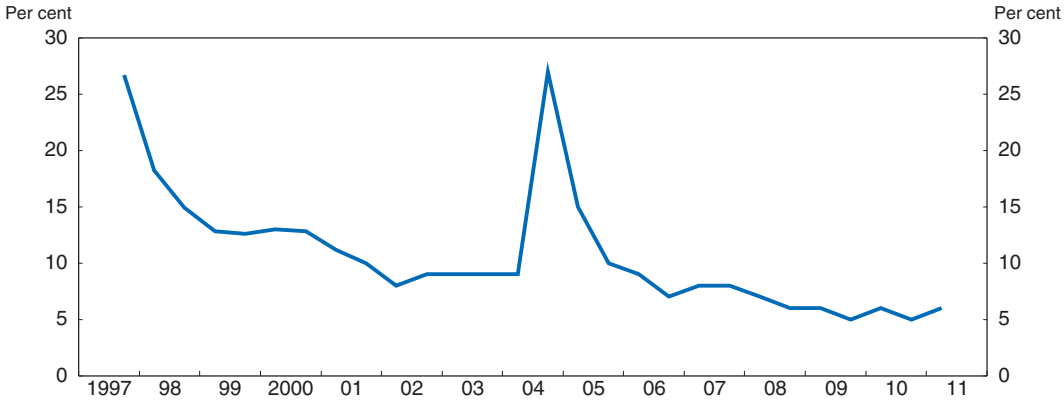
The political commitment to the Single Market could be boosted by a stronger analytical case for the gains from more market integration, including an even stronger *ex ante* analysis of the economic impact of new measures and more *ex post* evaluation of the gains from earlier initiatives and what can be learnt for future policy. The system of Regulatory Impact Assessment is highly developed and all initiatives with significant direct economic impacts in the SMA have been assessed. However, there could have been a deeper *ex ante* analysis of the economic impact of the package as a whole, taking into account the complementarities between reforms in different areas, and a better quantitative identification of the priorities. The *Monti Report* (Monti, 2010) provided useful insights and covered much of the same ground, but was qualitative in nature. Sectoral studies undertaken in relation to competition policy have also provided useful insights into required policy measures in some areas. There should be more systematic *ex post* evaluation of Single Market policies. From a political economy perspective, convincing analysis of the gains from the past measures would help to make the case in terms of growth gains for future policies. It would also help to learn lessons about the design of policies and to identify the outstanding priorities.

Better implementation is essential to making Single Market policies work

The chequered implementation of Single Market policies is a major obstacle to market integration. The first difficulty is to ensure that Directives are timely and accurately transposed into national law. Although EU law has led to a major shift in national regulation overall, in some cases EU law has not been transposed at all as required and implementation deadlines are sometimes ignored. This problem has been particularly acute in a small number of countries. This is likely to reflect a combination of ack of political will and weak administrative capacity. The ultimate responsibility for this failure rests with the relevant national authorities. However, there should be a greater willingness by other EU countries and the Commission to tackle in a timely way the lack of transposition of EU directives. Overall, the implementation as a share of directives due to be notified has improved over a long period of time but it has remained at a similar level over recent years (Figure 1.11). These statistics are somewhat difficult to interpret given variations in the number of measures outstanding, and no detailed breakdown by policy or sector is available. Significant progress has been made in Greece and Portugal in catching up with implementation obligations as a result of requirements under Economic Adjustment Programmes. EU funds and support should be used to help overcome weaknesses in administrative capacity, which hold back transposition. New legislation could more carefully take into account the technical ability of some countries to

Figure 1.11. **Non-transposed internal market directives**

Share of internal market directives due for notification but not notified[1]



1. As a percentage of all internal market directives, the 2004 spike being due to the initial effects of enlargement.
Source: European Commission, *Internal Market Scoreboard*, various issues, *http://ec.europa.eu/internal_market/score/index_en.htm*.

StatLink http://dx.doi.org/10.1787/888932590342

implement it given that some national administrations are very small or have limited administrative capacity.

Infringement procedures and complaints to the national authorities and EU bodies are the main legal and administrative recourse to enforce correct application of EU law. Private enforcement before national courts of EU rights, which flow from provisions of EU law that have direct effect (such as the EU antitrust rules), is also an important tool to ensure correct application of EU law. This legal approach can be used to challenge national legislation on a wide range of grounds, including cases of discrimination against non-residents and non-discriminatory rules: hinder cross-border activities; block competition; violate proportionality; duplicate home requirements; or go beyond what is strictly required to meet the stated objective. However, it is a slow, costly and difficult process to go through the courts to ensure that enforcement takes place. In particular, for individuals or firms, these barriers can be sufficient to prevent pursuing valid actions. In many countries, complaints can only be put forward by individuals or companies, rather than groups such as trade associations. As a country may replace a rule that has been found to be incompatible with the EU law with another, the process can be drawn out while the new rule is assessed. Judgements of the European Court of Justice apply directly only to the specific infringements in the country which is subject to the action, so ensuring compliance in several countries can be a painstaking process. The Commission should be more active in ensuring that possible infringements of EU law are challenged and if necessary taken to court, in part to overcome these collective action problems. The Commission in recent years has launched only a very small number of infringement procedures related to the Single Market. This in part reflects the 2008 "EU Pilot" project, which aims to improve co-operation between participating countries and the Commission in the application of EU law across all domains so that problems are clarified or resolved before formal infringement proceedings are undertaken. A large share of cases is resolved during this process and there has been a reduction in formal infringement procedures in countries taking part in the new process relative to those that did not (EC, 2011i). It is striking, however, how much remained to be done for example in Greece, as judged by the

measures included in the Adjustment Programme (OECD, 2011), given that in principle enforcement powers existed to ensure that the Single Market applied fully. There is a case for considering whether more rigorous political and economic sanctions could be used to support the enforcement process more widely, including for access to EU cohesion funds and other transfers through the EU budget.

There is a problem of lack of information as consumers and businesses do not know their rights and do not know where to turn for help where needed. In addition to these legal mechanisms, the SOLVIT on-line problem solving network is designed to deal with misapplication of internal market law by public authorities by ensuring that they understand the EU law correctly. It does not have legal powers. Although the caseload has risen rapidly, it remains tiny with fewer than 10 cases per million inhabitants (EC, 2011b) in most countries and extremely limited resources, having only a handful of staff in each country at most. The Commission also runs an internet portal, Your Europe, as a single gateway to further information and help on rights within the EU.

The implementation of the Services Directive is a central issue for enforcement of the Single Market. The legal transposition of the Directive has required wide-ranging reviews and changes to national laws: more than a thousand legal texts have been adopted at national level. Only seven countries had fully implemented the Directive by the deadline of end 2009. Only one country has not yet fully transposed the Directive. Monitoring the details of the implementation of the process has been a complex task, in which the Commission and EU countries have invested significant resources through monitoring, expert meetings and bilateral meetings between the Commission and individual countries. The Commission has submitted regular reports to the Council and the European Parliament, which in turn have made their own assessments of progress. More progress needs to be made in making the Services Directive apply in practice, particularly for the professional services.

An innovation in the Services Directive was a set of measures to improve enforcement on the ground:

- A **mutual evaluation process** by which EU countries have conducted a "peer review" of legal requirements imposed by national legislation on service providers in terms of establishment and cross-border provision with the aim of unblocking obstacles to the effective operation of the Services Directive. A common methodology for the reviews of 35 000 requirements was agreed in October 2009 and the evaluation undertaken during 2010. The process is viewed by the Commission as having led to a useful dialogue, encouraging the sharing of best practice, raising the profile of the Single Market in national administration, giving a detailed picture of the Single Market for services and identifying remaining obstacles. This has demonstrated the progress being made in streamlining the regulatory environment in the services sector at national level in the process of transposition of the Directive (EC, 2011d).
- **Points of single contact** have been created in all EU countries. However, many of the internet sites do not yet offer all the required services and many are only in the national language, reducing their usefulness to people in other countries. A further significant weakness of the points of single contact is that they still do not support widely enough the cross-border use of e-ID and e-signatures, which prevents users from other countries in many cases from completing procedures online. Efforts are continuing to encourage

the take up of technical solutions to enhance cross-border e-identification and e-signatures.

- The **Internal Market Information System** (IMI) links over 6 800 authorities with the aim of administrative co-operation. There were over 2 500 information exchanges in 2011, out of which 352 in the area of the Services Directive. This is still limited as compared with usage for professional qualifications, *inter alia* due to the fact that responsibilities in the area of services are very decentralised to regional and local levels within the national administrations. At these levels, the tradition of administrative co-operation is developing and it will take more time for this practice to be developed.

The enforcement of the Single Market is not just a legal question in a narrow sense but also about identifying the real barriers to cross-border integration. There is a need for much more active and systematic analysis by the Commission and national authorities of dysfunctions in the scope for cross-border economic activity. EU countries and the Commission should give this a higher priority in terms of the determination and allocation of resources. One possibility would be to publish a clear and concise report for each country on an annual basis, detailing both the state of enforcement of EU laws and barriers to the Single Market at EU level. For national authorities too, there should be a greater priority on ensuring that the benefits of the Single Market are being fully realised through ensuring that national rules do not present unnecessary obstacles. In addition, national competition authorities should be designed to work effectively. While national competition authorities are bound to enforce the EU Treaty with regard to competition under Council Regulation (EC) No. 1/2003 on the implementation of the rules on competition, greater priority could be given to ensuring that cross-border competition works effectively, which could be reflected in their mission statements.

More generally, encouraging national "ownership" of the Single Market and raising awareness about cross-border economic integration could help bring about the necessary reforms to domestic institutions and regulations. Many areas of economic activity are subject to sector-specific regulation involving specialised institutions, particularly in the network industries. Such regulators typically have a national remit and tend to focus on achieving national objectives, within the broader EU framework. The development of closer co-operation between national regulatory authorities in some sectors and more effective EU bodies to facilitate this process could help to overcome co-ordination problems and lack of trust between the competent authorities at national level, making it easier for economic activity to develop seamlessly across borders. Furthermore, such bodies could provide a useful forum to identify barriers and develop effective regulatory solutions and legislative ideas. By working more closely together, trust could be fostered between national bodies and the concept of reciprocity more easily applied.

The Single Market needs to move closer to a Single Rule Book

Moving to a more integrated and better functioning Single Market would require a much more similar set of basic economic institutions across countries, so that doing business across borders would be as close as possible to operating within one country. As argued above, many large federal economies already have a much more similar approach within their single markets and they already benefit from favourable conditions such as a common language. The basic features of the business environment in any country include regulations around corporate governance, product markets, competition policy and

intellectual property rights, in addition to the tax system. Within a coherent system, these should provide clear legal certainty, avoid excessive compliance costs and provide the structure for a well functioning market economy. While the EU is not constructed as a federal state and there are differences and inconsistencies in the business environment even within large federations, differences between national systems within the EU create large administrative costs, informational barriers and can lead to inefficient economic outcomes. Some multinational companies have to comply with local requirements in a large number of different EU countries, while smaller enterprises and consumers may be put off doing business or making purchases in other countries altogether.

A coherent and efficient approach to cross-border corporate taxation is needed

Free movement of capital and cross-border ownership are important instruments for generating growth within the Single Market. However, achieving these gains may be complicated by the operation of different national tax systems and their interaction. This creates the scope for high transactions costs and could distort some incentives in terms of trade and investment, although it may also promote some useful forms of competition. The administrative burden on firms may be increased by having to comply with different regimes and deal with different tax authorities. In the absence of a consolidated tax base, there can be differences from a tax perspective between setting up a new activity in the same country and doing so in a different EU state. For example, losses incurred in a subsidiary in another EU country cannot always be written down against the overall tax costs of the group as a whole. This could discourage firms from taking the risk of setting up businesses in other EU countries. There is a risk that resources could be misallocated from an EU perspective: given differences in tax rates and bases, the lack of consolidation can create an incentive for firms to locate activities where taxes are low to maximise post-tax profits rather than where the pre-tax returns would be highest. At the same time, the mobility of capital can reduce the effective burden of taxation on investment and provide good incentives to maintain efficient corporate tax regimes. In addition to possible efficiency effects, differences in tax regimes and their interaction can lead to a different distribution of tax bases across countries than would otherwise be the case. Some aspects of the potential difficulties related to cross-border corporate taxation have been dealt with: in particular, the risk of double taxation is largely eliminated through the almost complete set of bilateral double taxation agreements between EU27 countries. While developing a more coherent approach to cross-border corporate taxation is a complicated issue and taxation remains an issue of national competence, the interaction between the benefits and costs of different approaches needs to be considered further.

The Commission has made a proposal for a Common Consolidated Corporate Tax Base (CCCTB). This would introduce a common system for the computation of the tax base which companies could opt into for a number of years. Profits would be consolidated on an EU-wide basis and apportioned according to a formula based on three equally-weighted factors for the allocation of revenues (assets, labour and sales by destination). According to the Commission's analysis, this would significantly reduce the incentives for profit-shifting. Furthermore, any new incentives to artificially relocate the factors of the formula to low tax jurisdictions would be discouraged based on the fact that assets, labour and sales by destination reflect the real commercial activity of a company. Compared to arm's length separate accounting, the formula introduces a different way for attributing the tax base which looks at closely integrated groups as a whole and this is why it may in cases

appear to introduce a rough link between corporate taxes and employment and turnover. The optional CCCTB proposal is assessed by the Commission to have small welfare effects and a negative impact on investment and GDP in the framework of a computable general equilibrium model at least in the short term (EC, 2011g). At the same time, survey evidence presented in the Commission's evaluation report points to significant gains in terms of reduced tax-related compliance costs for firms operating across national borders, particularly in the case of parent companies establishing subsidiaries into new markets. For most countries, this specific proposal would widen the tax base. The Impact Assessment finds that half of non-financial multinational groups would gain by consolidating cross-border losses when opting into the regime. Different schemes for corporate tax harmonisation would have different advantages and drawbacks. The EU should thus consider putting in place a clear strategy to improve the functioning and efficiency of the corporate tax system inside the Single Market. To raise competition and lower costs, creating more similar tax regimes and simplifying tax administration for cross-border firms would lead to significant gains from lower on-going compliance costs, notably for smaller companies, and a reduction in the costs associated with setting up foreign subsidiaries leading to an increase in cross-border establishment. One of the advantages of the Commission proposal is that firms would only need to deal with a single tax authority. Any strategy to raise growth in the EU will need to manage the likely redistribution of tax revenues across countries and create incentives for countries to reach agreement.

The system of indirect taxation needs to be overhauled

The system of indirect taxation is an essential part of the infrastructure of the Single Market and raises almost a quarter of tax revenues in the EU. However, it has serious shortcomings and these weaknesses hold back the potential of the Single Market. *Firstly*, the complexity of the current system imposes a high administrative burden on firms and is likely to account for a high share of all business compliance costs. While this inefficiency is costly in itself, high transactions costs can be an important barrier to sourcing supplies in other EU countries or selling into other markets. This administrative cost and complexity is likely to affect smaller companies particularly severely, although small companies under established thresholds can opt to be exempted. Some administrative arrangements can impose cashflow costs for business, which have paid VAT and are waiting to claim it back. However, there is a clear need for tax administrations to conduct controls as this is a very high risk area. *Secondly*, differences in tax rates and exemptions can distort the allocation of resources and patterns of trade, creating inefficiency and holding back productivity. Fraud, such as missing trader or carousel fraud, appears to be taking place on a substantial scale, although few EU-wide estimates are available (Reckon, 2009). This may be lower than some forms of domestic fraud, such as underreporting, but the current EU system provides a large potential for fraudulent activity that could be reduced through improved design.

The current VAT system has been "transitional" since its creation in 1967 and has had the long-term objective to move to a system based on the "origin principle", under which VAT would be paid depending on where the product is made. However, the system has largely operated on a "destination" basis, whereby VAT on transactions between businesses is charged on the basis of the location of customers and VAT on inputs can be claimed back from the country where it was paid. The Commission has now concluded in the

Communication on the Future of VAT that the long aim of shifting to an "origin principle" is no longer realistic and future work is to be predicated on the destination principle. The Communication confirms that preparatory work has already begun on the measures needed for a modern destination-based system. For consumers, VAT is usually paid where the vendor is based, but there are some exceptions, such as for distance selling, e-commerce, telecoms and broadcasting, where the tax is paid or will be paid (by 2015) based on where the customer is located. For certain electronic goods, electricity and gas supply and certain services, the liability of the payment of VAT in business-to-business transactions has been shifted on the purchaser through a "reverse charge" system, and VAT is paid at the final stage when collected by the seller from the final consumer. This is a much simpler system, akin to a sales tax, but moves away from the fractioned payment system of VAT and could create a greater risk of fraud at the end of the chain**.** A key problem facing all these arrangements is the lack of physical frontiers in the EU, which makes it very difficult to track cross-border transactions accurately.

The Commission has set out proposals for reform in the December 2011 Communication. While the choice of model and design of the most effective scheme is a highly technical and in part administrative question, it is crucial that a coherent and effective system is put in place soon to support the good functioning of the Single Market, as well as to help address the fiscal consolidation needs set out in the *Economic Survey of the Euro Area*. After many decades of considering a wide variety of options, a definitive answer needs to be provided for the question of the long-term design of indirect taxation in the EU. Whatever solution is chosen, better administrative co-operation and information sharing between national authorities will be essential to improving the efficiency of the system. This calls for systematic and rigorous co-ordination to ensure that administrative procedures are as closely aligned and integrated as possible, while at the same time respecting the principles of subsidiarity, proportionality and sovereignty. In any system where some VAT revenues are collected by one national administration to be reapportioned to another, a high level of trust is required between national revenue agencies, as well as excellent information sharing, and all national agencies need to meet the same standards of administrative efficiency and rigour. The creation in 2010 of the Eurofisc network for swift exchange of targeted information and surveillance is a useful development, but remains well short of an integrated system for the smooth and robust administration of VAT in Europe. There is a case for establishing a stronger body at EU level to ensure information sharing, coherence in administrative procedures and the robustness of national tax collection.

Competition policy at the national level can do more to support the Single Market

Effective competition policy is a key part of a well functioning market economy and is important for ensuring that prices remain low, quality high, and that growth is encouraged through innovation and firm turnover. Competition policy at the EU level is well developed and the Commission plays an active role in policing mergers, competition and state aid. The main priorities of competition policy in recent years have been the ICT, energy, transport and financial services sectors. Enforcement actions have been pursued on interbank transaction fees and in the credit default swap market. Fines in 2010 exceeded EUR 3 billion. Sectoral analyses have been used to identify barriers to competition. For example, the sectoral inquiry into the gas market in 2007 (EC, 2007c) has led to a large number of cases and settlements for abuses of dominant position in the gas sector.

However, EU competition policy largely addresses economic behaviour that has an impact on the Single Market as a whole, rather than conditions that can prevent national economies fully benefitting from the Single Market. National competition authorities should play the main role in ensuring that competition is effective in each country and that the full benefits of market openness at the country level are being realised. Domestic authorities are well placed to analyse local barriers to the entry of firms from other EU countries and the main obstacles to competition. To that end, since 1 May 2004 national competition authorities have been empowered to apply the EU competition rules in full. The effectiveness of national competition authorities may vary between countries and should be brought up to a high standard in all cases, both to improve the functioning of the domestic economy but also to allow them to help ensure that the Single Market works on the ground. EU countries should equip their national competition authorities with all relevant legal powers and adequate resources to ensure effective enforcement of the competition rules. Appropriate priority should be given to applying EU competition rules and tackling wider obstacles to effective cross-border competition, which would strengthen competition in the domestic market. This could be encouraged by monitoring by the Commission.

A simpler EU patent regime would boost innovation

Growth-enhancing innovation is held back by the fragmented legal framework for intellectual property. The costs of obtaining and maintaining a patent in Europe are considerably higher than in Japan or the United States because of the fragmented patent system (OECD, 2009). This holds even without taking into account higher "post-grant costs" associated with enforcing patents in different jurisdictions or being unable to enforce protection in other countries. It would cost EUR 36 000 in fees to obtain protection in every EU country, even with the current so-called "European Patent", most of which is the cost of validation and translation (EUR 32 000), as, in general, this still requires the patent to be translated into the official language of most countries and validated by most countries separately with some exceptions where countries opt into the London Agreement. The European Commission has proposed enhanced co-operation on unitary patent protection, based on the existing system of European patents. Under the proposed system, once a European patent is granted by the European Patent Office, the patent holder would have the possibility to request a unitary effect for 25 EU member states participating in the enhanced co-operation, instead of validating the patent in each of them separately. Reducing the requirements, after a transitional period, to the translation of the claims to the three working languages of the European Patent Office would lead to huge savings. As a result, the post-grant costs of unitary patent protection would only reach EUR 2 500, which would fall after a transition period to EUR 700. This would make it easy for innovators to ensure that their intellectual property was preserved throughout the EU, increasing the incentive to innovate and to share ideas. However, the proposal is weakened because two countries, Italy and Spain which together account for more than a fifth of EU27 GDP, will not participate in this initiative, which has been undertaken under the provision of the Treaty that allows a group of EU member countries to advance alone. This is the first time that this provision has been used in connection with Single Market policies: given that the value of the Single Market depends on the "network" of countries that adhere to it, this development is of concern. In parallel, long-delayed proposals for a unified system of patent litigation have progressed, following rejection by the European

Court of Justice of the 2009 draft agreement on the European and EU Patents Court. This would put in place a unified Patent Court for the settlement of litigation related to the existing European patents and European patents with unitary effect.

Enhancing consumer protection would support cross-border sales

Effective consumer protection is important in its own right but also to underpin the confidence of customers in making transactions. Consumers' lack of confidence that their rights will be respected in other countries limits cross-border sales and the direct ability to benefit from the Single Market. The ECC network (ECC-Net) plays a role in this context, providing advice and assistance to individual consumers. The ECC-Net handles an increasing number of contacts (around 70 000 contacts a year), many of which are related to activities with a strong inherent cross-border component, such as travel and tourism (ECC-Net, 2011). However, awareness of the existence of the ECC-Net among consumers is low, although efforts are being made to increase it. Other measures are needed to strengthen the backstop for cross-border purchases and to reduce widespread variations in the quality of consumer protection across countries. Basic requirements for cross-border consumer protection are set out in Regulation 2006/2004 on Consumer Protection Cooperation. These requirements should be supported and further reinforced. The new European Commission Communication on e-commerce sets out a number of actions to improve conditions for cross-border online trade and enhance confidence, including online dispute resolution, better enforcement of EU legislation governing business-to-consumer (B2C) online transactions, and better information for consumer and businesses.

Targeted sector-specific measures policies are needed to open some markets fully

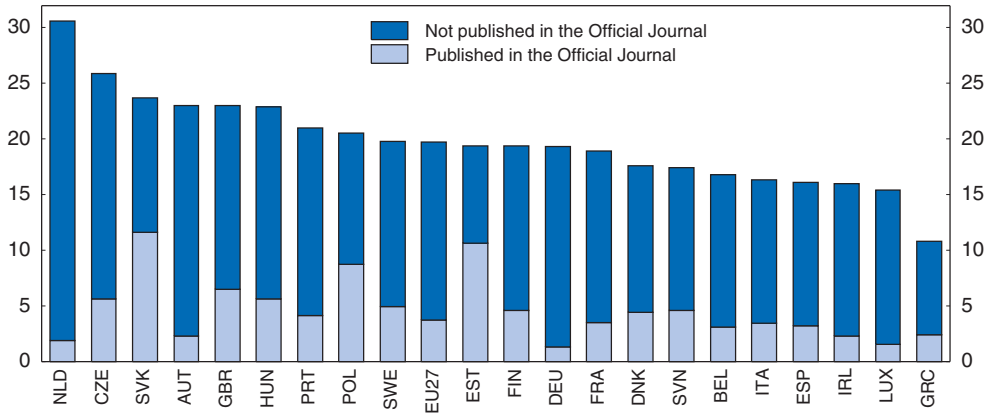
Sector-specific measures are required in some areas to ensure that obstacles to the Single Market and effective competition are removed. While the EU Services Directive is the main framework to increase competition in the services sector, specific measures are needed in some areas, notably government procurement and the network industries. These industries in Europe, such as energy, transport and telecommunications, are hindered by the fragmentation of national markets with an insufficient level of network interconnection and interoperability of services across countries, differences in regulations and a lack of EU standards, and insufficient co-ordination and control at the EU level. Market regulation in the network industries is generally the responsibility of an independent national regulatory authority in each country. The resulting fragmentation into national markets reduces competition and cements the predominance of incumbents. In order to increase the effectiveness of network industries in the EU, the most efficient solution would imply a higher degree of harmonisation of national legal frameworks and technical standards, a move towards EU-level regulatory authorities for cross-border or pan-European markets, a co-ordinated approach to building and utilising backbone national and cross-border infrastructure, and full ownership unbundling of production and supply activities from the distribution and transmission sides of the industry.

Government procurement should be more open

Lack of integration in government procurement markets is a significant gap in the Single Market, given that government purchases account for almost one-fifth of GDP and that import penetration is relatively low in the public sector. Cross-border procurement

appears to take place largely through local affiliates, rather than directly on a cross-border basis (EC, 2011j). EU directives from 2004 set out basic requirements for public procurement, including compulsory international competitive tendering for contracts in some areas over certain internationally agreed thresholds.[6] There are many barriers to firms entering other markets in this area, including language and a lack of experience in foreign markets. However, purchases accounting for only 3% of GDP were published in the Official Journal for international tender in 2010 (Figure 1.12). One reason for this low share of overall procurement is the size of activities that are not covered by the procedures in the Directives. In addition, the costs of taking part in tendering procedures may be high relative to the potential gains to bidders, particularly for small bids. This underlines the importance of reconsidering the current directives to achieve more streamlined public procurement procedures, while ensuring that cross-border markets for cross-border procurement are increasingly open to effective competition.

Figure 1.12. **Public procurement**
As a percentage of GDP, 2010



Source: Eurostat.

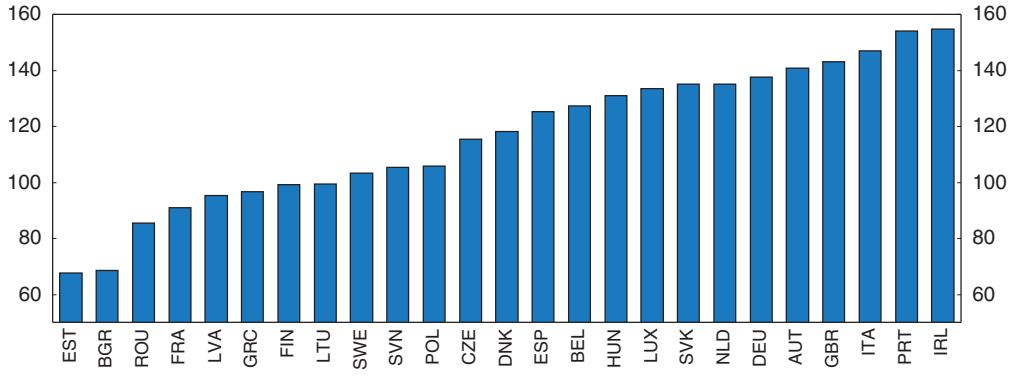
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Energy markets are still far from integrated

A competitive internal market for electricity and gas has been a long-standing goal, but there are still large price differentials in electricity prices even in neighbouring countries such as Germany and France (Figure 1.13). A series of liberalisation directives has led to full market opening for all customers, unbundling of transmission networks and the mandatory establishment of independent regulators (OECD 2009). The major 2003 package of measures, however, left some serious shortcomings, including a lack of transparency in prices and market information, distortive tariff regulations, high concentration and vertical integration in both electricity and gas with incumbents inhibiting competition within countries and stifling investments in interconnection capacity (EC, 2007a). The EU's third liberalisation package, adopted in July 2009, forces more effective unbundling but still allows Transmission System Operators (TSOs) to remain part of vertically-integrated companies, subject to detailed rules governing their autonomy, independence and investment. Progress has also been made in establishing entities to ensure the optimal management of transmission networks and to allow cross-border trade of electricity and gas. The European Network of Transmission Operators (ENTSO) has been set up to ensure

Figure 1.13. **Electricity prices[1] for households**

EUR per thousand kilowatt hours, 2010[2]



1. Prices before tax.
2. 2009 for Spain.

Source: IEA, *Energy Prices and Taxes Database*.

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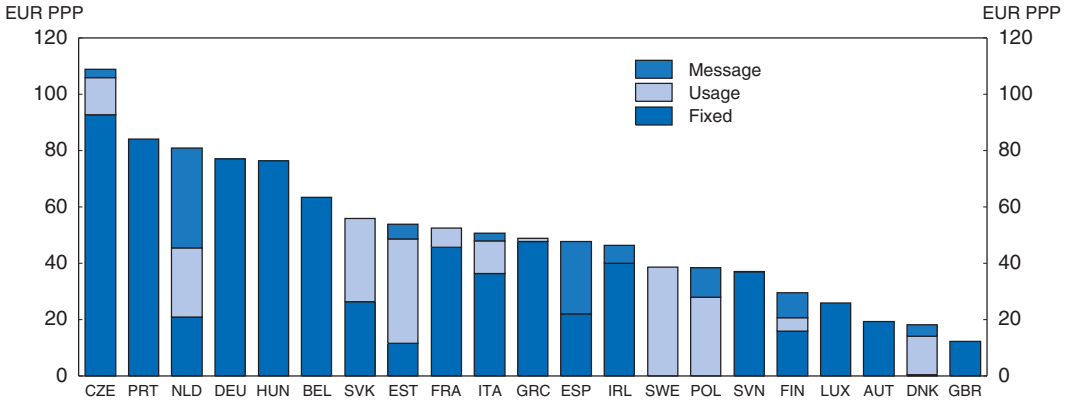
co-ordination and co-operation. It establishes network codes, which are legally binding, and a non-binding EU-wide Ten-Year Network Development Plan. The Agency for the Co-operation of Energy Regulators (ACER) has also been established to assist national regulatory authorities to perform their duties at EU level and to co-ordinate their actions, although it only has limited decision-making powers. The formation of ACER and ENTSO-E is a step in the direction of a more co-ordinated approach to electricity grids but it remains to be seen whether they will achieve the required integrated approach to management of energy grids.

Telecommunications remains fragmented

Competition has steadily increased in the telecom markets of individual EU countries. Regulatory barriers to entry have gradually decreased (OECD, 2009). This has helped telecommunications prices to decline rapidly over the past decade. The policy design and implementation of the EU regulatory framework for electronic communications, which trace back to 1998 and have been modified in 2002 and 2009, have been successful in improving the functioning of national telecom markets, but have not lead to full market integration across borders. Europe is still hampered by the heterogeneous nature of its national markets, as evidenced by large price differences (Pelkmans and Renda, 2011). There are only few operators offering services across several countries and virtually none across the whole of the EU. Based on a representative basket of monthly use, mobile phone costs in countries such as the Czech Republic, Germany, Hungary, the Netherlands and Portugal are many times higher than in countries where calls are the cheapest (Figure 1.14). These huge price differences are not consistent with effective cross-border competition and an environment that fosters pan-European expansion strategies. However, it is too early to judge the impact of the 2009 reforms to the EU regulatory framework, as these have only been in force since May 2011.

The key obstacle to greater market integration and stronger competition is the segmentation of the European market by national regulatory systems. This leads to heavy replication costs of entry into national markets and make it difficult to generate EU-wide economies of scale. A range of measures should be taken to move from 27 national

Figure 1.14. **Mobile phone prices**
OECD 300 calls mobile basket, August 2010[1]



1. Price per month, VAT included.
Source: OECD (2011), *OECD Communications Outlook 2011*, OECD Publishing, Paris.
StatLink http://dx.doi.org/10.1787/888932590399

markets to a Digital Single Market as proposed by the Commission. It is necessary to improve the existing national approach with more harmonised regulations, and reduce the heterogeneity in the implementation of these regulations. Better co-ordination of regulatory authorities and more regulatory oversight at European level is warranted. Moving powers from national level to the Body of European Regulators for Electronic Communications (BEREC) would help. This could contribute to building and better using the cross-border infrastructure. A more centralised approach to the use of radio spectrum for mobile communication should be considered. This could help to make the best use of spectrum freed as the result of digitalising televisions broadcast. A further effect of more centralised regulatory oversight and stronger competitive pressure could be a further reduction in roaming charges: while direct price controls have had a powerful impact in reducing prices for cross-border communications, a structural solution is required to ensure low prices. To support the objective of a real Single Market in digital services, the Digital Agenda for Europe also includes pan-European licensing for online rights management, strengthening EU data protection rights of consumers, updating the e-Signature directive and evaluating the impact of the e-Commerce Directive on online markets, as well as ensuring interoperability of secure e-authentication systems. The gains from a Digital Single Market could be substantial, both in terms of increased productivity of the existing infrastructure and in terms of new large-scale investments. The opportunity cost of the lack of a Digital Single Market is estimated to be 4% of EU GDP (Copenhagen Economics, 2010a). According to a recent study from the Commission, the opportunity costs from the lack of a Single Market for electronic communications amount to more than 0.8% of EU GDP (Ecorys, 2011).

A competitive transport system is needed to get the Single Market moving

A well functioning transport system, optimising and integrating marine, inland waterways, air, road and rail transport is needed to connect workers and firms in the integrated European market. Growth-friendly reforms for the transport sector would not only improve productivity in these sectors directly, but also contribute to higher productivity in other sectors by reducing costs, lowering the impact of geographic distance,

contributing to cross-border activities and ensuring that the supply-chain is efficient at connecting downstream suppliers to upstream users. Major regulatory barriers and physical bottlenecks to an efficient transport system remain. As shown in previous *Surveys* (OECD, 2007; OECD, 2009), some European ports are efficient and competitive but others are well behind the productivity frontier. Congestion in port access, poor connections with the hinterland, market access restrictions, restrictive labour practices and administrative burdens hold back the efficiency of ports in some countries, and limit the effectiveness of intra-EU maritime transport. For historic reasons, the existing rail infrastructure in Europe suffers from a lack of standardisation, and large lock-in effects hinder change. Investments in high-speed rail have however been more standardised. All European high-speed lines use standard gauge 1435 mm tracks and, except for Austria, Finland and Germany, all countries use the same 25 kV AC electrification system. In road transport, infrastructure bottlenecks still exist. In all transport modes, efficiency can be increased by simplifying procedures and utilising new technology. In aviation, much has been done to increase market efficiency, notably in air traffic management with the ("Single European Sky" initiative). In 2011, the European Commission presented proposals for transport in a White Paper entitled "Roadmap to a Single European Transport Area", along with a new transport infrastructure policy (TEN-T) (EC, 2011h) with funding from the "Connecting Europe Facility". The Commission proposals include the opening of rail markets to competition, implementing common technical and professional standards, measures to enhance quality and performance of port services, including financial transparency of port financing, "one-stop" administrative shops for multimodal freight and harmonised intermodal rights for passengers. In addition, the proposals aim to increase efficiency of short sea shipping through modern, reduced and harmonised rules and procedures, and data exchange. These measures should reduce costs and increase competition. In addition, a dual-layer core European multi-modal (TEN-T) transport network is proposed to remove infrastructure bottlenecks based around 29 pre-identified projects, mostly in the railway sector and including crucial connections of ports with railways. These goals should be completed by 2030. These measures should contribute in addition to the necessary improvement in the resource efficiency of the transport system (OECD, 2009).

With the adoption of the Third Postal Directive in 2008, the final legislative step of gradual market opening was taken. To date, most countries have fully opened their postal markets to competition by abolishing exclusive rights traditionally present in this network industry. The remaining countries have until the end of 2012 to transpose the Directive. Remaining barriers to postal services liberalisation should be removed. Increased competition should lead to better services at a lower cost to the consumer. Since there are significant economies of scale in the postal market, competing with the incumbent is challenging, and will be even more so if there are regulations in place which favour the incumbent (Copenhagen Economics, 2010b). A number of measures are required to make postal competition effective, including avoiding unnecessary and unjustified sector-wide extension of regulations on wages and employment standards. The independence of the national regulatory authorities needs to be assured so that there is full access to postal infrastructure. The Commission should also continue to promote and facilitate the exchange of best practices pursued by national regulators within the European Group of postal regulators (ERGP) that was established in 2010.

Box 1.4. **Summary recommendations to strengthen the Single Market**

A step change is required in the political priority and effort devoted to encouraging economic integration through the Single Market. Passing the Single Market Act by the end of 2012 would be an important first step.

Improving the implementation, enforcement and follow-up of Single Market

- Ensure that national governments fully implement EU requirements within the specified deadlines and ensure that implementation works on the ground.
- The Commission should pursue enforcement more rigorously, including by allocating more resources to this function and launching more legal enforcement actions. It should take a pro-active approach to identifying implementation problems and barriers. There should be an annual country-specific report published on the state of the Single Market with clear indicators and recommendations.
- Strengthen the evidence-base for Single Market policies to identify priorities and likely benefits. *Ex post* evaluation of Single Market measures should be systematically applied to ensure full implementation and identify future priorities.
- Use a more innovative approach to decision-making drawing on the full range of policy instruments, including Lamfalussy-type processes and enhanced co-operation, where this would improve the Single Market and full agreement cannot be attained.

Creating a real Single Market

- Continue to reform national product market regulations to facilitate entry and competition.
- Enhance the framework conditions for doing business across borders and setting up in another country, including through:
  - A clear strategy for cross-border taxation. This should include measures to create consistency across countries, reduce the administrative burden and enhance co-operation between national administrations. Long-standing design questions need to be resolved.
  - Strengthening national competition authorities with appropriate priority to applying EU competition rules and tackling wider obstacles to effective cross-border competition.
  - Putting in place effective consumer protection in all countries and ensuring that it protects cross-border purchasers.
  - Pursuing the introduction of unitary patent protection and a unified patent court to reduce the costs of patenting in Europe.
- Make further progress with the sectoral approach to the market integration by fully implementing the Services Directive and targeted measures at that sector, changes to public procurement rules to facilitate a wider application and further efforts on network industries, notably through cross-border regulators and investment in infrastructure.

Notes

1. Based on OECD STAN database and Eurostat ESA 95 Supply Use and Input-Output tables.
2. These figures are based on survey responses and there may be a bias towards under-reporting transactions with foreign vendors as it may not always be clear to the consumer if they are dealing with a domestic or foreign company.

3. The country of origin principle would not have applied to the mutual recognition of professional qualifications or to cases covered by the Posting of Workers Directive (which applies where a worker is temporarily posted by a company established in an EU country to a different EU country to perform a work there but remains subject to the main home employment conditions).
4. The excluded sectors (see Articles 2, 3 and 17 of the Directive) include: financial services; electronic communications services with respect to matters covered by other EU instruments; transport services falling into Title V of the EU Treaty, healthcare services provided by health professionals to patients to assess, maintain or restore their state of health where those activities are reserved to a regulated health profession; temporary work agencies' services; private security services; audiovisual services; gambling; certain social services provided by the State, by providers mandated by the State or by charities recognised as such by the State; services provided by notaries and bailiffs (appointed by an official act of government). It should further be noted that the provision of the Services Directive on the "freedom to provide services" does not apply among others to services defined as of general economic interests (postal, water distribution, waste disposal, electricity), although specific directives exist in most of these areas.
5. This does not cover non-economic planning issues and there is an exception where this is a matter of overriding public interest.
6. The harmonised threshold values range from EUR 130 000 to EUR 400 000 for public supply and service contracts to EUR 5 000 000 for public works contracts.

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Chapter 2

Mobility and migration in Europe

There are large differences in labour market performances in EU countries, resulting in part from different policy settings. High unemployment, particularly among young people, and low labour mobility within and between countries coexist with skill and labour shortages in some countries and regions. This reflects weaknesses in national labour market policies, such as high costs of exit and entry, training mismatches or disincentives to participation, and also barriers to labour mobility. Well performing labour markets are important for facilitating adjustment to shocks, especially in the monetary union, allocating resources to best uses, and in dealing with potential labour market shortages related to ageing.

Mobility within the EU can in principle help to fill labour market shortages, but the cost of moving for individuals is increased by policy-induced barriers to mobility such as the loss of pension entitlements, lack of recognition of qualifications, inaccessibility of some public sector jobs and housing market frictions. To achieve better functioning EU labour markets, labour market institutions should be improved and obstacles to mobility reduced.

With demographic changes underway, most EU countries expect growing shortages of skilled labour. In principle, this should be addressed through increasing labour participation and employment rates of female, young and older workers and migrants already living in the country, and making sure that training and education match skill requirements by employers. Nevertheless, policies at the EU level should be developed to ensure that migration responds more directly to specific labour market needs particularly for high-skilled workers.

EU labour markets are fragmented between and within countries and overall mobility is low

European labour markets have large imbalances and structural weaknesses. While overall employment rates are relatively low in the OECD context, due to modest participation rates and high and persistent unemployment rates in some countries (Table 2.1), the employment rate varies from 56% in Hungary and Greece to 75% in the Netherlands. Groups with weak attachment to the labour force, such as women, immigrants, and older and younger workers, are particularly affected by unemployment, especially in Southern and Eastern Europe (EC, 2011d). Youth are over-represented among workers on temporary contracts (Scarpetta *et al.*, 2010); as a consequence youth

Table 2.1. **Labour market indicators**

2011 data[1]

	Employment rate	Unemployment rate	Youth unemployment rate (15-24)	Labour market participation rate
Austria	72.1	4.1	8.2	75.2
Belgium	61.8	7.2	19.4	66.6
Czech Republic	65.6	6.9	17.9	70.5
Denmark	73.2	7.7	14.2	79.3
Estonia	64.9	13.2	22.2	74.7
Finland	69.2	8.2	20.9	75.4
France	63.9	9.2	21.7	70.3
Germany	72.3	6.2	9.0	77.1
Greece	56.2	16.9	42.6	67.7
Hungary	55.6	11.1	26.0	62.6
Ireland	59.2	14.7	29.4	69.4
Italy	57.0	8.1	27.8	62.0
Luxembourg	64.8	5.0	16.4	68.2
Netherlands	74.7	4.3	7.5	78.1
Poland	59.6	9.8	25.6	66.0
Portugal	64.6	12.9	28.3	74.3
Slovak Republic	59.5	13.4	32.8	68.8
Slovenia	64.4	8.2	15.2	70.1
Spain	57.7	21.8	46.5	73.7
Sweden	74.2	7.9	23.5	80.5
United Kingdom	69.4	8.1	20.8	75.6
EU27	**64.3**	**9.6**	**21.1**	**71.1**
EU27 standard deviation	6.1	4.3	9.8	5.1
Australia	72.7	5.2	11.3	76.7
Canada	71.5[2]	7.5	14.8[2]	77.8[2]
Japan	70.3	4.8	8.2	73.8
United States	66.7[2]	8.9	17.3	73.9

1. Average of available quarters in 2011.
2. 2010 data.

Source: Eurostat; Australian Bureau of Statistics, *Cat 6202.0*, Tables 17 and 18; Japanese Ministry of Internal Affairs and Communications, Statistics Bureau; US Bureau of Labor Statistics; OECD, *OECD Economic Outlook Database*.

unemployment has risen during the crisis to an unprecedented 21% in 2011, ranging from 8% in the Netherlands and Austria to 47% in Spain. At the same time, skill shortages are emerging in some countries with tighter labour market conditions, pointing to large imbalances between supply and demand of labour within the EU. Some of the structural weaknesses in performance reflect weaknesses in national policy frameworks and institutions (Bassanini *et al.,* 2010). Women's participation, for instance, is influenced by tax systems, restrictions on part-time work or lack of child care. Despite recent pension reforms in some countries, generous early retirement or disability benefits keep large numbers of older workers outside the labour force. Performance is also affected by slow adjustment in real wages and employment in many EU countries, hampered by high employment protection, high minimum wages compared to skills or productivity, and inefficient social protection and wage bargaining systems (OECD, 2011a). Labour mobility could also be a key adjustment mechanism in a currency union, both for countries facing overheating pressures or prolonged excess capacity, and those with skill shortages would benefit from greater labour mobility (OECD, 2010). This chapter focuses on how to improve the functioning of the EU labour market by removing obstacles to intra-EU mobility and by developing policies at EU level to ensure that migration responds more directly to specific labour market needs.[1]

Mobility within and between European countries remains low despite the Single Market. Free movement of labour is a right of all EU citizens and should allow them to move where they are best suited or to where there are jobs (Box 2.1). However, only 3% of working-age EU citizens live in a different EU country.[2] Indeed, migration from outside the EU is much larger, with non-EU nationals accounting for around 5% of the working-age population. Annual mobility *within* EU15 countries between regions stands at an average

Box 2.1. **Legal rights around movement of workers in the EU**

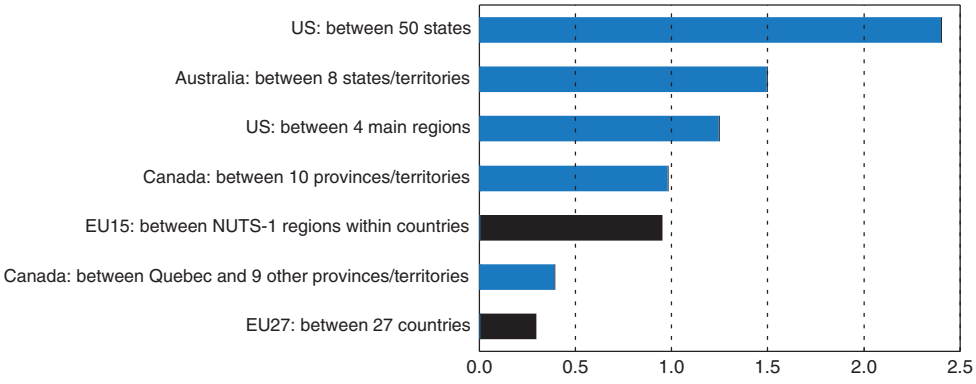
The principle of the free movement of workers is enshrined in Article 45 (ex-Article 39 EC) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") and has been developed through secondary law and by the case law of the Court of Justice of the European Union. EU nationals who move to another country under Article 45 TFEU enjoy full equal treatment with nationals in particular with respect to conditions of employment and work, including pay and social advantages. Initially, only workers benefited from free movement but over time this right was extended to all EU citizens under certain conditions. Self-employed workers have the right to establish or to provide services in other EU countries. Non-EU nationals living in the EU do not benefit from these rights.

Free movement of workers is legally different from the freedom to provide services. Posted workers are persons crossing borders in the EU to provide services for a limited period, generally for less than one year, to persons, enterprises or governments, either as employees of an enterprise in another country or as self-employed persons. The key distinction between free movement and posting of workers is where the employing firm is based. For free movement, it is in the destination country; for posted workers, it is in the country of origin. According to the Services Directive, posted workers are normally subject to the social security provisions of the origin country of the firm which employs them (EC, 2006b). However, the minimum wage, working time and standards of work safety and security are excluded from the application of the principle. The social security regime applicable, on the other hand, can be that of the origin country (OECD, 2011c).

annual rate of 1%, but *cross-border* mobility is only 0.35%. Both within and between countries mobility rates are far below the rates within Australia (1.5%) and the United States (2.4%), although the rates are similar to those between Canadian provinces (Figure 2.1). Commuting to work is an alternative to making a permanent move to a different country and 1.5 million commuters crossed borders in 2009 (0.5% of the working-age population). Posting workers by companies within Europe is substantial too: close to 1 million certificates (0.3% of the working-age population) were granted for potential posted workers in 2009, mostly in the service and construction sectors (OECD, 2011c). EU migrants are substantially younger than the average worker. Moving workers from EU15 countries tend to be slightly older on average than their counterparts from the EU12 (Table 2.2). Workers from the EU12 tend to have a medium-level educational background, while movers from the EU15 often have a high-level educational background.

Figure 2.1. **Annual cross-border mobility**[1]

Per cent of total population, 2010[2]



1. Population mobility for Australia, Canada and the Unites States and labour mobility for the EU.
2. Or latest year available.

Source: ABS, Cat. No. 3412.0; Eurostat, *Population Statistics*; Statistics Canada; US Census Bureau, *American Community Survey.*

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Table 2.2. **Mobile working-age population**[1] **by selected characteristics**

As a percentage of the active working-age population of the category

Selected characteristics	2010			
	Total population	EU15 "Mobile"[2]	EU12 "Mobile"[3]	Non-EU27 "Mobile"[4]
Age group				
15-24	11	11	20	17
25-34	24	44	50	48
35-64	65	45	30	35
Education				
Low	24	17	27	36
Medium	49	32	55	35
High	28	51	17	29

1. EU residents aged 15 to 64 who are either employed or who are unemployed but are available for and actively seeking work.
2. Active working-age EU15 citizens resident for less than 5 years in EU27 countries.
3. Active working-age EU12 citizens resident for less than 5 years in EU27 countries.
4. Active working-age non-EU27 citizens resident less than 5 years in EU27 countries.

Source: Eurostat, *Labour Force Survey*.

The most recent EU enlargements boosted worker mobility

EU enlargement since 2004 has resulted in a substantial increase in labour mobility in Europe. Although many EU15 countries have applied transitional restrictions on access to their labour markets by EU8+2 migrants (Table 2.3), the stock of EU8+2 nationals residing in EU15 countries tripled over the period 2003-09 from about 1.6 million to about 4.8 million (2% of the working-age population), although part of this was due to a *de facto* regularisation of persons already present (Figure 2.2).[3] The accession of Romania and Bulgaria (EU2) in 2007 further increased the number of mobile workers substantially. Almost all labour flows between the newer and older member states have been East-West flows from EU8+2 to EU15 countries. The unprecedented rise in mobility since the latest accessions reflects the large income differentials between East and West. This situation compares with negligible movement out of Greece, Portugal and Spain to the EU upon their accession: incomes per capita in PPP terms in Greece, Portugal and Spain were about two thirds of the average EU, compared to below one half in most of the EU8 and below one third in Bulgaria and Romania (Dustmann *et al.*, 2003).[4] Influenced by strong labour demand, output growth and even larger income differentials, migrants into the EU rose substantially during the period 2003-07 with the number of non-EU citizens living in the EU15 increasing by around 3.4 million. Since the onset of the crisis, all types of migration flows, both within the EU and from outside, have slowed (OECD, 2011c; EC, 2011d). There remains great uncertainty about how labour mobility and migration flows will develop in the coming years and what the impact of the crisis will be in the medium term.

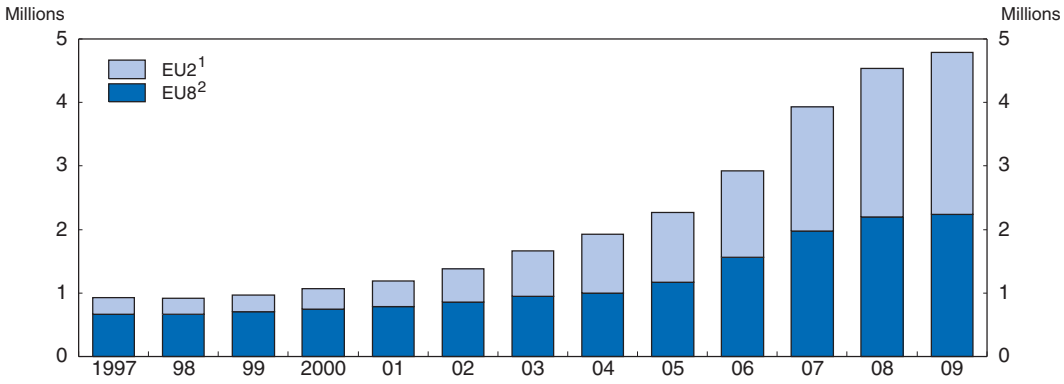
Table 2.3. **EU countries policies towards workers from the new EU member states**

EU countries	Workers from EU8 to EU15	Workers from Bulgaria and Romania to EU25
Austria	Free access (May 2011)	Restrictions with simplifications[1]
Belgium	Free access (May 2009)	Restrictions with simplifications
Denmark	Free access (May 2009)	Free access (1 May 2009)
Finland	Free access (May 2006)	Free access (1 January 2007)
France	Free access (July 2008)	Restrictions with simplifications
Germany	Free access (May 2011)	Restrictions with simplifications[1]
Greece	Free access (May 2006)	Free access (1 January 2009)
Ireland	Free access (May 2004)	Restrictions
Italy	Free access (July 2006)	Free access (1 January 2012)
Luxembourg	Free access (November 2007)	Restrictions with simplifications
Netherlands	Free access (May 2007)	Restrictions with simplifications
Portugal	Free access (May 2006)	Free access (1 January 2009)
Spain	Free access (May 2006)	Free access (1 January 2009) Restrictions for workers from Romania[2]
Sweden	Free access (May 2004)	Free access (1 January 2007)
United Kingdom	Free access (May 2004)	Restrictions
Czech Republic	No reciprocal measures	Free access (1 January 2007)
Estonia	No reciprocal measures	Free access (1 January 2007)
Hungary	Reciprocal measures	Free access (1 January 2009)
Poland	No reciprocal measures (January 2007)	Free access (1 January 2007)
Slovak Republic	No reciprocal measures	Free access (1 January 2007)
Slovenia	No reciprocal measures (May 2006)	Free access (1 January 2007)

1. Restrictions also on the posting of workers in certain sectors.
2. Since 22 July 2011, Spain has applied a so-called safeguard clause, which gives EU countries the possibility to reintroduce restrictions on free labour market access, if it is undergoing or foresees serious labour market disturbances.

Source: European Commission (2012), *http://ec.europa.eu/social/BlobServlet?docId=119&langId=en*.

Figure 2.2. **Stock of EU8 and EU2 nationals in EU15 countries**



1. EU2 comprises Bulgaria and Romania.
2. EU8 comprises the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

Source: Holland, D. *et al.* (2011), "Labour Mobility within the EU – The Impact of Enlargement and the Functioning of the Transitional Arrangements", based on a study conducted for the European Commission, NIESR, London.

StatLink http://dx.doi.org/10.1787/888932590437

EU mobile workers, particularly from EU12 countries, tend to be over-qualified for the jobs they end up doing. This applies to workers moving from one EU15 country to another, but even more so to workers from the EU12. The rate of highly-educated individuals working in low- and medium-skilled occupations was more than twice as high among recent mobile workers from the EU8+2 than for EU15 native-born workers in the period 2008 to 2009. Over-qualification is even more striking for workers with a medium-level education working in low-skilled occupations (OECD, 2011f). While EU15 mobile workers often work in business services, transport and real estate, EU12 mobile workers tend to work in the agriculture, manufacturing, construction, wholesale and retail trade (Table 2.4). Differences also exist among EU12 mobile workers: EU10 intra-EU movers work mainly in manufacturing and wholesale and retail trade, whereas EU2 intra-EU movers

Table 2.4. **Structure of employed working-age population by sector**

As a percentage of all economic sectors

Economic sector (NACE Rev. 2)	2010			
	Total employed[1]	EU15 "Mobile"[2]	EU12 "Mobile"[3]	Non-EU27 "Migrants"[4]
Agriculture, fishing and industry (A to E)	23	15	25	13
of which: Manufacturing (C)	16	12	19	9
Construction (F)	8	6	14	8
Wholesale and retail trade (G)	14	10	12	11
Accommodation and food services activities (I)	4	11	15	13
Transport and storage, information and communication (H and J)	8	11	7	7
Financial and insurance activities (K)	3	6	0	2
Real estate; Professional, scientific and technical activities; Administrative and support service activities (L to N)	10	15	9	11
Other service activities (O to U)	30	27	18	34

1. Total employed aged 15 to 64.
2. Employed EU15 citizens aged 15-64 resident less than 5 years in EU27 countries.
3. Employed EU12 citizens aged 15-64 resident less than 5 years in EU27 countries.
4. Employed non-EU27 citizens aged 15-64 resident less than 5 years in EU27 countries.

Source: Eurostat, *Labour Force Survey*, spring results.

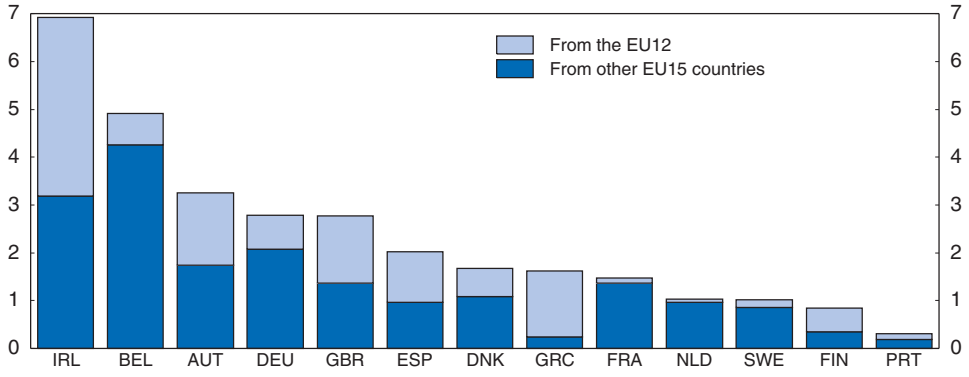
work in construction and domestic services (EC, 2011d). This may reflect difficulties in obtaining the recognition of professional qualifications in some areas and sufficient language proficiency that is needed for higher skilled employment. Even after correcting for differences in age and gender structure, there is a strong over-qualification risk for migrants, particularly from EU12 countries, than for the native population (EC, 2009b).

However, the stock of cross-border mobile workers remains low

Despite substantial East-West labour flows in recent years, the stock of cross-border mobile workers as a share of the overall population remains small both in the destination and sending countries (Figure 2.3). Of the destination countries, Ireland has the largest share, reflecting a big influx of foreign workers during the boom, relatively low language barriers and no restrictions imposed after accession. The share of EU12 nationals in the working-age populations of Austria, Greece, Spain, and the United Kingdom is relatively high, reflecting favourable economic opportunities in these countries during the past decade. Except in Ireland and Greece, EU15 immigrants still outnumber EU12 workers in EU15 countries. Despite the relatively large East-West flows, the stock of emigrants in most EU12 countries remains modest.

Figure 2.3. **Immigrants[1] living in EU15 countries**

Per cent of destination country working-age population, 2009[2]



1. Foreign nationals.
2. 2008 for Denmark, Finland, Germany, Portugal and Spain; 2007 for the Netherlands; 2006 for Ireland and Sweden.

Source: OECD, *International Migration Database*.

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Income differentials are main determinants of the post-enlargement wave

Income differentials are a key driving force behind cross-border labour mobility in Europe (Box 2.2). Movement towards the EU15 shows a strong correlation with relative GDP per capita (Figure 2.4), although the propensity to leave from Romania towards the EU15 rather than the other countries is markedly higher than its GDP per capita would suggest. In a Eurobarometer questionnaire (EC, 2007a), almost 85% of citizens in the EU8+2 mention work and income as the key motive for moving to another country, while EU15 mobile workers say that job-related factors do not play a predominant role influencing the decision to move in the EU15 (Table 2.5).

Box 2.2. **A theoretical perspective on the labour migration decision**

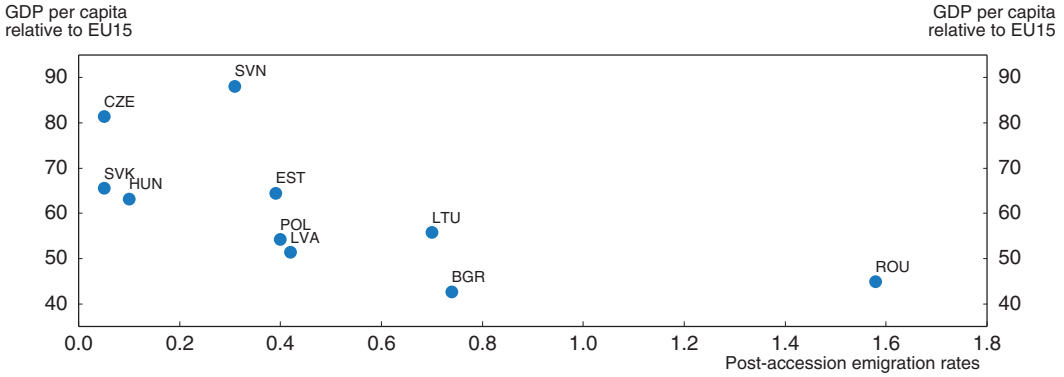
Economic theories of migration suggest that income differentials between the migrant's host and destination countries are among the key factors influencing labour migration. Income differentials exist in wages, social security systems, employment opportunities and unemployment rates. Individuals are assumed to base their decisions on comparing the discounted value of expected utility of staying in the country of origin to that with moving to the destination country. Migration occurs if the expected utility of moving is higher than the expected utility of staying, net of migration costs (Hunt, 2006). The costs of migration, which include both the explicit and implicit costs (such as lost work time and loss of community ties), play a major role in the pull of emigrants away from their native country. As transportation and technology have improved, travel time and costs have decreased dramatically.

There are other pull and push factors that impact on migration decisions. Language and geographic distance play an important role. Irish workers often emigrate to the United Kingdom, as well as to the United States and other English-speaking countries, while Portuguese workers often move to Spain and Switzerland and linguistically-similar countries such as France.

Existing social networks act as pull and push factors whereas social networks abroad facilitate a move. Costs of relocation decrease with the number of immigrants already there, encouraging more emigration, and leading to immigrant clustering. Sweden, for example, received most of its migrants from other Nordic countries until the late 1970s, but a substantial portion of its recent immigration consists of refugees from the Middle East. Germany has received large inflows from Turkey, while Moroccan immigrants have the largest share in the Netherlands. Migration networks affect migrants' location decisions through different channels. Such networks provide information about the destination labour market, migrants expect previous migrants to help them in the settlement process and ethnic goods are more available (Epstein and Hillman, 1998).

The individual's decision to migrate also depends on their socio-demographic characteristics, such as human capital endowment and transferability of skills to the destination, on personal preferences and expectations, as well as on restrictions on migration or requirements imposed by the destination country (Zimmermann, 2009). The causes and decision frameworks of migration are less studied empirically than the economic impacts of resulting flows. Questionnaires provide some evidence of migrant rationales, particularly surrounding the choice of destination country. Migrants frequently cite higher income levels, better personal safety, short distance to home countries, established immigrant networks as the main reasons for choosing their new destination countries (EC, 2010g). Econometric studies support this; the role of income differentials is also evident in comparisons of income or GDP levels between destination and origin countries (Coppel *et al.,* 2001, Munshi, 2003, Kerr, 2008, Kerr and Kerr, 2011). Generosity of unemployment benefits plays a negligible role (Giuletti *et al.,* 2011).

Figure 2.4. **Post-accession emigration rates and relative GDP per capita**[1]



1. The post-accession period is set to 2004-09 for the EU8 and 2007-09 for the EU2; the GDP per capita is calculated relative to the EU15 in PPP terms.

Source: Eurostat and Holland, D. *et al.* (2011), "Labour Mobility within the EU – The Impact of Enlargement and the Functioning of the Transitional Arrangements", based on a study conducted for the European Commission, NIESR, London.

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Table 2.5. **Factors influencing the decision to move, Eurobarometer 2007**

	EU15	EU10	EU27
Reasons for past moves			
Job-related	40.5	58.6	42.3
Education-related	14.7	12.2	14.5
Family-related	32.2	16.6	30.6
Other	12.6	12.6	12.6
Factors encouraging further moves			
Work and income	47.9	84.7	58.7
Social network	52.8	37.3	48.3
Housing and local environment	71.2	57.0	67.1
Public facilities	17.2	18.2	17.5

Source: EC (2007), "Geographic Mobility of Citizens", *Report on Special Eurobarometer,* 281/Wave 67.1, TNS Opinion & Social, Brussels.

Mobility is held back by Europe's diversity but also by administrative obstacles

Europe's linguistic diversity is a factor influencing mobility. In daily life, national languages play a dominant role, particularly in workplaces. Language borders, even if they do not coincide with country borders as in Belgium or Switzerland, can play a large role in explaining the lack of labour market integration across borders (Bartz and Fuchs-Schündeln, 2011). There are also many administrative obstacles to mobility. For example, there is still no system providing for mutual recognition of official documents, such as authentic acts or civil status documents issued by national administrations (Monti, 2010). Legal rights from the Single Market are often not implemented in national laws or enforcement remains weak (Chapter 1). Policy-induced barriers to mobility such as the loss of pension entitlements, differences in national regulations of professional qualifications, inaccessibility of some public sector jobs and housing market frictions increase the cost of migration for individuals. These barriers exist not only between EU countries but also within many EU countries. The persistence of national forms of labour and housing market regulations, welfare state and fiscal systems constrain mobility both between and within

EU countries (EC, 2010c). These constraints affect mobility to a different extent. For instance, barriers in the housing market or losses from pension entitlements are less important for young people, which is also supported by the fact that mainly young people are moving. These obstacles are discussed in more details below.

Lack of pension transferability is a barrier to mobility

Pension rights and entitlements are often not portable between schemes or across borders in EU countries' diverse pension systems. People moving jobs can lose part of the value of their existing rights or miss out on the chance to continue accumulating pension rights. The loss of value for workers moving between pension schemes, either public or private, depends on their exact design. Common problems include high penalties in terms of replacement rates for incomplete work histories and revaluation of accumulated pension rights in terms of prices rather than earnings in defined benefit schemes (OECD, 2011d). There are taxation treaties that generally only allow occupational pensions to be taxed in the state of residence, and hence avoid double taxation, but the network of such treaties is not complete. It means that if workers receive a pension from one country but live in another, they run the risk of being taxed twice. Moreover, the taxation of cross-border transfers of pension capital can restrict the free movement of workers. If an EU country allows tax-free domestic transfers of pension capital but taxes cross-border transfers, such taxation is against EU law.

Long vesting periods and high vesting ages are a significant barrier to pension portability. Many pension schemes – in particular defined benefit schemes – require workers to contribute to the scheme for at least two years before they acquire a right to a pension when moving jobs. Long vesting periods can mean that no entitlement is received for shorter periods of work. An amended proposal for an EU Directive (EC, 2005b) on minimum requirements to improve the acquisition and preservation of supplementary pension rights was adopted in October 2007; a White Paper (EC, 2012) was recently proposed that reinforces these ideas. The Directive aims to ensure minimum standards across the EU for the minimum vesting period. A vesting period of no more than one year across the EU is being proposed – and should be adopted – when transferring into pension schemes across borders and between employers.

The lack of pension portability is an obstacle to mobility particularly for older workers and a source of lost income for EU citizens. At a minimum, efforts should be made so that workers can continue to contribute for a limited period of time into occupational and supplementary pension schemes in their home countries while working in another EU country. Pension reforms, which are desirable in broader terms because of their efficiency, fairness and contribution to fiscal sustainability, should also be designed with a view to facilitating movements both between employers and across borders. To reduce losses in pension value, efforts should be made to align pension payoffs with respective contributions to avoid unfair penalties due to revaluation effects or incomplete work histories. However, the weak funding position of many public and private schemes makes it difficult to reform pension systems along these lines.

Cross-country information about job vacancies remains scarce

Better information about job vacancies in other countries or regions would facilitate mobility within the EU. Assistance of national employment agencies for jobseekers from other EU countries is low; co-operation of national employment agencies needs to be

intensified in a systematic way and information sharing should be improved. There have been recent attempts in that direction within the EURES context (EC, 2010d). There have been initiatives such as the "permanent co-operation bridges" agreement between the German Bundesagentur fuer Arbeit and the Spanish Public Employment Service to attract much-needed high-skilled workers to Germany, but these attempts remain on a limited scale. The European Employment Services Network EURES has not proved to be very effective in redirecting people to existing job vacancies. EURES has a million registered vacancies, but the number of job matches initiated has been low. In the period 2006-08, around 28 000 job-matches took place at 248 events. In addition, a further 15 000 job outcomes were registered by the EURES network in the same period. Job matching across borders could be improved through co-operation between national employment agencies, as well as private employment service providers and by upgrading the EURES network and portal to make it the main vacancy clearance system in the EU.

Recognition of professional qualifications is complicated across countries

The assessment and recognition of professional qualifications is often complicated by lengthy administrative procedures and requirements. It may be a reason behind over-qualification of many mobile workers from EU8+2 and migrants from outside the EU. In principle, EU law guarantees that professional qualifications acquired in one EU country are valid to practise a regulated profession in another EU country. Recognition must also be granted if the profession is not regulated in the country of origin and a person has worked there full time in that profession for two years. In practice, regulation of professions is under national authority. For most regulated professions, EU nationals must explicitly obtain recognition from the destination country, which can involve administrative difficulties (Bonin *et al.,* 2008). In specific circumstances the authorities can require an adaptation period under the supervision of a locally qualified professional for a period of up to three years or an aptitude test. If the profession is not regulated in the destination country, EU citizens can practice it there under the same conditions as the nationals of that country.

A new Directive (EC, 2005a) that came into effect in 2007 sets out a general system for the recognition of training for the purposes of establishment in a destination country. Professional qualifications are grouped so that they can be compared. However, while the Directive mainly summarises 15 different regulations of mutual recognition of professional qualifications in one place, it has not reduced any administrative hurdles or made recognition more automatic. Automatic recognition of qualifications applies to seven out of more than 800 professions. Architects, doctors, dentists, nurses, midwives, pharmacists and veterinaries have their diplomas recognised in other countries without any test or probation period. Similarly, lawyers are entitled to provide services under their home professional title. For all other professions, recognition is complicated by administrative hurdles, delays in recognition processes and overly strict regulations at national level (EC, 2011a). For professions in the craft, commerce and industry sectors, automatic recognition of professional experience holds. However, between 2007 and 2010, all professions together, 94% of the professionals requesting the recognition of their qualifications received a positive decision (EC, 2011h). To promote mobility, additional recognition mechanisms should be developed to achieve more automaticity in the recognition of professional qualifications, and administrative hurdles at the national level should be reduced. A recent Green Paper (EC, 2011g) has suggested further simplifications to

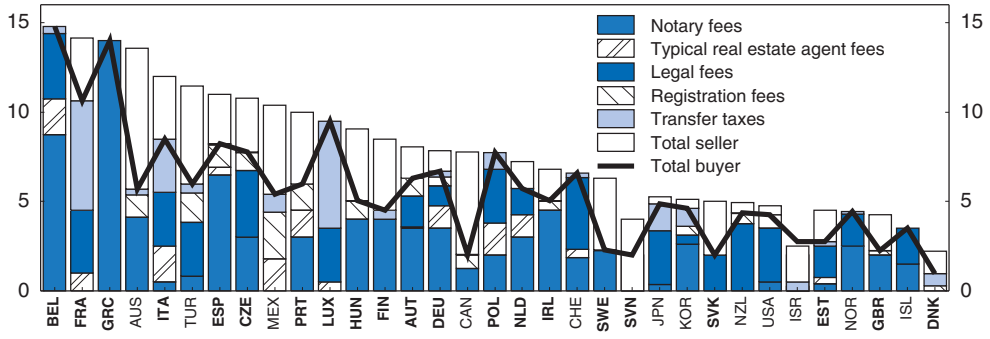
recognition procedures. The legislative proposal presented by the Commission in December 2011 proposes "common training principles" and a European "professional card" summarising all relevant information, which would help to simplify and fasten the recognition procedure.

Housing market policies raise costs of moving

In many EU countries, housing policies such as housing regulations and taxes on property transactions are an impediment to mobility, both within and between countries. Housing transaction costs are particularly large in some continental and southern European countries, while they are lower in Nordic countries and the United Kingdom (Figure 2.5). Also, stricter rent controls and tenant-landlord regulations significantly reduce residential mobility by discouraging the supply of rental housing and by locking-in tenants (Caldera Sanchez and Andrews, 2011). Home-owners and social housing tenants – in particular tenants in highly means-tested social housing systems – tend to be less mobile than private renters. For instance, on average, an owner is estimated to be 11% less likely to move than a private renter (Andrews *et al.*, 2011). Policies should tackle these obstacles by shifting the tax base to less distorting sources of revenue such as replacing stamp duty with property tax, by removing anticompetitive regulations in the real estate brokerage sector and tax breaks for home ownership.

Figure 2.5. **Housing transaction costs**[1]

As a percentage of property value, 2009



1. Transaction costs refer to average costs. The estimates do not take into account the various tax breaks that exist in countries for certain dwellings, implying that the estimated cost may overestimate the actual cost in some countries, in particular in Italy, where such tax breaks are frequent.

Source: Calculations based on OECD Housing Market questionnaire.

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Mobility is especially difficult for public sector jobs which remain mostly closed for non-nationals

EU law is in principle clear that EU citizens should have similar access to public sector jobs as nationals. A ruling by European Court of Justice States that only certain posts (exercising of powers conferred by public law and safeguarding general interests) in the public service can be reserved for nationals.[5] Jobs such as postal or railway workers, plumbers, gardeners or electricians, teachers, nurses and civil researchers do not fulfil the criteria and thus may not be reserved for nationals of the EU country. However, EU nationals or returning nationals are often *de facto* barred from public sector jobs that are reserved for nationals (EC, 2010a). Regulations in this area reduce mobility because the

public sector accounts for around 20% (varying from 12 % to 34 %) of total employment in EU countries. Some countries reserve all posts in specific ministries for nationals: such as foreign affairs, budget, defence, economy, interior, justice, and finance including tax authorities. In a number of countries, many posts at high and middle management level of the government and administration are reserved as well and in some countries all civil/public servant posts are open only to nationals (Ziller, 2010). There are also EU countries with a low number of positions restricted for nationals only and with recruitment based on professional experience and skills.

The most common problem for workers trying to get a job in the public sector of another EU country relates to the recognition of professional experience and seniority. Other problems are the recognition of professional qualifications, language requirements of native language. Many infringement procedures on this issue have been initiated against specific countries and some reforms have been undertaken. Except for Luxembourg, the share of other EU nationals working in teaching professions is low (Table 2.6), which is also a lost chance in terms of improving the quality of foreign language classes in EU countries. Requirements for public sector employment to be open to all EU nationals and returning citizens should be translated into national laws and procedures. Public sector employment practices should facilitate labour mobility, including through recognition of seniority and qualifications acquired in other countries.

Table 2.6. **Non-national teachers**

Share in total numbers of teachers, 2005 data

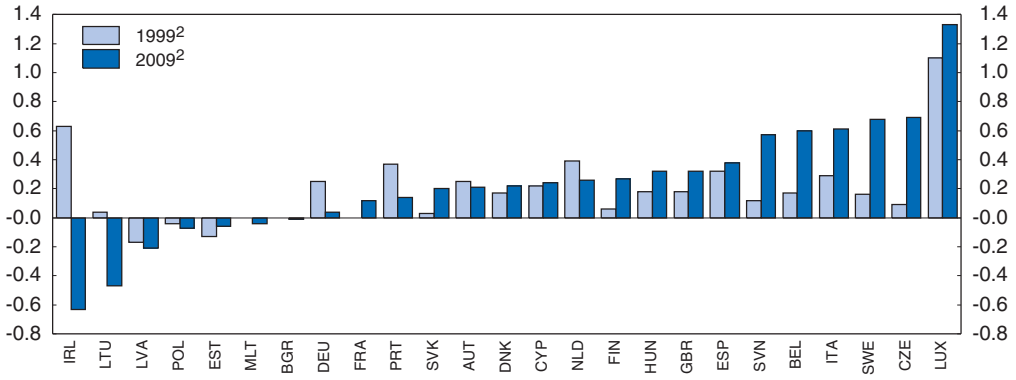
Country	EU25 nationals (%)	Country	EU25 nationals (%)
Luxembourg	25.0	Poland	0.7
Belgium	3.9	Portugal	0.7
Austria	3.6	Greece	0.4
Ireland	3.4	Czech Republic	0.0
Denmark	3.3	Italy	0.0
Sweden	3.2	Latvia	0.0
Germany	3.1	Lithuania	0.0
Spain	2.8	Malta	0.0
United Kingdom	2.5	Slovak Republic	0.0
Netherlands	1.8	Slovenia	0.0
Hungary	1.2	Estonia	0.0
Finland	0.8	Bulgaria	0.0
France	0.7	Romania	0.0
		Total EU27	**1.7**

Source: EC (2006), *Study on Key Education Indicators on Social Inclusion and Efficiency, Mobility, Adult Skills and Active Citizenship, Lot 2: Mobility of Teachers and Trainers, http://ec.europa.eu/education/more-information/moreinformation139_en.*

Migration from outside Europe can reduce labour market imbalances

Migration from outside the EU is larger than cross-border labour mobility within the EU and has been important in filling gaps in the labour market. Twenty-seven million foreign-born migrants live in EU countries, representing 5% of the population. Most live in EU15 countries. Both relative and absolute numbers of migrants in EU12 countries are small, although increasing in recent years. Before the crisis started, increases in migration had been strongest in Southern European countries, Ireland, the United Kingdom and some of the EU12 countries (Figure 2.6). Good growth performance has turned some EU12 countries into countries of destination; Hungary, the Czech Republic, Slovakia and

Figure 2.6. **Net migration[1] in the EU27**
Per cent of total population



1. Immigration minus emigration (EU and non-EU).
2. Or nearest year available.

Source: Eurostat.

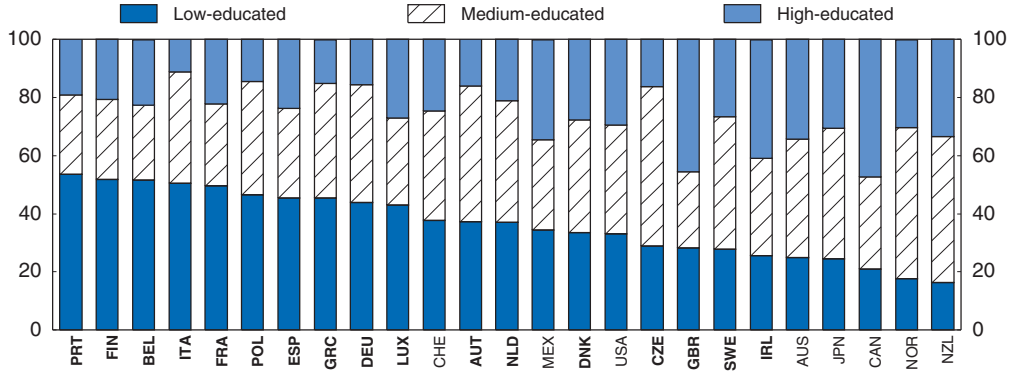
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Slovenia all now have positive net migration rates. Recent flows figures suggest that mobility within the EU has become more important than labour migration from third countries, if not always total migration from third countries.

Many current migrants are low-skilled

Driven by labour needs in low-wage occupations, the share of low-skilled migrant workers remains high in many EU countries (Figure 2.7).[6] The increasing educational attainment of younger workers as well as the decline in the size of youth cohorts mean that there are fewer takers for low-skilled jobs and, in particular, the so-called "3D jobs" (dangerous, difficult or dirty) (OECD, 2009). In southern European countries, Belgium, Finland and France, more than half of migrants do not have more than a primary education. In Australia, Canada and New Zealand, but not the United States, the percentage of low-skilled immigrants is much smaller, usually below 25%. Between 1.9 and 3.8 million migrants are estimated to live irregularly in the EU (approximately 10% of all migrants); most of them

Figure 2.7. **Immigrants by level of education**
Share in the total of foreign-born, 2005/06



Source: Widmaier, S. and J.-C. Dumont (2011), "Are Recent Immigrants Different? A New Profile of Immigrants in the OECD based on DIOC 2005/06", *OECD Social, Employment and Migration Working Papers*, No. 126, OECD Publishing, Paris.

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arriving with tourist visas, then overstaying and working in irregular, low-skilled jobs such as agriculture, construction and domestic services. There is a growing recognition that offering limited possibilities of legal entry for workers for low-skilled jobs when there is strong demand may create ground for irregular migration (OECD, 2009).

Shifting to high-skilled migration can better reduce labour shortages

Motivated by increases in demand for high-skilled relative to low-skilled labour – especially in information technology – many EU governments have favoured high-skilled migration (Kahanec and Zimmermann, 2011). Migration of researchers, scientists, university students and IT specialists increases innovation capacity and the stock of available human capital in destination countries as well as the international dissemination of knowledge. In addition, due to ageing, most EU countries expect growing shortages of skilled labour or workers in specialised activities in the future (CEDEFOP, 2008). Estimates indicate that demand in EU countries for high-skilled workers will grow, whereas the need for low-skilled workers is likely to decline (OECD, 2011e). Migration, particularly of high-skilled workers, is often viewed as one way of addressing this challenge. While migration can alleviate the ageing pressures only in the short run (Box 2.3), labour migration systems

Box 2.3. **Addressing shortfalls from a shrinking working-age population**

Most EU countries expect growing shortages of skilled labour or workers in specialised activities. Already, young cohorts entering the labour force are smaller than those retiring. Without migration, all EU countries except Ireland are projected to experience a decline in the working-age population by 2020, based on the current age structure of the population (OECD, 2009). If current net migration rates were to stay at today's levels, the EU population would be projected to increase up to 2040 and decline thereafter (EC, 2011c). In the medium term, fewer workers will have to provide for a stable or growing population, implying a smaller national income per person. Declining working-age population could pose problems for the financing of social protection but also for living standards if the labour force also declines. A declining workforce can be problematic for employers if the reduced supply means that they are unable to find the workers they need to maintain or expand production or to compete in international markets.

However, migration can alleviate the ageing pressures only in the short run. Migrants are younger on arrival than the existing population, but any effect would be short-lived because the migrant population is also ageing. So any sharp rise in migration over the coming decades would result in a similar situation but at a somewhat later point in time (Coppel *et al.,* 2001). Another limitation is political objections towards migration in many EU countries. The empirical literature is not conclusive in terms of the impact of migration on wages of natives with most studies finding none or a slightly positive impact in the destination county (Docquier *et al.,* 2010). Migration flows have a small positive impact on aggregate GDP, but no permanent impact on unemployment and GDP per capita in the destination country. In sending countries, migration outflows can have a permanent negative impact on aggregate GDP, although this is often compensated by remittances (Holland *et al*., 2011). There are, however, potential complementarities between external migration and internal mobility. A study on the Italian labour market finds displacement effects for low-skilled natives; in particular, a high non-EU migrant concentration in the northern regions has partially substituted the traditional Italian South-North mobility of less skilled natives (Mocetti and Porello, 2010).

Box 2.3. **Addressing shortfalls from a shrinking working-age population** *(cont.)*

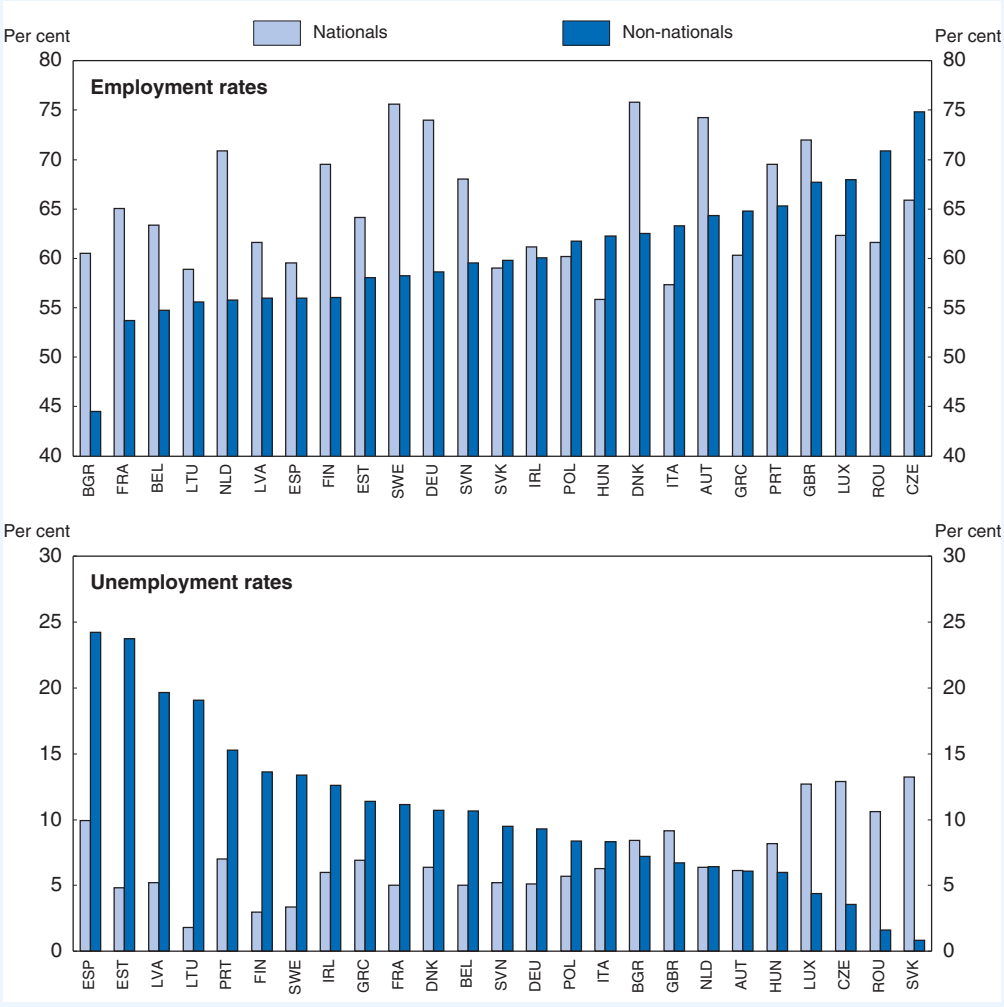
The most obvious way to address shortfalls from a shrinking working-age population is to increase the retirement age and working hours to sustainable levels. There are several other options available. *First,* improving technology and labour productivity would make it possible to produce more with fewer workers (OECD, 2010b). *Second*, moving production abroad to places with available workers would help to tackle skill shortages. *Third,* addressing structural weaknesses in national policy frameworks and institutions would increase labour supply. Over the medium term, labour supply can be increased by prolonging labour force participation of persons living in the country, *e.g.* the mobilisation of available labour reserves, in particular among women, older workers and immigrants already living in the country. For example, despite recent pension reforms in some countries, generous early retirement or disability benefits keep large numbers of older workers outside the labour force. Women's participation is influenced by tax systems, restrictions on part-time work or lack of appropriate child care. There are also positive effects from low-skilled immigration on female labour participation rates; having immigrants as cleaners, nannies, and home-care assistants allows high-skilled women to work more (Cortés and Tessada, 2011). Improving wages and working conditions could move people into occupations facing shortages, although this is not possible in the short term for occupations requiring significant training.

The potential of migrants already living in EU countries is not fully used. Labour market outcomes of migrants vary significantly. The poor integration of many migrants in EU countries is causing social costs and friction, increasing imbalances in labour markets. Many practical and institutional barriers exist which, together with differences in cultural backgrounds and religious beliefs, affect proper integration of migrants within the labour market, educational and social systems (OECD, 2011c). Partly due to discrimination, the labour market situation for non-EU migrants is substantially worse than that of migrants from other EU countries. Migrants tend to have lower employment rates, higher unemployment rates and are often more likely to have jobs of lower quality or for which they are over-qualified (Quintini, 2011). Migrants also have weaker labour force participation rates than natives, which generally lead to lower employment shares compared to population shares (Causa and Jean, 2007). Children of migrants have an unemployment rate that is higher than that of the children of natives, for both genders (Liebig and Widmaier, 2009). Migrants are generally over-represented in manual low-skilled occupations. This is particularly evident in countries accepting more refugees and asylum seekers like Denmark, Germany, Netherlands or Sweden (Figure 2.8). On average, the highest unemployment rates for the foreign-born population are observed for North African origin countries (16%) and Sub-Saharan African countries (16%); the lowest unemployment rates are registered for North American migrants (5%), as well as for migrants from within the EU27 (7%). Also, foreign-born women seem to be at an even greater disadvantage and exhibit in general lower employment rates (Brodmann and Moeser, 2009). Over-qualification, *i.e.* being employed in a position that requires less experience and education, is particularly widespread among high-skilled migrants originating from poorer countries due to lack of language proficiency, discrimination and administrative hurdles in the recognition of professional qualifications (Eichhorst *et al.*, 2011).

Box 2.3. **Addressing shortfalls from a shrinking working-age population** *(cont.)*

Figure 2.8. **Labour market outcomes**

Per cent of the respective working-age population of each group, 2010



Source: Eurostat.

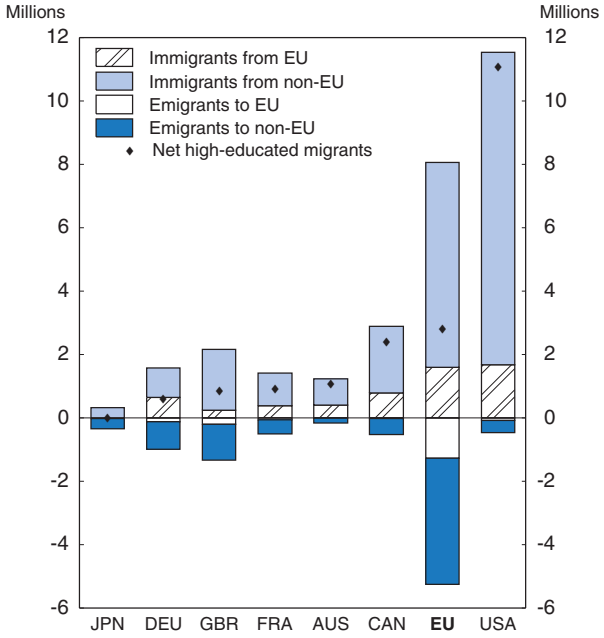
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offer an opportunity to tackle skill shortages. To manage migration flows effectively, countries need to take a comprehensive long-term perspective.

Many EU countries have introduced policies aimed at facilitating the recruitment of high-skilled workers from non-EU countries with the aim of meeting growing shortages. However, with the exceptions of Ireland and the United Kingdom, high-skilled migration to the European Union has been limited. Australia, Canada and the United States are the leading net beneficiaries of high-skilled migrants; almost two-thirds of non-OECD nationals of working age with tertiary education living in OECD countries can be found there (Figure 2.9). For some countries, like Ireland, Italy or the United Kingdom, outflows of their own high-skilled citizens even cancel the inflows of high-skilled foreign nationals. Poland and Portugal experienced the largest net loss of high-skilled workers due to important outflows, respectively to Ireland, the United Kingdom and the United States (Figure 2.10).

Figure 2.9. **High-skilled migrants:[1] Main OECD countries *vs.* EU**

Population aged 15 and over, 2005/06



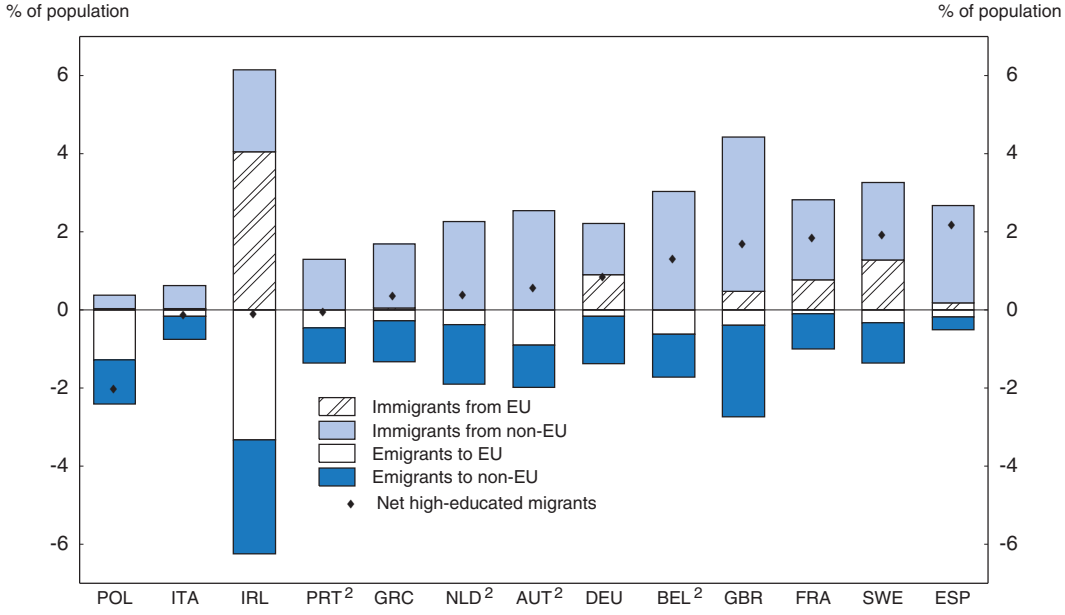
1. Excluding persons with unknown education.

Source: Widmaier, S. and J.-C. Dumont (2011), "Are Recent Immigrants Different? A New Profile of Immigrants in the OECD based on DIOC 2005/06", *OECD Social, Employment and Migration Working Papers*, No. 126, OECD Publishing, Paris.

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Figure 2.10. **High-skilled migrants[1] in the EU**

Population aged 15 and over, 2005/06



1. Excluding persons with unknown education.
2. No breakdown between EU and non-EU immigrants is available for Austria, Belgium, the Netherlands and Portugal.

Source: Widmaier, S. and J.-C. Dumont (2011), "Are Recent Immigrants Different? A New Profile of Immigrants in the OECD based on DIOC 2005/06", *OECD Social, Employment and Migration Working Papers*, No. 126, OECD Publishing, Paris.

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A stronger EU-level migration policy can ease future skill shortages

Migration policies in EU countries are shaped by domestic needs; countries decide how many economic migrants to admit. Most European countries have demand-driven labour migration systems, where labour migrants must have a job offer to obtain a residence permit and a work permit. EU countries often favour temporary migration for the low-skilled and reserve permanent residence permits for high-skilled foreign workers (OECD, 2009). In 2009, EU countries issued about 2.3 million new permanent residence permits to non-EU citizens; family and employment are the main purposes followed by education (Table 2.7). Currently, the types of work permits, the link with the residence permit, the duration of the work permit, the eligibility criteria and the exemptions from work permits for non-EU nationals vary significantly across countries (Kahanec and Zimmermann, 2011). Point-based migration systems, which assess people based on their skills and other factors, are implemented in Denmark and the United Kingdom. Some countries have quota systems which limit the annual inflow of migrants. Earnings thresholds for obtaining a work permit also differ substantially between countries. In Belgium they stand at EUR 36 000 per annum, compared to roughly EUR 65 000 in Germany. In almost all EU countries, employees transferred within multinational companies and high-qualified/high-level employees are exempt from the work permit requirement (*e.g.* researchers in Belgium) or they fall under special schemes and simplified procedures (*e.g.* Denmark, Germany and Italy). Many EU countries have discussed or facilitated legal

Table 2.7. **Total number of new residence permits issued**

2010 data

	Total	Family reasons	Education reasons	Employment reasons	Other reasons
	Number of permits	Per cent of total			
Austria	30 596	48	12	10	31
Belgium	67 653	42	8	6	43
Bulgaria	4 051	44	37	7	12
Czech Republic	34 653	43	15	33	9
Denmark	28 576	18	21	43	19
Estonia	2 647	37	15	29	19
Finland	19 210	35	23	15	27
France	194 973	42	32	9	17
Germany	117 202	45	26	14	16
Greece	33 623	49	4	29	18
Hungary	14 601	23	27	29	21
Ireland	22 235	9	61	14	15
Italy	589 988	31	4	61	4
Latvia	2 329	33	13	17	37
Lithuania	1 861	39	23	32	7
Netherlands	54 478	40	19	19	22
Poland	101 574	3	9	85	3
Portugal	37 010	47	15	29	9
Romania	10 218	45	32	17	6
Slovak Republic	4 373	27	8	41	25
Slovenia	7 537	42	8	49	1
Spain	257 721	51	10	33	6
Sweden	74 931	35	19	25	20
United Kingdom	732 208	17	37	17	29
EU26 (excl. Luxembourg)	**2 466 150**	**30**	**21**	**32**	**17**

Source: Eurostat (online data code: migr_resfirst).

channels for migration into lower-skilled jobs, by offering limited possibilities of legal entry for workers for low-skilled jobs to reduce irregular migration (EC, 2011b). This is also one of the elements of the Commission's 2010 proposed Directive on seasonal workers (EC, 2010h). Competition for high-skilled migrants is more intense and a number of countries have streamlined the migration procedures to accelerate the delivery of work permits to attract high-skilled non-Europeans. In Belgium permits for high-skilled migrants and investors are issued within an average of three weeks, while in Spain or Italy it can take up to six months.

To attract high-skilled migrants, lowering administrative barriers alone is not sufficient. It is not enough to allow high-skilled people to enter: they must also wish to do so (Chaloff and Lemaitre, 2009). Some factors are more important than others in determining the attractiveness of a country for migration: wage levels, quality of life, existing communities, language, the likelihood of permit extension and permanent residency and access to the labour market for family members. Countries also have to implement more active recruitment policy, including reaching out – through international job fairs, multilingual job postings, special assistance to high-skilled migrants, attractive terms for international students in key sectors – to achieve their objectives. Employers need to make an effort to actively recruit from abroad. This is more difficult for SMEs, if there is a very limited supply of native-speakers outside the country.

In recent years, efforts have been made to develop a common migration policy at the EU level (Article 79 of the Treaty, Box 2.4). The EU approved a continent-wide work and residence permit, the so-called "Blue Card", allowing high-skilled non-EU citizens to work and live in the EU (EC, 2009d). The Blue Card, one of the EU's main policy initiatives, attempts to create an attractive package for high-skilled migrants (including favourable rules on family reunification) to work in the EU rather than elsewhere in the world. The Blue Card is granted dependent on a job offer with a salary at least 1.5 times the average from an employer. The aim is to create a common application procedure for non-EU workers to reside and work within the EU. It would provide high-skilled migrants with a scheme that would grant free movement within the EU.

Box 2.4. **Migration policy at EU level**

Since 1999, there were first steps towards a joint-EU migration and asylum-related policies. The Hague Programme (2005-09) developed for the first time a policy plan for labour migration and a range of mechanisms for exchanging information on integration policy. In December 2009, EU countries agreed to the Stockholm Programme (2010-14), which consists of a long list of action points including migration and development, labour migration, rights of non-EU nationals (integration, irregular migration and a range of asylum issues). But while the programme has lots of details, it offers few specifics on how to achieve a common approach to labour migration. The common EU policy framework on the EU common rules on labour migration is laid out in the "Policy Plan on Legal Migration":

- The right to family reunification is recognised throughout the EU. Legally residing non-EU nationals can bring their spouse and children to the country in which they are residing. Family members receive a residence permit and obtain access to education and employment. After a maximum of five years of residence, family members can apply for autonomous status (EC, 2003a).

Box 2.4. **Migration policy at EU level** *(cont.)*

- The status of long-term residents with equal rights as nationals is awarded after five years. It is dependent upon the person having a stable and regular source of income, health insurance and, when required, having complied with integration measures (EC, 2003b).
- The directive on the conditions of entry and residence of third-country nationals for the purposes of highly-qualified employment proposals (the "Blue Card") was adopted in May 2009, but has not been implemented in all countries yet (EC, 2009d).
- In December 2011, the Commission's proposal for a directive on a single application procedure for a single permit for third-country nationals to reside and work in the territory of an EU country, and on a common set of rights for third-country workers legally residing in an EU country was adopted. The so-called "Single Permit" Directive aims to simplify the procedures and improve the working conditions of all non-EU nationals residing and working in an EU country (EC, 2007b).
- The EU applies common rules of admission for non-EU students (EC, 2004). The 2005 "Researchers" Directive provides for a fast track procedure for the admission of non-EU researchers for stays of more than three months if the researcher has a "hosting agreement" with an approved research organisation (EC, 2005c).
- Two other proposals were adopted by the Commission in July 2010. The proposal on intra-corporate transfers aims at facilitating the temporary migration of high-skilled professionals (EC, 2010b), while the proposal on seasonal workers aims to create common criteria and procedures for low-skilled migration (EC, 2010h).

Further initiatives aim to curb irregular migration and to improve integration of non-EU nationals into labour markets.

- Curbing irregular migration. The EU develops measures by targeting employers who hire irregular migrant workers, fostering *return policies*, targeting human trafficking networks and smugglers. In February 2010, the Council of Ministers of Justice and Home Affairs approved a number of measures aimed at reinforcing the protection of the external borders and combating irregular immigration (EC, 2011b). Frontex opened its first specialised office in charge of the Eastern Mediterranean in Greece, and organised its first return flight for a group of irregularly residing foreigners to Georgia. The year 2010 was also marked by the deployment of the first Rapid Border Intervention Team at the external EU border with Turkey. This Rapid Border Intervention Team, which was deployed on 2 November at the request of Greece, which could no longer monitor this border alone, consisted of 190 persons (mainly border guards) from the other EU countries (EC, 2009a; EC, 2010e; Council 2011).
- Managing migration through partnership with non-EU countries. In November 2011, the Commission adopted a Global Approach to Migration through partnerships with non-EU countries. The plan would address effective border controls to reduce irregular migration, facilitate legal migration and better protect victims of human trafficking (EC, 2011e).
- Improving integration into labour market. The EU is promoting European co-operation to develop common approaches and exchange information at the EU level. The most significant element of the conclusions adopted on this occasion concerned the launch of European modules for migrant integration intended to help the EU countries set up integration programmes. The themes concern language learning and courses introducing the destination society, integration by the host community and the active participation of immigrants in all aspects of collective life (EC, 2011f).

National schemes can be maintained alongside the Blue Card. EU countries will have the possibility to define quotas for the non-EU high-skilled workers they allow onto their territory and a certain amount of flexibility with regard to some provisions of the Blue Card. Many criteria and conditions are much stricter than the comparable Green Card issued by the United States. The Blue Card should have been implemented in the participating EU countries by 2011 but some EU countries have not passed national legislation so far. While granting the ability to work in any EU country is a significant step forward, the conditions offered are too restrictive. The two-year initial validity is shorter than in some other countries, while the required income conditions are tighter. Furthermore, to move to another EU country, the migrant would have to overcome the same administrative hurdles and paperwork that exist today. Another limitation to the Blue Card is the assumption that the possibility of secondary mobility is a significant drawing card. High-skilled migrants are especially sensitive to language requirements. It is difficult to work at one's level of competence in another country, without a high level of proficiency in the national language or in an international language that is commonly used in the workplace.

Policies at the EU level need to be further developed to ensure that migration responds to labour needs, such as expected shortfalls in labour supply and skill shortages. Managing labour flows in a labour migration framework at the EU level is important because high-skilled migrants are sensitive to obstacles such as the still fragmented nature of EU labour markets. The recent Blue Card scheme should be used effectively to make the EU more attractive to high-skilled workers. Over time, the EU should move to a single regime for labour market migration to remove inconsistencies resulting from differences in national approaches to labour migration while respecting the principle of subsidiarity**.**

Box 2.5. **Summary recommendations on mobility and migration**

While overall freedom of movement of workers in the EU is guaranteed from a legal point of view, *de facto* many obstacles induced by national policies remain. To reduce them:

- Improve portability of public and private pension entitlements to avoid losses in pension value from moving between countries. Pension reforms should be designed with a view to facilitating movements both between employers and across borders. As proposed by the Commission, a vesting period of no more than one year across the EU should be ensured when transferring into pension schemes across borders. Allow workers to pay into occupational and supplementary pension schemes in their home countries while working in another EU country.
- Eliminate double taxation of cross-border pension benefits and discriminatory taxation of cross-border transfers of pension capital.
- Develop recognition mechanisms aiming to ensure more automaticity in the recognition of professional qualifications.
- Open public sector employment as far as possible to all EU citizens in national laws and procedures. Public sector employment practices should facilitate labour mobility, including through recognition of seniority and qualifications acquired in other countries.
- Improve job matching across borders. Pursue the reform of EURES enabling greater European mobility, and enhancing placement and matching between labour supply and demand. The EURES network and portal should be upgraded and co-operation, and information-sharing between national employment services should be improved.

Box 2.5. **Summary recommendations on mobility and migration** *(cont.)*

Migration policy

Policies at the EU level need to be developed to ensure that migration responds to labour needs, such as expected shortfalls in labour supply and skill shortages.

- Managing labour flows in a labour migration framework at the EU level is important because high-skilled migrants are sensitive to obstacles such as the still fragmented nature of EU labour markets.
- Use the Blue Card scheme effectively to make it more attractive to high-skilled workers.

Notes

1. In this report, migration should be understood as referring to legal migration.
2. Foreigners are foreign nationals living in a country. If available, shares are in percentage of working-age population.
3. EU8+2 refer to all Central and Eastern European countries. EU12 refer to all countries that joined the EU since 2004.
4. A similar cross-border labour mobility wave as after the EU10 accession took place in the second half of the 1950s and the 1960s. Strong economic growth and labour shortages induced a number of western European countries to actively recruit unskilled workers from southern European countries. Germany, Austria, Belgium, the Netherlands, Switzerland, Denmark, and Sweden recruited workers from the southern European countries on a temporary scheme (guest-worker system) which became permanent in many cases. Many workers stayed eventually, but many also returned to their home countries, as is the case with enlargement.
5. Since there is no specific EU legislation on employment in the public sector, the Court of Justice is decisive in the interpretation of EU law in this field. Article 45(4) TFEU makes an exception to the general right to free movement of workers. It states that "The provisions of this Article shall not apply to employment in the public service". However, the ECJ has ruled that Article 45(4) TFEU only covers restrictions of access to certain posts in the public service to nationals (Case C-370/90 Singh ECR [1992] I-04265). In principle, the ECJ has stated that once an EU national or a returning national is applying for a post reserved for nationals, no different treatment can be justified by invoking Article 45(4) TFEU. For any other aspect of access to a post (*e.g.* recognition of qualifications) or determining working conditions (*e.g.* taking into account professional experience and seniority), equal treatment of EU and returning nationals with national workers must be guaranteed.
6. Low-skilled persons are defined as having an educational attainment level of primary education or less (ISCED 0, ISCED 1 or ISCED 2). High-skilled persons are defined as having completed at least the first stages of tertiary education, which corresponds to ISCED 5 or ISCED 6 according to the International Standard Classification of Education (ISCED 1997).

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Glossary

ACER	The Agency for the Co-operation of Energy Regulators
ASEAN	Association of South East Asian Nations
BEREC	Body of European Regulators for Electronic Communications
CAP	Common Agricultural Policy
CCCTB	Common Consolidated Corporate Tax Base
CEDEFOP	European Center for the Development of Vocational Training
EBA	Everything But Arms
ECC-Net	European Consumers Centers Network
ECJ	European Court of Justice
EIB	European Investment Bank
ENTSO	The European Network of Transmission Operators
ESAs	European Supervisory Authorities
ETS	Emissions Trading System
EU	European Union
EURES	European Employment Services
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
GSP	Generalised System of Preferences
ICT	Information and Communication Technology
IMI	Internal Market Information System
IORP	Institutions for Occupational Retirement Provision
MERCOSUR	The Common Market of the South
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
PMR	Product Market Regulation
PPP	Purchasing Power Parities
PPS	Purchasing Power Standards
R&D	Research and Development
SEA	Strategic Environmental Assessment
SMA	Single Market Act
SMEs	Small and Medium Enterprises
SOLVIT	Internal Market Problem Solving System
TEN-T	New Transport Infrastructure
TFEU	Treaty on the Functioning of the European Union
TSOs	Transmission System Operators
UNFCC	United Nations Framework Conditions on Climate Change
VAT	Value Added Tax
WTO	World Trade Organisation

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(10 2012 08 1 P) ISBN 978-92-64-12733-3 – No. 59945 2012

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Please cite this publication as:
OECD (2012), *OECD Economic Surveys: European Union 2012*, OECD Publishing.
http://dx.doi.org/10.1787/eco_surveys-eur-2012-en
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Volume 2012/8
March 2012

OECD publishing
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ISSN 0376-6438
2012 SUBSCRIPTION (18 ISSUES)
ISSN 2072-5078
SUBSCRIPTION BY COUNTRY

ISBN 978-92-64-12733-3
10 2012 08 1 P

