Market Integration: EU Integration, Globalisation and Delocalisation

Prof. Dr. R. Veugelers

EC-BEPA, KULeuven & CEPR

Changing economic environment

- **Firms and industries have witnessed considerable changes in basic demand and supply conditions : Technoglobalism: Speed of technological change (ICT) & Market integration at the global scale**

Ongoing process of global market integration

- **The process of market integration initially triggered in the EU by the Single Market Program (SMP) and continued by the EURO, Internal Market Strategy (IMS) (financial markets integration, liberalisation in network industries…) systematically changes the nature of competition, and therefore the structure and performance of industries and firms.**
- **A single European market should strengthen the Community's competitiveness in world markets : *Lisbon strategy***

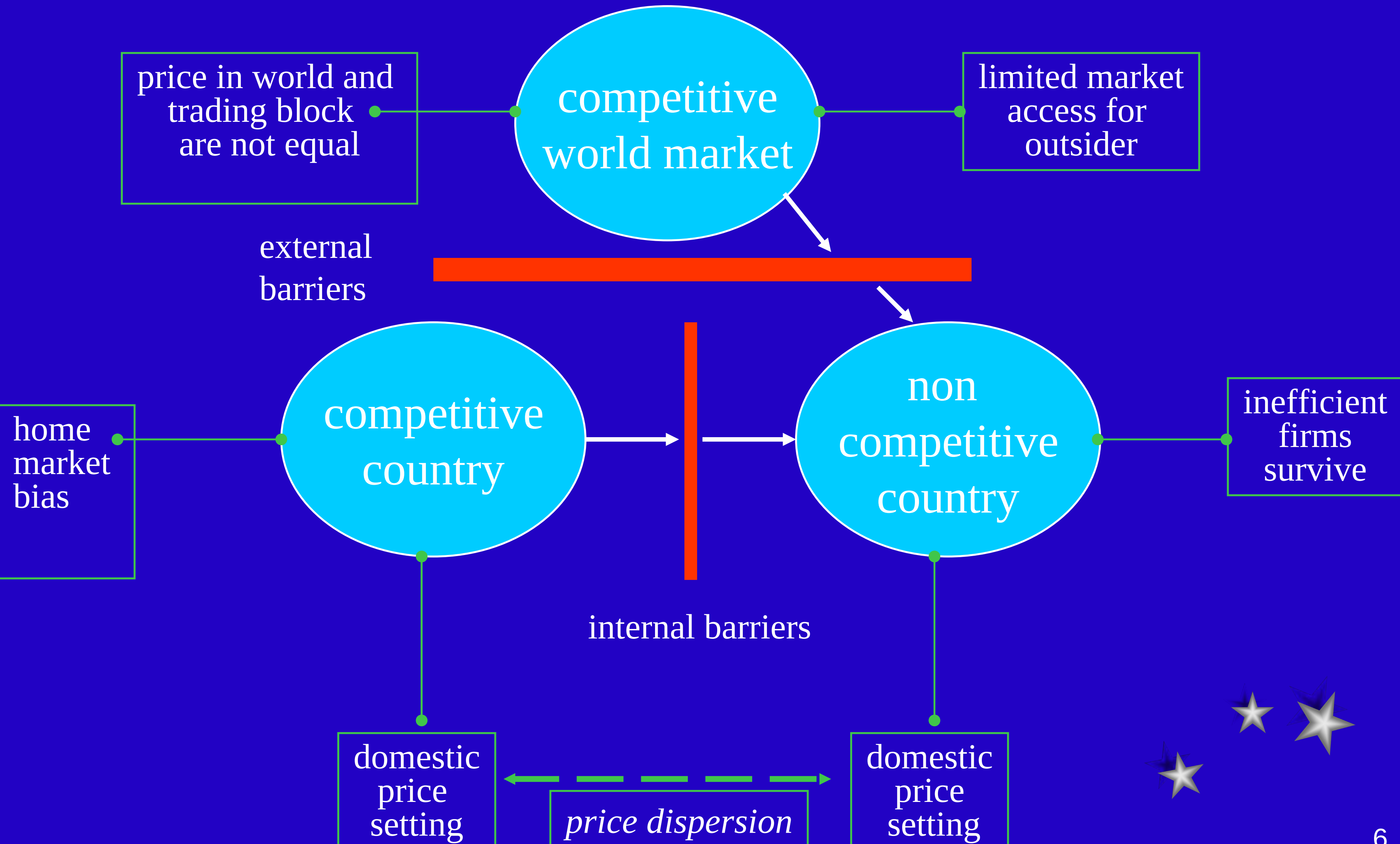
Impact of Market Integration

- Defining market integration: the implementation of the four freedoms
- A macro-view on market integration: specialisation according to comparative advantage
- A micro view on market integration: restructuring corporate strategy

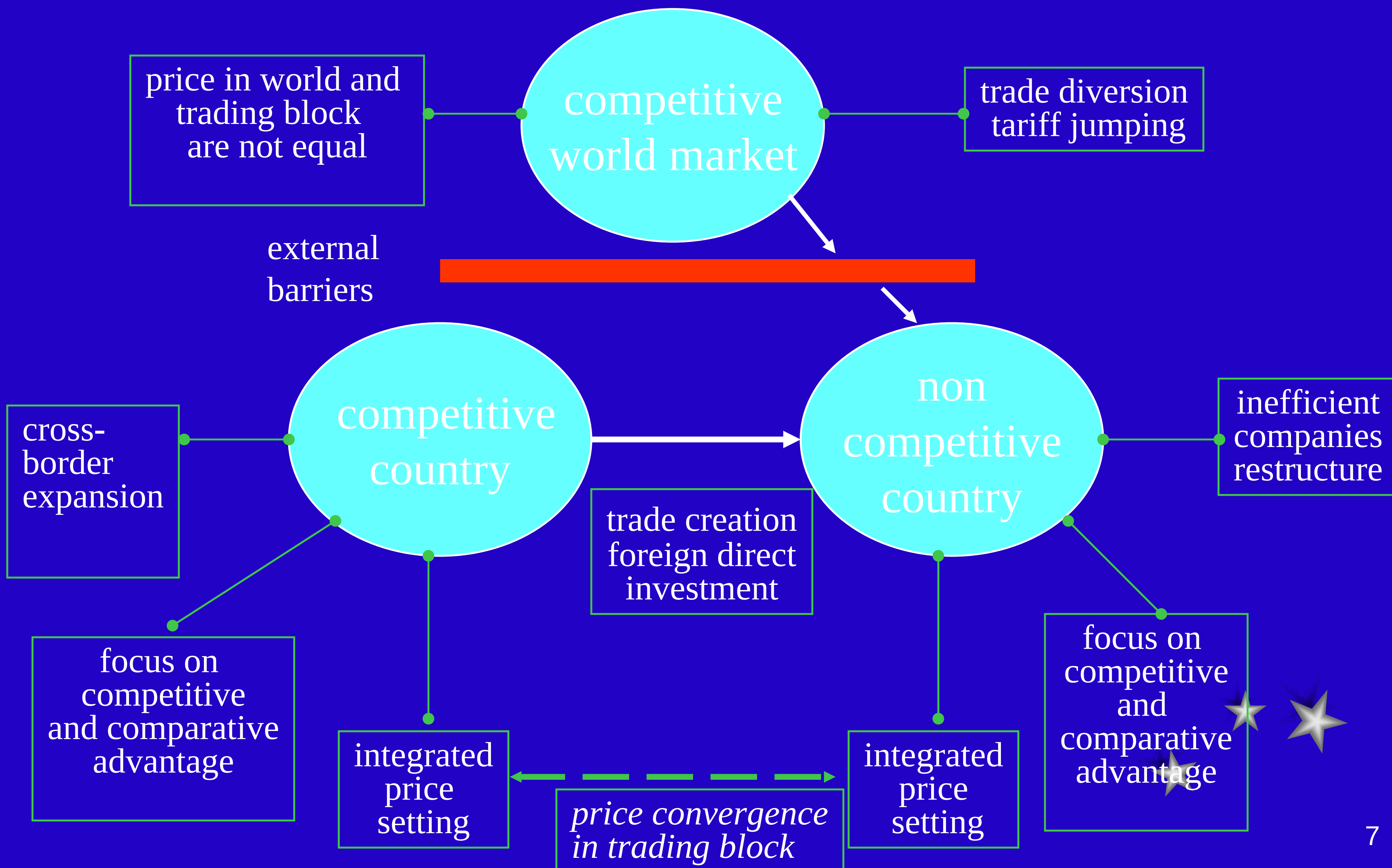
mobility of goods	trade integration	customs union
	standards & rules	mutual recognition minimum standards
	taxes	VAT and excise taxes
mobility of services	liberalization	mixed success Bolkestein directive
mobility of capital	integration of financial markets	home country control partial success
	taxes	profit and financial tax harmonisation
	mobility of firms	integration with protectionist backlash
mobility of labor	free movement of labor	restrictions result in limited labor mobility

The Macro View: Specialisation According to Comparative Advantage

segmented markets



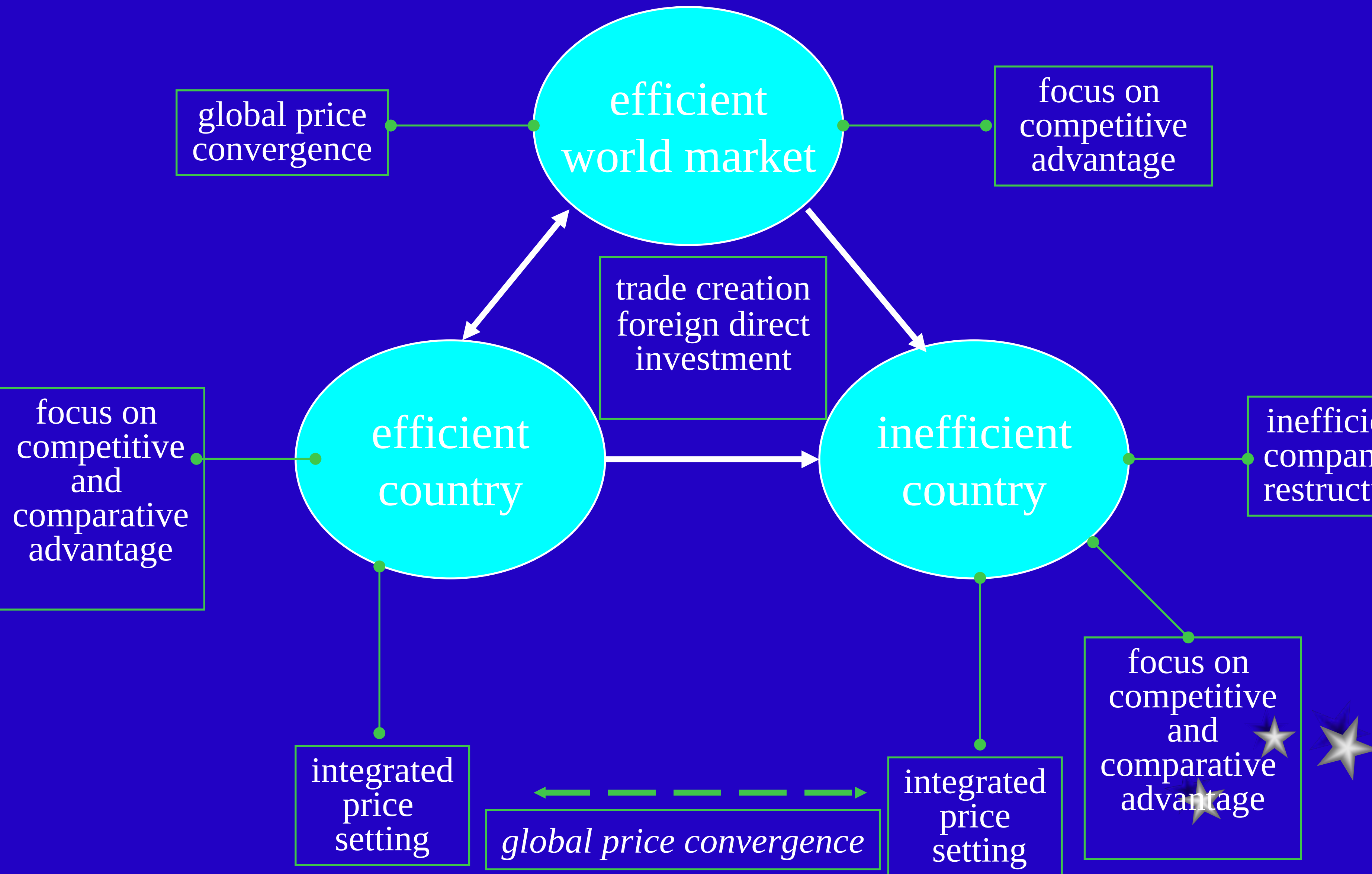
integration in trading block



Macro-economic effects of integration: ex ante analysis

- **price convergence**
- **from home bias to cross-border expansion**
- **specialisation of countries according to comparative advantage**
- **focus of firms on core competences**
- **trade diversion: insiders versus outsiders in the trading block**

global integration

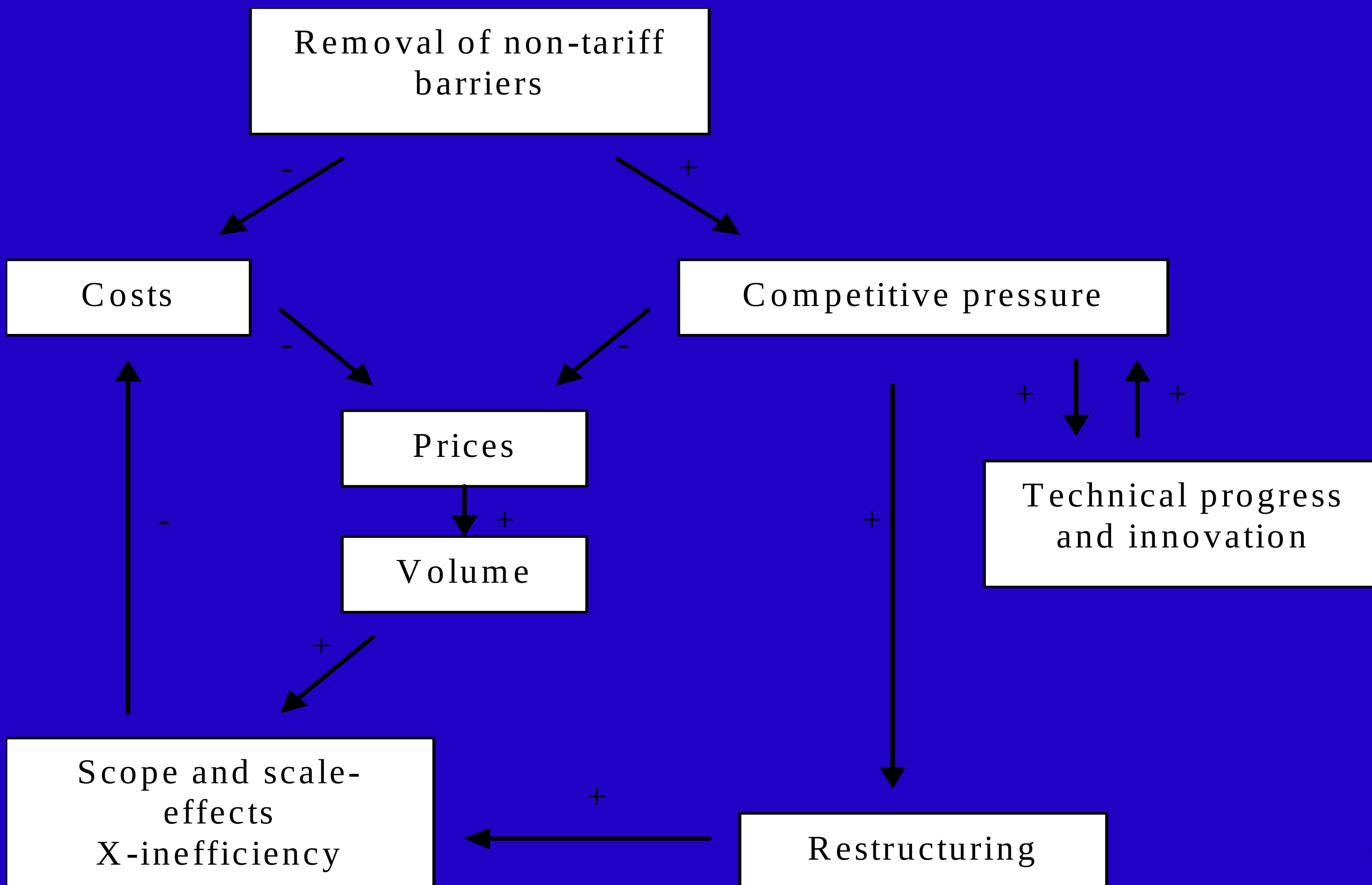


The micro-view

Market Integration and Corporate Restructuring

Major micro-economic effects: ex ante analysis

- direct cost savings due to the elimination of non-tariff barriers, such as fewer customs delays and costs of multiple certification;
- cost savings derived from increased volumes and more efficient location of production,(scale and learning economies and better exploitation of comparative advantage);
- tightening of competitive pressures, reduced prices and increased efficiency as more firms from different member states compete directly in the bigger market place;
- increased competitive pressures generating speedier innovation.


Removal of non-tariff barriers
Costs
Competitive pressure
Prices
Volume
Technical progress and innovation
Scope and scale-effects
X-inefficiency
Restructuring

Main Predictions on the impact of market integration on firm and industry structure

- **Firm structure:**
  - Increased multinationality: both intra-EU and extra-EU FDI
  - Reduced diversification: return to core business
- **Industry structure:**
  - Higher producer concentration: exit of marginal producers; smaller number of larger, more efficient producers-
  - Lower seller concentration

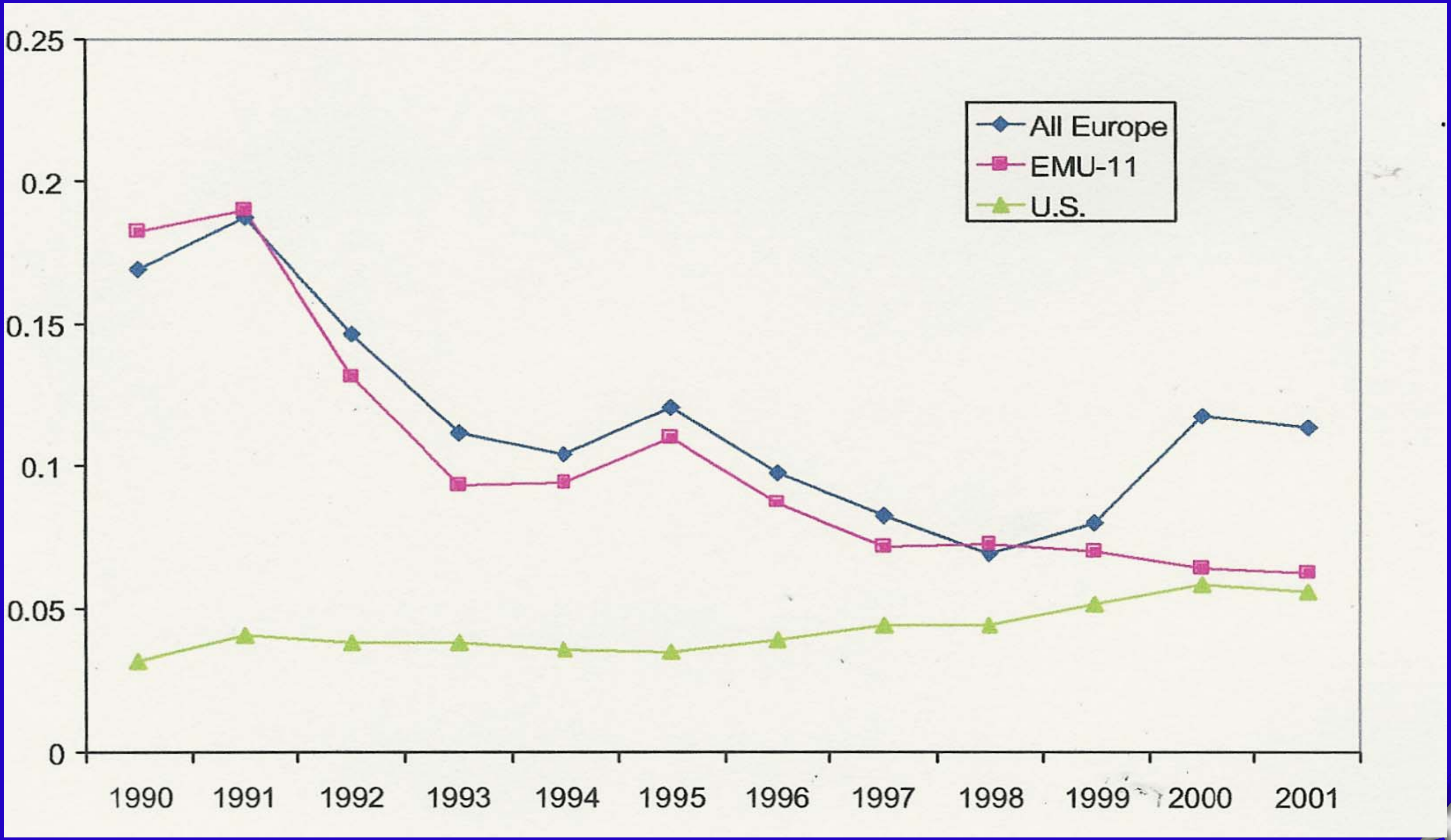
European Market Integration

An assessment ex post

Are EU product markets fully integrated ?

An analysis of price convergence?

PRICE DISPERSION OF TRADEABLES ACROSS EU AND US CITIES

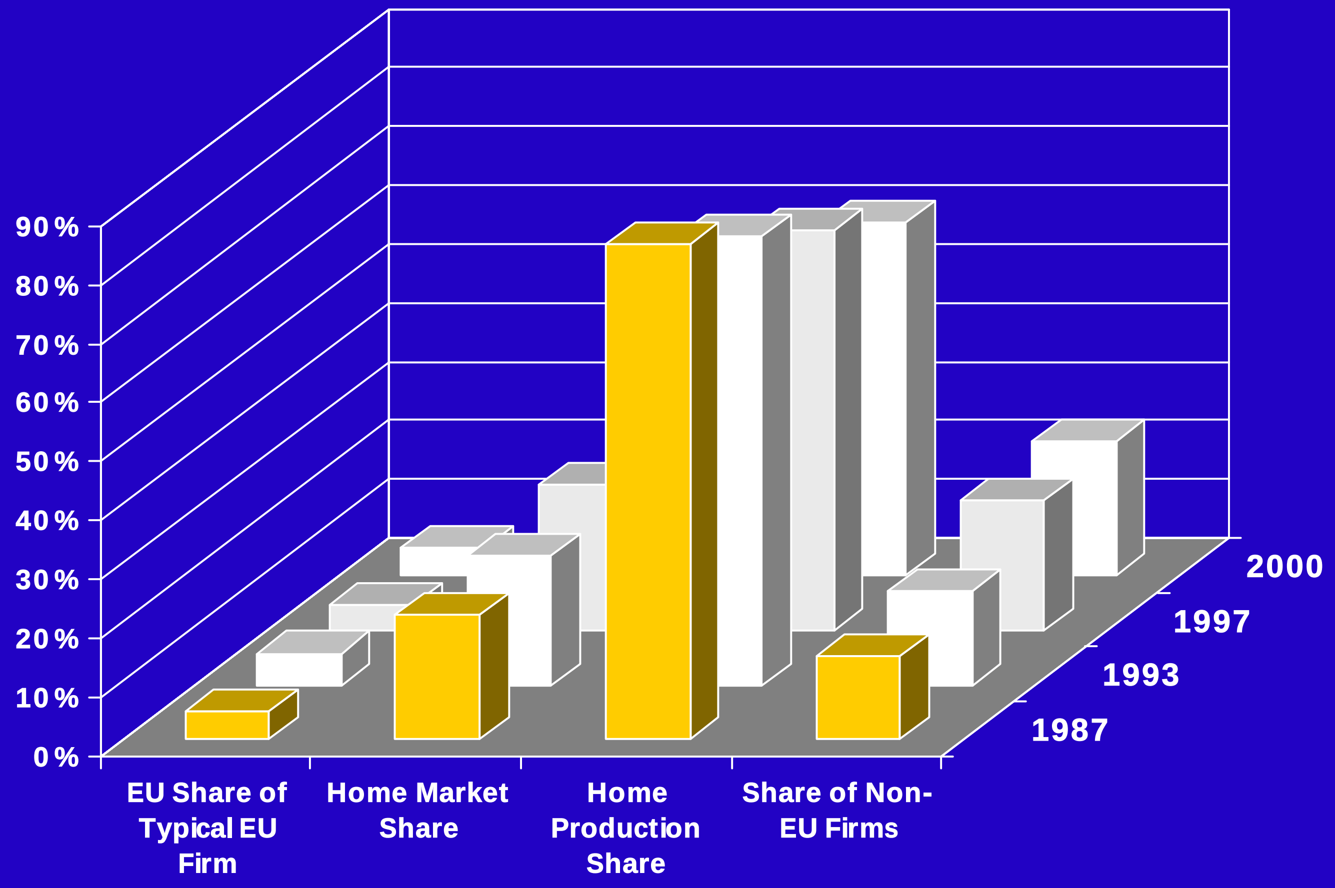


Source: Rogers, J.H. (2002) "Monetary Union, Price Level Convergence, and Inflation: How close is Europe to the US", International Finance Discussion Paper no 740, Board of Governors of the Federal Reserve System.

Price Dispersion in the car market

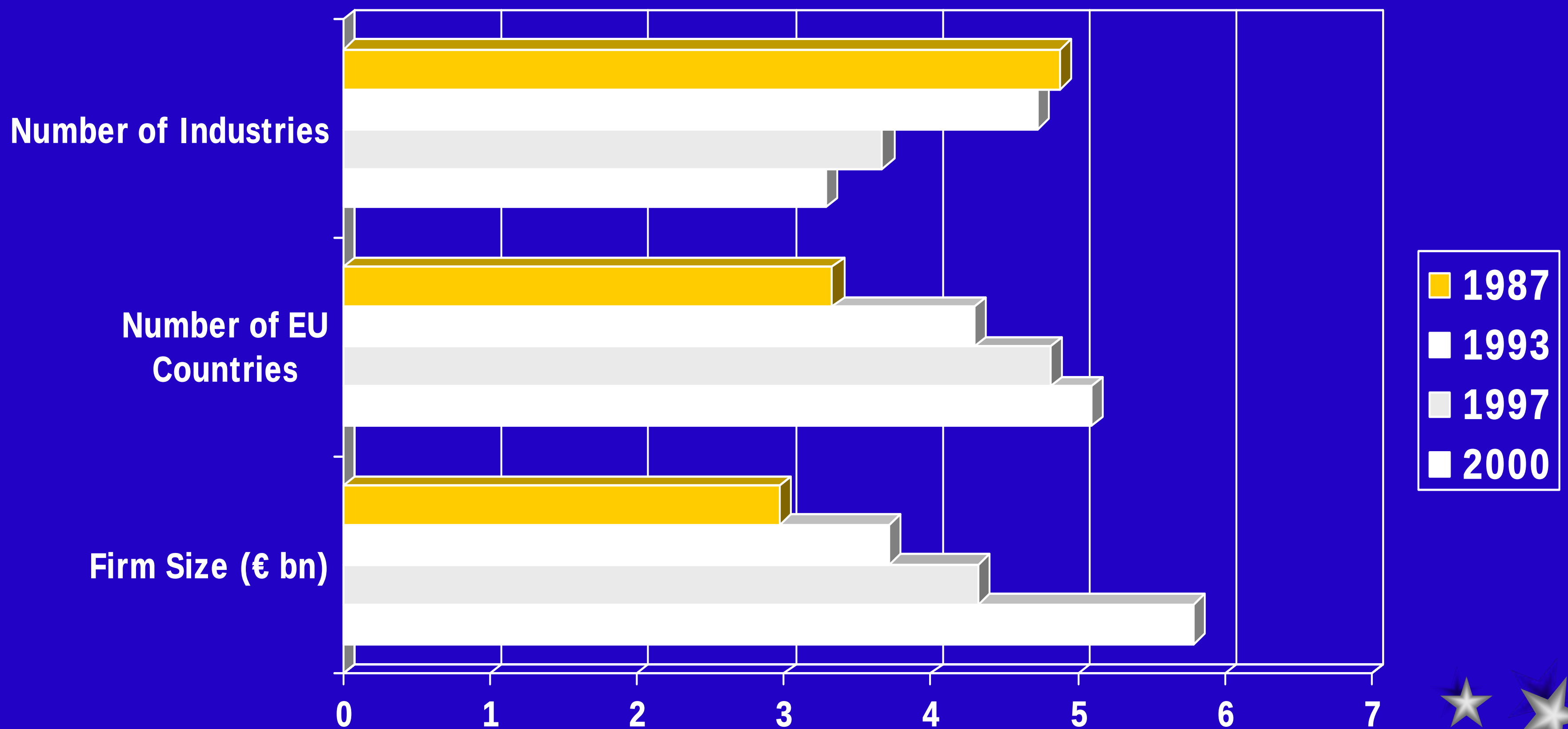
	1993-1998	1999-2001	2002-2003
	All Countries		
Price Range, all Countries	**36.0**	**38.1**	**25.4**
Price Range, excl. most expensive and cheapest	**20.7**	**19.7**	**15.9**
Coefficient of Variation	**9.8**	**9.6**	**7.0**
	Euro Countries Only		
Price Range, all Countries	**25.3**	**20.6**	**17.6**
Price Range, excl. most expensive and cheapest	**14.8**	**13.2**	**12.1**
Coefficient of Variation	**7.7**	**6.2**	**5.5**

Home Market Bias in EU Manufacturing



Based on data for the 5 leading companies in 67 sectors
Source: Van Pelt. De Voldere. Sleuwaegen and Veugelers (2001. 2002)

Geographic and Sectoral Specialization in EU Manufacturing



Based on data for the 5 leading companies in 67 sectors
Source: Van Pelt. De Voldere. Sleuwaegen and Veugelers (2001. 2002)

Effects on corporate & industrial structural

- Leading firms have considerably increased their size
- Leading firms have substantially reduced their diversification, especially their non-leading diversification
- Leading firms have substantially increased their non-home production within the EU.

- Producer concentration has declined slightly initially, but increased again later
- Although concentration increased only slightly on average, this hides considerable turbulence of market shares. The leading companies have considerable market share position relative to new leading firms

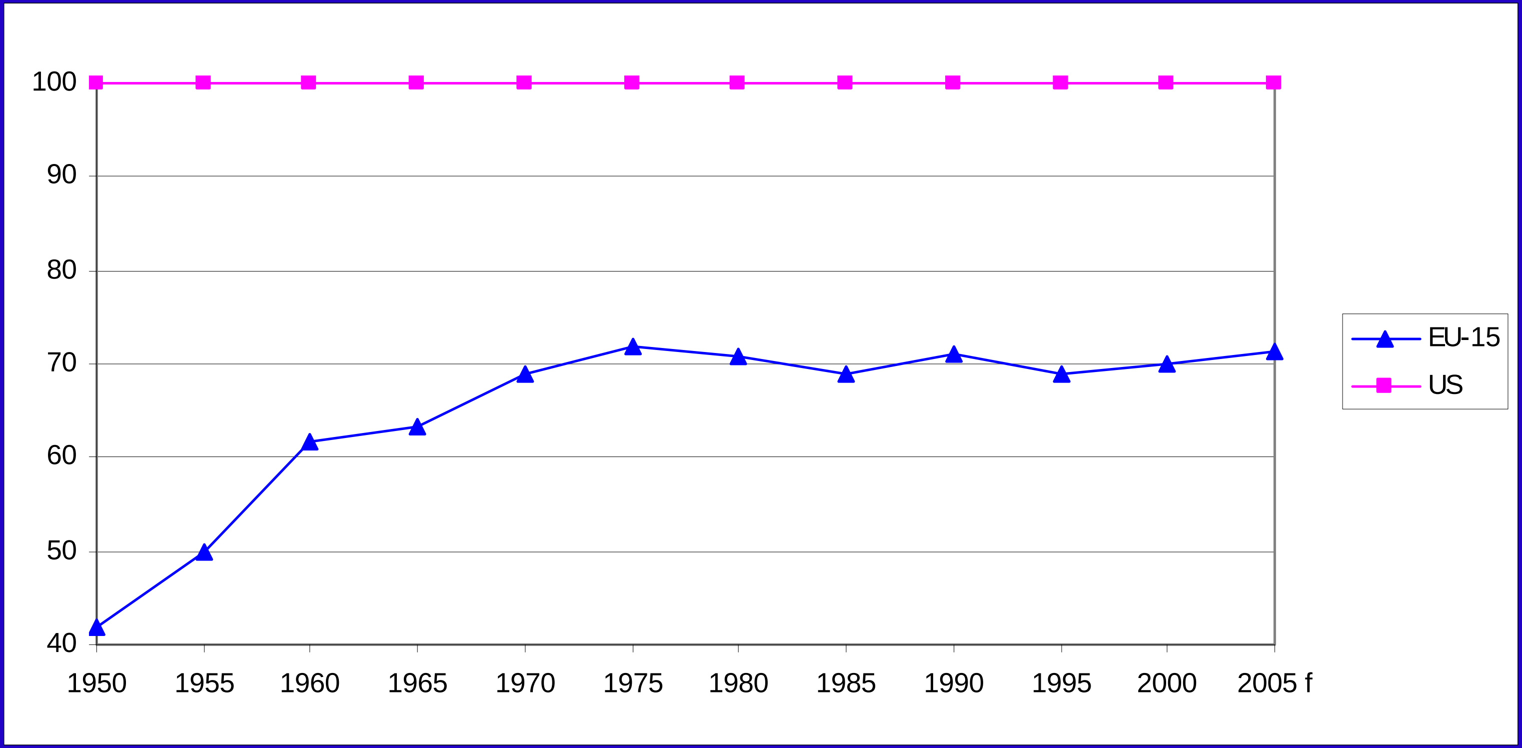
Effects on corporate & industrial structure

- All this suggests that the increasing size of EU leading firms is mostly related to refocusing on leading businesses in which a more multinational production base is build. The changes are most marked in the later periods, as compared to the pre-93 period, suggesting an ongoing, accelerating, process of market integration.
- M&A have been an important driver for the observed trends in turbulence, increasing concentration, increasing multinational production and refocusing.

Macro-economic performance of the EU economy

- **Macro-model simulations show that annual GDP growth rates would have been a quarter of a percentage point lower without the process of product market integration**
- **In spite of the progress made in the 1990s in terms of product market integration, EU living standards were no longer catching up with those in the US.**
  - Need for further structural reforms: the Lisbon Agenda

GDP per capita in PPS (US=100)



Annual % change of GDP per capita	EU 15	US
1961-1980	3,3	2,5
1981-1990	2,1	2,2
1991-1995	1,2	1,2
1996-2000	2,4	2,9
2001-2005	1,2	1,6

Delocalization

A heated public debate

Eurobarometer (Spring 2005):

➔ **The “transfers of jobs to other countries that have lower production costs” scores the highest on the list of things EU citizens say they are afraid of (73%)**

The wider context: Globalisation

- ➔ **The current debate on delocalisation is an integral part of growing globalisation over the past decades.**
- ➔ ***Economic theory* and the *historical record* suggest that increased international integration has rarely if ever led to a net reduction of employment over more than short periods of time.**

Problems of definition and measurement of delocalisation

- **Problems of definition**
  - Delocalisation: substituting home for abroad production
    - Offshoring: intra-firm *FDI*
    - (International) Outsourcing: inter-firm *intermediates' trade*
- **Problems of measurement**
  - FDI statistics (to where?) & Trade statistics (what and where?)

    Evidence so far suggests limited size as yet and on average
  - Surveys (representative? Subjective?)

    Evidence suggests the phenomenon will increase in future

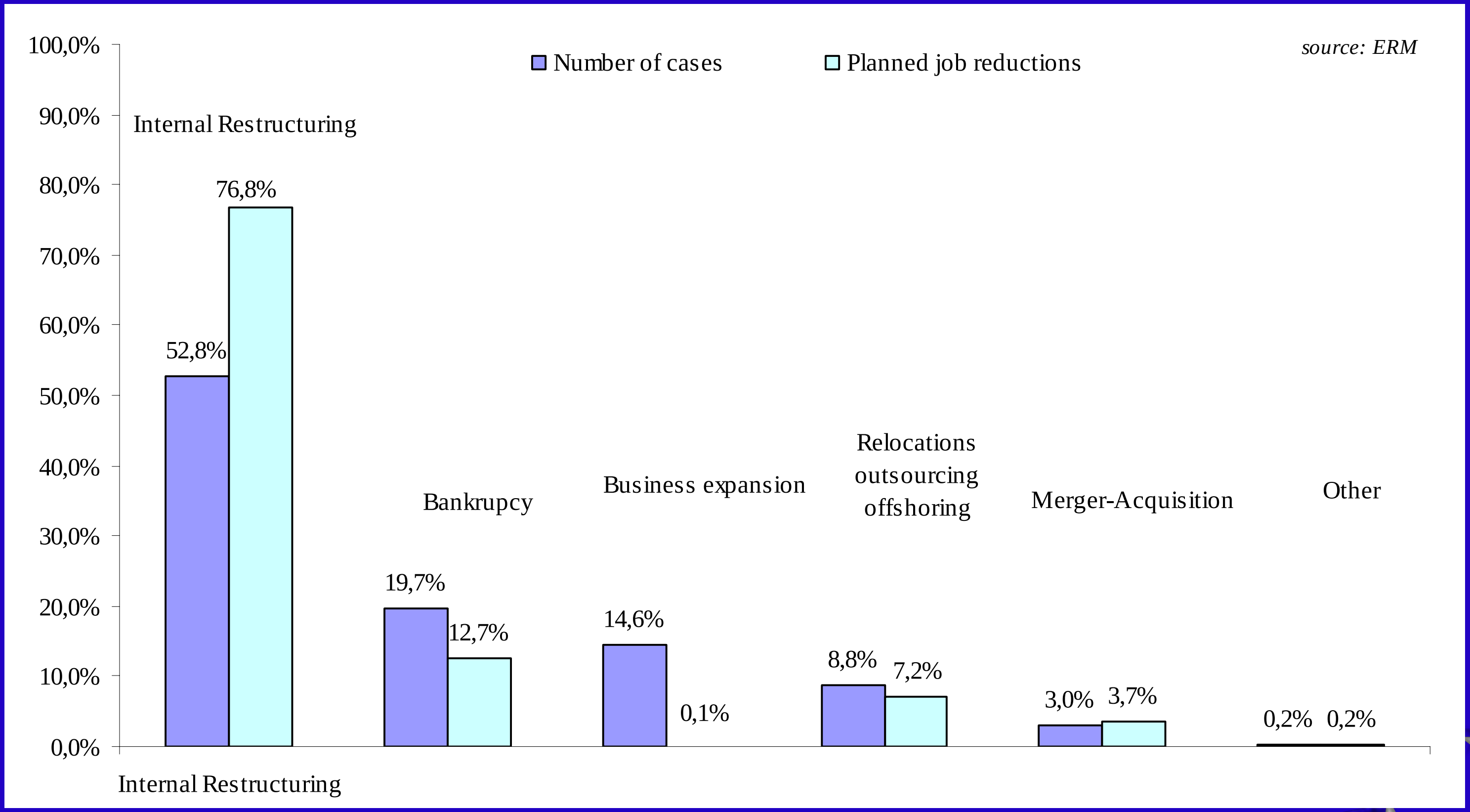
Surveys on relocation intentions:

Example: Ernst & Young European Attractiveness Survey (2005):

- 32% of the surveyed companies responded positively on the question on relocation intentions (33% in 2004).
- Geographical distribution of relocation sites for these intentions is 40% NMS, 22% China, 16% W-Europe, 7% India and 2% US.

But currently relocation still small relative to restructuring in general

European Restructuring Monitor



Relocation of business services

- **Overall, still minor in size compared to manufacturing, but growing faster, esp in US**
- **Delocalisation in services is a two way street:**
  - Increasing exports from India and China.
  - However, both countries also significant outsourcers (importers) of business services, mainly to US and UK.
  - Largest surplus countries are UK and US

Source: Amiti and Wei, Economic Policy (2004)

Impact

Evidence from individual country studies

- **Positive impact on productivity**
  - Outsourcing firms have higher productivity/profitability, esp. firms selling on world markets
  - Lower cost savings for DE/FR compared to US (McKinsey)
- **Limited impact on employment**
  - Minor part of overall labour market turnover
  - Source of impact difficult to determine (technological change?)
- **Larger impact on income distribution (US)**
  - Reduced demand for low skills (skill bias)
  - Skills improve the speed of reallocation
  - Negative impact on wage equality (esp US)
  - Source of impact difficult to determine (technological change?)

The reallocation process

Can the EU address effectively the process of reallocation in the short term?

- **Policy objective:**
  - NOT: prevent relocation by closing borders
  - BUT: ensure that globalisation and delocalisation no longer a threat to jobs, but an opportunity for growth
- **Twin-track policy response aimed at improving ability to adapt:**

  A. Improve EU's capability to create/sustain growth
    - Make EU an attractive location for investment
    - Improve EU firms' competitive position ➔ exploit opportunities offered by international markets

  B. Facilitate transition

Need for policy mix approach to exploit complementarities among policy instruments: the Lisbon agenda