FONDATION ROBERT SCHUMAN

POLICY PAPER

Schuman Paper
n°761
24th September 2024

Benoît CŒURÉ

Europe in a fragmenting global economy: leveraging the Single Market and competition policy

Global economic waters are incredibly perilous. The Trump presidency has widened the rift between the United States and China, estranged the United States from its economic allies and dealt a blow – maybe a fatal one – to the international trade system. Fragmenting forces were then fully unleashed by the Covid pandemic and the Russian invasion of Ukraine. Global production chains and cross-border financial links are under strain[1]. How can Europe navigate these choppy waters?

THE GLOBAL ECONOMY IS FRAGMENTING UNDER OUR FEET

For analytical clarity, it is useful to differentiate between economic, strategic and regulatory fragmentation.

Economic fragmentation is easier to see. In fact, it is all around us. Covid and the war in Ukraine have wreaked havoc in global production chains. This has been by and large mended, but with a long-term cost: longer production chains (ECB, BIS) and the lingering threat of other disruptive events will make international trade permanently costlier. Moreover, both shocks have evidenced the dependency of advanced economies on critical inputs such as raw material and chips, as well as energy. As for *strategic* (or *geopolitical*) *fragmentation*, its economic consequences can be illustrated by the impact of financial sanctions on the global financial system, and by the rise of sovereignty concerns about critical technologies (such as chips) and data. Finally, *regulatory fragmentation* could come next. Has it materialised yet? How would it materialise? Here we can see in this field, the good, the bad and the ugly.

Good news comes from the financial sector, where the Basel Committee on Bank Supervision and the Financial Stability Board have upheld cross-border cooperation. I have also been pleased to see a convergence in the field of competition. As an example, G7 competition enforcers gathered in Tokyo in October 2023 exchanged strong words on risks to competition in the emerging artificial intelligence industry. With the Digital Markets Act, Europe has provided a template which many other regions are now trying to adapt and adopt.

Results have been more mixed in terms of trade. The World Trade Organisation has been struggling with the temptation of reshoring and friendshoring, or what may also be called "trustshoring", that is, the temptation to relocate to countries you trust politically rather than countries with superior comparative advantages. Free trade agreements are increasingly challenged by interest groups. The early 2024 farmers uprising in France has shown that the benefits of free trade agreements have been at best miscommunicated, and most likely overstated by economists.

Where regulatory fragmentation might become plainly ugly will be in terms of data and technology, in areas such as data transfers, the provision of cloud services or the regulation of artificial intelligence. This is for reasons we can understand: national security concerns always prevail, and approaches to privacy vastly differ across regions. The economic costs of fragmentation will be there, regardless.

[1] This text was originally published in the 'Schuman Report on Europe, the State of the Union 2024', Editions Marie B., April 2024, 236 p.

Persistent global fragmentation would raise the cost of doing business globally, prevent an efficient allocation of resources, and make it more difficult for our nations both to sustain the living standards of their citizens and deliver global public goods, such as fighting climate change. The cost would be particularly dire for Europe, an open, exporting economy with an ambition to be the poster child of multilateralism. So, how can it rise to the challenge?

BUILDING ON EUROPE'S STRENGTHS

Europe can leverage its key asset, the Single Market, and build a new industrial policy toolkit. But the devil is in the details.

Completing the Single Market

In 2012, upon the 20th anniversary of the Single Market, Jacques Delors called it the "cornerstone of the European Union". The Single Market serves not only our businesses and our consumers at home, it also serves to disseminate our values globally and assert our sovereignty. This is not always appreciated by European citizens who reap its benefits in their daily lives, just like the air they breathe. Looking back at what has been achieved since 1992, the picture looks rather different along the Single Market's four dimensions (goods, services, capital and people), particularly when it comes to services and capital.

First, the Single Market was clearly established with trade in goods in mind, rather than that in services. Today, the latter account for 65% of the EU's GDP, while industry is down to 23%. The services sector accounts for more than 75% of European employment, compared with 45% in 1970. This is a massive shift from when the Single Market came into being. In services, much more than in goods, widespread regulatory heterogeneity between Member States adds to the costs of doing business. Thousands of rules continue to give a headache to, or discourage entirely, professionals willing to exercise their skills in another Member state. Regulatory barriers are also entry barriers in the competition sense. They stand in the way of European services firms achieving scale and profitability, they deprive consumers of access to a wider array of purchasing options, and they ultimately stifle innovation. Let's not be mistaken: it is not because of competition policy that pan-European firms have not emerged in the telecom or media industries, but because of fragmented national markets, which competition rules can only acknowledge. Completing the Single Market in services is a necessity in order for European economies to boost business entry rates, technology creation and dissemination, and to lift our weak productivity growth – all of which we know for a fact are closely linked.

Turning to capital, a truly integrated single market would enable it to flow to where it can be optimally invested. It would foster competition for good credit and lower the cost of firms' equity capital. By diversifying the funding mix of European businesses, it would help them finance investments in intangible assets for which collateral values are hard to quantify, or in new technologies with uncertain future payment streams. But there is a long way to go. European businesses tend to finance their debt through bank lending rather than on the stock market, and four fifths of this lending is domestic. Stock market capitalisation in Europe is less than a fifth of that in the United States. There is no unified market for government securities providing liquidity and safe investment opportunities, as it is the case in the United States. This is another fragmented market.

The Capital Markets Union (CMU) project was launched to great fanfare in 2014, but it has been sputtering along the road. Besides a few tangible achievements such as the regulation on markets in crypto-assets, it has failed to face the twin challenges of on the one hand, removing barriers to cross-border capital flows that are deeply rooted in national laws and regulations, and on the other hand, overcoming vested interests to create a single financial watchdog. Rebooting the Capital Markets Union is urgent if we want the artificial intelligence revolution to be funded with European money. The most convincing argument to convince politicians in that the « C » in CMU could as well stand for « Climate ». Given the amounts which will be needed (620 billion euros per year on average

until 2030 according to the European Commission), there will be no climate transition in Europe without a genuine Capital Markets Union. Recently, there has been a renewed commitment to the project. Let's hope that this newfound wisdom is not like Hegel's Minerva owl, that spreads its wings only when dusk has fallen.

Setting the rules of the game

One European policy has flourished steadily and rather consistently over the years, that was neither born out of nor abated by economic shocks: competition policy.

Competition policy is intrinsically connected to the Single Market. A level playing field allows firms to flourish and to put forward their own merits. Competition law enforcement pursues all types of behaviour that distorts this process. It forbids agreements among market players to freeze market conditions – for instance by allocating customers or fixing prices. It also sanctions conduct that allows companies to stifle competition because they are dominant and abuse this special position, and force rivals out from the market or impose on them exploitative conditions of operation. It does so, moreover, by identifying regulatory obstacles that hinder or prevent altogether entry onto a market and further development therein. In both aspects, the Single Market is the reference of national competition enforcers. It is the very aim of EU competition policy to ensure that undertakings can compete on equal terms throughout the Union. Competition policy does not only support the establishment and functioning of the Single Market. It also embodies the Single Market in that it is indeed a single policy. It also allows Europe to affirm its international standing and contributes to one of its raisons d'être, which Václav Havel described on receiving the Charlemagne Prize in Aachen as being "to help to shape creatively a new pattern of global coexistence". In the eyes of the companies that are fined by the Commission or by any of the national competition authorities on the basis of articles 101 and 102 TFEU, the Single Market is undoubtedly a regulatory and enforcement bloc.

The digital economy is a case in point. In June 2022, Meta submitted for the first time commitments to an antitrust authority – the French Competition Authority – to address competition concerns regarding its behaviour in the online advertising sector. Although the French Competition Authority has jurisdiction only over French territory, Meta voluntarily chose to extend the benefit of its commitments to all eligible business partners, beyond this geographic scope. The European legal perspective on the abuse of dominance thus prevailed on a worldwide scale, due to the perception that the single market is large and unified enough that it makes sense for such a global player as Meta to refer to it as an authoritative standard. Similarly, the establishment of an ad hoc European regulation of digital platforms – the Digital Markets Act – shows how the lessons learnt from competition law enforcement do, in turn, reinforce the Single Market, and project its values globally. The definition of the specific obligations on gatekeepers set out in the Digital Markets Act was largely based on the antitrust decisions issued by European competition enforcers. Here again, the values embodied in our approach to competition have been enshrined in a legal standard, that will be binding upon any firm doing business in Europe.

The new industrial policy toolkit and its shortcomings

Until Russia invaded Ukraine, not much had happened. This has changed. European institutions have matched initiatives taken by other global players, including the United States' Inflation Reduction Act, with an aim to overcome the energy crisis, make their economies more resilient and drive the green transformation. A series of European laws have been drafted to step up funding of renewable energy, connect energy grids across the continent, secure access to critical raw materials, strengthen the chips ecosystem, etc.

This industrial retooling is good news, but things are not as easy as they seem. First, delivery will be key. The (next) Commission and Council will need to make sure that they can keep all these balls in the air and make their decisions reality. Second, a closer look at the new industrial policy toolkit reveals that it has been mostly funded by national budgets, through temporary exemptions to the State aid framework. At

the end of 2023, the Commission had approved around 750 billion euros of State aid under the temporary framework, representing 5% of the European Union's gross domestic product. Only a fifth of it has actually been spent, but this is not the point. Today, industrial policy is only available to countries with a strong fiscal position (such as Germany) or a prodigal approach of public finance (such as France). This comes with the dual risk of tying the fate of Europe's industrial renewal to a discussion on fiscal rules, and using industrial policy to nurture local champions. It sows the seeds of political division and risks harming the single market in a way that will eventually outweigh the benefits.

The obvious solution is to supplement Capital Market Union with joint permanent funding instruments for industrial policy, building on the successful experience with NextGenerationEU. This would have the additional merits of securing a Europe-wide approach to industrial policy, which would leverage the benefits of the Single Market while safeguarding competition. History has shown that the path leading to joint European funding is legally narrow and fraught with political difficulty, but it has also proved it to be possible, with the establishment of the European Stability Mechanism and of NextGenerationEU. We are again at one of these historical moments where European countries can only succeed if they act together. Let's trust Mario Draghi and Enrico Letta to find the right words, in their reports on Europe's competitiveness and the future of the Single Market, to convince European leaders of this.

Benoît Cœuré
President of the Autorité de la concurrence

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Publishing Director: Pascale JOANNIN
ISSN 2402-614X

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