

## Views on the Turmoil and Internal Market<sup>1</sup>

### Authors:

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The Internal Market has been the focus of much political attention, efforts from lawmakers and commentaries of all sorts. At the occasion of the tenth anniversary of the Internal Market in 2002, the benefits of this extraordinary reform programme were outlined: wider choice, higher quality, lower prices, 1 million cross-borders students thanks to the Erasmus programme. In economically measurable terms, the internal market was estimated to translate into 1.8% additional GDP, 2.5 million jobs created and an extra prosperity of €5,700 per household delivered on average<sup>3</sup>.

Beyond these numbers, the Internal Market is a fantastic political achievement acknowledged around the world the successful outcome of one of the most comprehensive and ambitious programmes of structural reform.

Is this mission accomplished? No, it would be wrong to believe that the internal market is achieved. Professional accountants assisting enterprises of all size know by experience that, in practice, many obstacles remain and further harmonisation and simplification will be essential to enable business seize the opportunities of the Internal Market. This is especially true for SMEs, i.e. the vast majority of enterprises in the EU, more than 90%.

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<sup>1</sup> The views in this paper are those of the authors.

<sup>2</sup> FEE represents 43 professional institutes of accountants and auditors from 32 European countries, including all 27 EU Member States. In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 500.000 professional accountants working in different capacities in public practice, business, government and education, who all contribute to a more efficient, transparent, and sustainable European economy. To find out more about FEE, go to [www.fee.be](http://www.fee.be)

<sup>3</sup> Commission Working Document, The Internal Market – Ten Years without Frontiers.

The Internal Market is also SMEs' best asset to compete on global markets: it provides them with access to the necessary critical mass of consumers and sources of input, including capital, or it should. In this respect, it is interesting to take a closer look at what forms the infrastructure of the Internal Market for business, the basic foundation on which all other policies can prosper: company law.

A simple legal framework is essential to enable SMEs to seize the opportunities that the internal market is expected to deliver; it also contributes to enhancing legal certainty and reducing administrative costs. In the framework of the consultation on the European Private Company carried out in 2007, the Commission carried out a European Business Test Panel revealing that 56% of the companies participating thought that uniform company rules in the European Union would be useful. Harmonisation is essential to facilitate access to the Internal Market, make it easier to apprehend for companies irrespective of their size and to level the playing field.

Society is going through an unprecedented crisis affecting finance, economics and politics. Much of the focus has been on the banking industry and on other capital markets participants. In this context, it should be kept in mind that SMEs play a key role in the resilience of our economy and the dynamics of the job market. Many SMEs are integrated in the supply chain of larger business of which they form an essential element and to which they provide flexibility, innovation and cost efficiencies; however, SMEs often suffer more rapidly and more radically from a shrink in demand or a credit crunch. It is urgent to help SMEs make efficiency gains and secure their liquidity and access to finance. To this end, transparency and reliability of financial reporting is instrumental.

**Transparency** is essential to management and investors, regulators and supervisors and is a pre-condition of stakeholders' empowerment and democratic scrutiny. Historically, business is moving toward greater transparency and much progress has been made in the recent past. In addition, thanks to technological progress, the costs of transparency are decreasing. However, an insufficient degree of transparency has been largely blamed as one of the main cause of the crisis. Due to the importance of the SME sphere, information regarding SMEs has also become crucial for the governability of the economy<sup>4</sup>.

**Harmonisation** of financial reporting contribute to reducing administrative costs both on the side of SMEs producing the information (and also using the same information on their business partners), professional accountants verifying the information, creditors and public administrations using the information in their decision-making. Harmonised information is easier to understand and interpret. Legal certainty is increased; learning costs and errors rates are cut, compliance and enforcement costs are reduced.

On that basis, the European Parliament is right to call for a harmonised, coherent and comprehensive accounting framework for Europe and the recent commitment of the European Commission to table relevant proposals in October 2009 is welcomed.

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<sup>4</sup> See European Committee of Central Balance-Sheet Data Offices' Opinion on the Communication from the European Commission on Simplified business environment for companies in the areas of company law, accounting and auditing (COM 2007 394 final)

However, politicians and regulators, who remain essentially local, may lack the commitment to develop such a harmonised framework and may be tempted to look for national solutions. This would be an error in a world where markets, investors and businesses (and more and more irrespectively of their size) are – or think – European or global.

With current crisis, the time is right for Member States to overcome counterproductive differences or perceived divergences and agree to provide SMEs with a true and effective Internal Market.

On 26 November, the European Commission published its Communication on a European Recovery Plan<sup>5</sup>. This indeed welcomed initiative proposes a series of potentially helpful measures; it also aims at restoring the momentum for a number of pending proposals and launches ideas that will have to be further explored. However, it is surprising to note that it only makes limited references to the Internal Market, as if open competitive markets, policy coordination and harmonised and streamlined legal frameworks could not help.

The Plan notes "*the benefits of scale offered by the euro and the largest single market in the world*" and calls to accelerate the adoption of the European Private Company, on the basis that SMEs need to be able to "*work under a single set of corporate rules across the EU*". However, it is regrettable that the Plan did not benefit from more input from practice as it would have helped avoiding a fatal contradiction with another proposal made by the same plan to remove the requirement on micro-enterprises to prepare accounts and to allow business to work with a capital of one euro. What may look like a helpful hand may sometimes turn into a beat in the back, as there is no successful and sustainable business without three essential elements: (i) an effective market (the good idea), (ii) adequate capital, and (iii) proper management and accounting skills.

In practice, it is not so much a matter of more or less regulation, but a matter of better regulation. New or revised regulations should only be developed where there is clear evidence that the benefit they provide to society as a whole are greater than their costs. Experience tells that emergency legislation, political pressure and lack of stakeholders' consultation and evaluation often leads to unintended consequences.

It should also be reminded that much of the credibility of the European Commission has largely come from the objectivity and expertise it applies in approaching the issues. As a policymaking body, the Commission has become a world class benchmark in impact assessment. This key element of its better regulation strategy helps proposals to be based on objective grounds and robust factual evaluation, rather than resulting from mere political or communicational incentives. However, the word impact assessment is not mentioned once in the Plan.

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<sup>5</sup> A European Economic Recovery Plan COM(2008) 800.

Today, it is not only that the Internal Market is not fully operational, it is also that it seems to fall victim of the lack of political commitment. There are concerns of growing protectionist temptations in certain Member States and the EU Institutions, originally created to overcome this and impose the Rule of Law, seem to be having a harder time. More than ever, Europe needs a Guardian of its legal system; this is the role given by the Treaty of Rome to the Commission, turning it into a political arena will not help.

What is true for business can also be true for regulators. The financial crisis has made the case for proper coordination and the need for a European approach. As businesses and investors, regulators and supervisors also face additional burdens, uncertainties and pitfalls due to inconsistencies and conflicts or loopholes in legislations. The current policy debate on supervision and European coordination is an encouraging sign that the Member States realise the need to address the issue.

In a globalising world, policymakers are increasingly competing to make their jurisdictions attractive; however globalisation simultaneously enhances their common interest and forces them to cooperate. The starting point for such global coordination is however local. A disunited, uncoordinated, fragmented, slowed-down and ageing Europe will not be heard in the global arena. The need for a common voice and a common market is greater than ever.

However coordination and approximation of legislation will not solve of the issue. What the current crisis also tells us is that in the end, it is often a matter of persons. Behind many of the causes of the crisis, some see a common root that, in the end, has to do with individual behaviour, be it in the trading floor, the boardroom or the regulatory agency. The way certain financial instruments have been diverted from their original purposes for pure short-term speculation provides a topical example. It is up to society as a whole to reflect on ways to restore and enhance ethical standards, in particular in business practices. In its own field, the accountancy profession, being bound by a global Code of Ethics, will continue promoting integrity, objectivity, independence, professional behaviour, competence and due care amongst its members.

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