

## Policy Brief No. 57, January 2023

### EU's Single Market at 30

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**With the establishment of the Single Market in 1993, the EU created the centerpiece of European Integration. The Economic and Monetary union (EMU) with the introduction of the Euro should complete the economic integration. The anniversary of 30 years of EU's SM offers the opportunity to evaluate what has been achieved and what still needs to be accomplished. With the SMP the EU started with a noble goal to create a free market comparable to that of the USA. Over the last decade, however, a series of crises have prevented the goals from being achieved: the global financial crisis 2008, the Great Recession 2009, followed by the Euro crisis in 2010. Ten years later, the COVID-19 crisis 2020/21 shocked Europe, followed by the energy crisis (connected with Russia's invasion of Ukraine) in 2022. The last two crises have even led to deviating from the path of the free-market economy and to embark – via emergency measures – into a controlled market economy, if not into a semi-planned economy. Nevertheless, overall, the creation of EU's SM had increased prosperity via an intensification of intra-EU trade.**

#### 1. Introduction

The now called European Union, starting in 1958 as European Economic Community (EEC) with six founding Member States (MS) already had as one of its most ambitious goals the establishment of a "common market" in Europe. Only 35 years later, after the EEC transformed to the European Community (EC) and ultimately to the European Union (EU) in 1993, the EU launched the "single market" (SM).

After another 30 years, it is time to take stock of what has been achieved and what is still unfinished. In the following, firstly a brief history of the Single Market (SM) shows the development so far. Then, the achievements concerning the main features of the SM is reviewed. A literature review informs about the estimated economic impact of the SM. Finally, the outlook discusses the open questions how to reform the SM and the future challenges facing the EU's SM in view of the current multiple crises.

#### 2. A brief history of the Single Market

The Treaty of Rome that came into force in 1958 already aimed at establishing a "common market". Only parts of this goal were reached. On the one hand by the establishing of a "common market" for agriculture (later also fishery) via the Common Agricultural Policy (CAP) in 1962 and by the completion of the Customs Union in 1968 eliminating all tariffs for intra-EEC-trade.

This implied a common external tariff and a common commercial policy (CCP).

The Merger Treaty of 1967 brought about the first institutional reform that unified the three communities, the European Coal and Steel Community (ECSC), the European Atomic Energy Community (Euratom) and the European Economic Community (EEC) to the Economic Community (EC).

With the Free Trade Agreements between the EC and the EFTA states in 1973 a free trade area for industrial goods had been created by mid-1977 in Europe.

Starting with 1973 the EC began to expand: from EC6 to up to now (after the Brexit) 27 MS.

However, the grand goal of the founding fathers of the European integration, the creation of the "common market" was still open.

The impetus to finally establish a common or single market came from the fact that in the 1980s the European economies were lagging those of others in the west, particularly those of the United States. On March 23, 1983, President Ronald Reagan announced the Strategic Defense Initiative (SDI), nicknamed the "Star Wars program". Although the SDI project never came to fruition, it had a tremendous political impact. Alone its announcement not only alarmed the then Soviet Union, but also Europe feared that it would fall behind the USA in terms of competition. Therefore, top leaders of European companies forced the EC leaders to act.

In 1985, the Commission of the European Communities (1985, p. 4) presented the White Paper "Completing the Internal Market". The goals of the White Paper were then enshrined in the Single European Act (SEA), effective in 1987.

However, an internal or single market à la USA<sup>1</sup> is not completed if it not also is accompanied with a common currency. For this purpose, in 1988-89 the Delors Committee worked out the road map for an Economic and Monetary Union (EMU). The study "One market, one money" (Commission of the European Communities, 1990) evaluated the pros and cons of a common currency for the EU. With the Maastricht Treaty, effective on November 1, 1993, these ambitious goals, the creation of the SM and the introduction of a common currency - the Euro – was legalized.

On 1 January 1993 the EU started with the completion of the Single Market (SM)<sup>2</sup>. The SM project (SMP) was followed by the start of EMU in 1999 and the introduction of the Euro in 2002.

The European Council had to acknowledge twice that the development of the SM is not proceeding as favorably as predicted. Therefore, two growth-enhancing strategies (the Lisbon strategy of 2000, and the Europe 2020 strategy) were launched.

After several further enlargements (1995, 2004, 2007, 2013, and the Brexit in 2021), two reform packages (SM Act I, and SM Act II) aimed at further improving the functioning of the SM.

#### A setback with Brexit

The Brexit in 2021 not only reduced the number of MS from 28 to 27, but it also had a significant impact on the economic and political power of the EU. The size of the Single Market shrank by around 13% (measured as loss of population and GDP; see Breuss, 2021). With a smaller Single Market and less Member States the foreign policy importance of the EU also shrank. The UK was a member of NATO and without it the EU loses an important defense partner. With Brexit the EU lost also an important European member of the UN Security Council. The loss of around two percentage points of world GDP also weakens EU's negotiation power in future WTO negotiations.

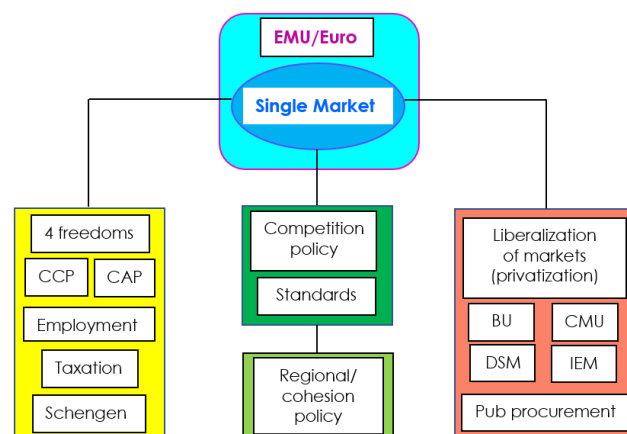
## 3. Main features of the Single Market

The SM is the core of EU integration. Each incumbent is a member of it, and the first task of a new Member State (MS) is to enter the SM. Furthermore, the SM is never finished, it is a permanent "moving target". The basic idea is that with the SM the EU transforms from national heterogeneous markets with their own rules to a common or single market with common rules.

The Single Market Project (SMP) in the strict sense is defined in the Treaty on the Functioning of the European

Union (TFEU; entry into force on 1 December 2009) in the Articles 4(a), 26, 27, 101, 114, and 115, and also in the Treaty on European Union (TEU) in Article 3.

**Figure 1:** EU's Single Market – in a broader perspective



BU = Banking union; CAP = Common agricultural policy; CMU = Capital markets union; CCP = Common Commercial Policy; DSM = Digital single market; IEM = Internal energy market.

In a broader sense not only the four freedoms and competition policy constitute the SM (see Figure 1). A true single market also includes a common currency. The Economic and Monetary Union (EMU) – also still uncompleted - with the Euro and its components Banking union (BU) and Capital markets union (CMU) fulfills this goal. The SM encompasses all supporting policies that have a direct impact on the SM such as taxation, employment, culture, social policy, education, public health, energy, consumer protection, transport, environment, and information society and media. The Schengen Agreement supports one of the four freedoms, the Visa-free movement between MS. Regional or cohesion policy aims at equalizing the development in the EU member states. In addition, in the meantime the EU has created additional single markets, one for energy (IEM) and a single digital market (SDM).

Common rules and laws on public procurement complete the SMP. One of the key principles underpinning the SM is "mutual recognition" of standards. This principle – initialized by Cassis de Dijon case<sup>3</sup> - was introduced because a complete harmonization of national legislation would have been too complicated.

With the start of the Single Market, EU MS more and more privatized their economic sectors and opened them to Single Market competition. Nevertheless, in some countries there are still significant shares of

<sup>1</sup> In a comparison with EU's SM Matthijs and Parsons (2022) claim that the US SM is also incomplete.

<sup>2</sup> The name of the "Single Market" changed over time. Following Mario Monti (2010), in the following we use the expression "Single Market" (SM), except when quoting legal documents, which refer to the "internal market".

<sup>3</sup> See the judgement of the European Court of Justice as of 20 February 1979: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61978CJ0120>

“State-Owned Enterprises (SOEs; see European Commission, 2016; and OECD, 2021).

### A not yet so common market

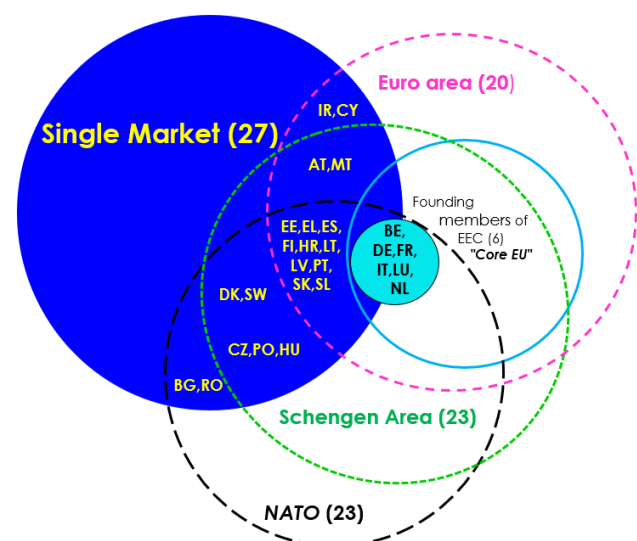
When evaluating the performance of the SM one must realize that it is far from being complete. Moreover, it suffers from several inequalities and inconsistencies:

- (1) There is no real common market, but it consists of regional heterogeneity.
- (2) The ideal of “one market, one money” is still not yet reached. Only 20 out of 27 MS pay with the Euro.
- (3) The EU is “united in diversity”, that means also – in contrast to the SM of the USA – the lack of a common language.

### SM not restricted to the EU27

The EU Single Market is a unified market with 450 million people compared to the USA with 330 million and China with 1,410 million. Through the Agreement on the European Economic Area (EEA) also three EFTA countries (Iceland, Liechtenstein, and Norway) and via bilateral agreements (Bilaterals I and II) also Switzerland take – with certain exceptions – part in EU’s SM.

**Figure 2:** Flexible integration or “Europe à la carte” in EU27



Finland and Sweden will become NATO members in 2023. Source: own drawing

### Flexible integration or “Europe à la carte

Only the six founding EU MS take part in all integration steps since World War II (see Figure 2). Since 2023, 20 EU MS pay with the Euro. 23 take part in the Schengen process. 23 EU MS are also members of NATO. As a rule, each MS must take part in EU’s SM. A country acceding to the EU must participate in the SM and adopt the respective *acquis communautaire*.

## 3.1 The four freedoms – a short performance check

In TFEU, Part Three (Union Policies and Internal Actions), Title I, ‘The Internal Market’ rules the respective provisions in Article 26. Also the TEU defines as one of EU’s goals in Article 3 to “... establish an internal market”.

In the following Titles and Articles of the TFEU the four freedoms and the right of establishment are ruled.

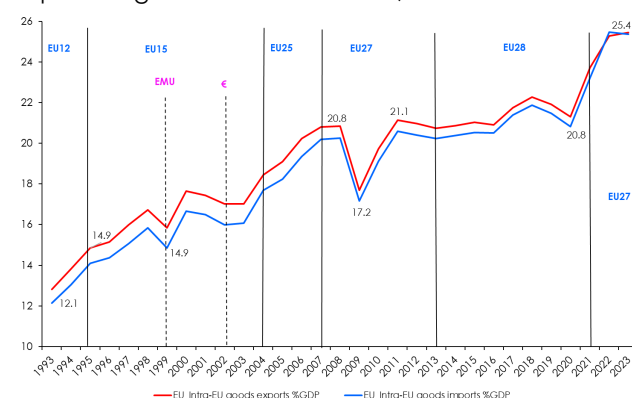
- Article 28 “Free Movement of Goods (Article 30 “Customs Union”)
- Article 45 “Workers”
- Article 49 “Right to Establishment”
- Article 56 “Services”
- Article 63 “Capital and Payments”

To put into practice, the four freedoms fundamentally guaranteed in the TFEU, the EU institutions (European Parliament and Council) must issue directives and regulations. The secondary law of EU’s Single Market has now reached a considerable volume. This became evident in the case of Brexit. The UK had to transform around 20,000 types of EU law into national UK law.

### 3.1.1 Freedom of movement of goods

The cross-border goods trade between the EU MS already were freed from tariffs through the Customs Union as of 1968. One of the major obstacles for bilateral EU trade were the costs of border controls. These hurdles were eliminated with the launch of the SM in 1993. Additionally, there are still some non-tariffs measures (NTMs). With the Brexit in 2021, border controls in trade EU-UK were reintroduced.

**Figure 3:** Percentage of EU-wide Intra-EU exports and imports of goods to EU-wide GDP, 1993 to 2023



The EU labels EU12, EU15, EU25, EU27, EU28 refer to the number of MS included in the EU-wide aggregate during the period for which the label is shown in the figure. Due to Brexit the number of the EU labels are less one (e.g., EU12 = EU11, etc.) Source: Own illustration with AMECO data of the European Commission

What remained the outstanding feature of the expansion of the SM is the strong increase in intra-EU trade

(see Figure 3). Of course, there were setbacks in times of a recession (2009 and 2020).

The increase of Intra-EU trade (in % of GDP) was strongest in the new EU MS. Whereas it increased by around ½% per year in the incumbent EU MS, it expanded by 1% or more in the new MS since 2004.

Openness to imports of goods (total goods imports in % of GDP) amounts to 32.7% in EU average. There is a wide range between EU MS: reaching from 88% in Slovakia to 22% in Italy (Austria 40%, Germany 31%).

The COVID-19 crisis has shown that the assets of a SM market (four freedoms) are not given: disruptions in the SM, such as border closures and breaks in integrated value chains escalated, deeply affecting citizens and businesses.

#### 3.1.2 Right of Establishment

The Right to Establishment is an additional regulation to the other freedoms, in particular to those for services, capital, and people.

#### 3.1.3 Freedom of movement of services

In TFEU, Article 57 addresses also the issue of posting. This was regulated by the "Posted Workers Directive" of 1996.

The Single Market Scoreboard<sup>4</sup> analyses annually the performance of EU's MS concerning their performance of the integration in the SM. The actual evaluation gives a quite heterogeneous picture. Even concerning the goods trade integration, founding members, like Germany, France, and Italy are below EU average. In the services trade most EU MS are below average.

Services account for about 70% of the GDP of the European Union (EU), and a similar share of employment. Nevertheless, the postulated free movement of services is still far from being fulfilled. It needed a separate Services Directive (SD) to eliminate the still existing barriers.

Whereas Intra-EU trade in goods amount to 25% of GDP, this share in the trade in services is only 8% of EU's GDP on average. Some countries, like Austria reach higher values (13%), others, like Germany lower values (5%).

Openness to imports of services (total services imports in % of GDP) lies way below those of the openness to imports of goods. EU average is only 12.6%. Three countries stand out: Luxembourg with 120%, Malta with 80%, and Ireland with 70%. It follows Cyprus with 38%. Austria and Germany reach only EU average. The high outlier indicates that financial services (legal or illegal) play an important role in the three best-performing countries.

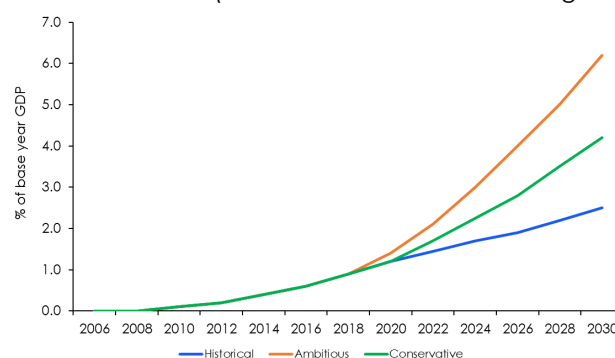
### Services Directive

At the inception of the SM in 1993, the trade services were still disturbed by a big variety of barriers. Only after 16 years (in 2009), the implementation of the Services Directive (SE) 2006/123/EC of 2006 brought an improvement (Breuss et al., 2008). However, the implementation varies from country to country. Furthermore, the SD excludes essential services, like finance, healthcare, audiovisual, notaries etc.

Several studies (Breuss et al., 2008; Moneteaguado et al, 2012; Wolfmayr and Pfaffermayr, 2022) evaluated the potential benefits of the implementation of the SD for trade and income. According to the study by Moneteaguado et al. (2012) with a range from 0.3% in Bulgaria to 1.8% in Cyprus (Austria 0.4%, Germany 0.5%). Wolfmayr and Pfaffermayr (2022) estimate the impact of the implementation of the SD with a structural gravity equation, applying two dummy variables (SD and SOLVIT indicator<sup>5</sup>). Firstly, the authors state that the implementation of the SD in 2009 had already led to an increase in bilateral EU services trade (+7%) and income in the EU (+0.2% weighted in 2018). Secondly, the "best implementation" scenario of SD would lead to the following potential results in the EU: intra-EU trade +10%, weighted income +0.4%.

Somewhat more optimistic are Barbero et al (2022). There are not effects until the implementation of the SD in 2009. The gradual removal of barriers to services trade between 2006 and 2017 stimulated GDP growth (see Figure 4). The "historical" path leads to cumulative gains of 2.1% of GDP by the year 2027. An "ambitious" approach would rise GDP cumulative by 2.5% by 2027, resulting in a total cumulative gain in GDP of up to 4.7% by 2027.

**Figure 4:** Impact of removal of barriers in the services sector on EU GDP (Cumulative discounted GDP gains)



Sources: Barbero et al. (2022), p. 2 and European Commission (2022B), p. 20.

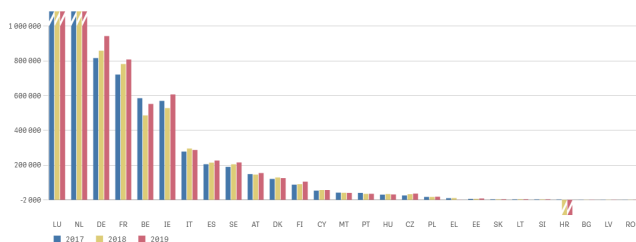
<sup>4</sup> See: [https://single-market-scoreboard.ec.europa.eu/integration\\_market\\_openness/trade-goods-and-services](https://single-market-scoreboard.ec.europa.eu/integration_market_openness/trade-goods-and-services)

<sup>5</sup> SOLVIT is a database collecting difficulties with the functioning of the SM. See: [https://ec.europa.eu/solvit/index\\_en.htm](https://ec.europa.eu/solvit/index_en.htm).

#### 3.1.4 Freedom of movement of capital

According to the data of the Single Market Scoreboard Luxembourg, the Netherlands and Germany invest absolutely the most in other EU MS (see Figure 5).

**Figure 5:** EU capital integration 2017, 2018, and 2019 (Outward intra-FDI stocks in Euro)



Source: Single Market Scoreboard

The provisions of the freedom of movement of capital are ruled in Article 63 of the TFEU. In principle, the free movement of capital has worked quite well since the start of the SM. However, the shock of the global financial crisis in 2008 and the following Great Recession in 2009 as well as the Euro crisis in 2010 made it necessary to implement significant improvements in the financial and banking system in the EU with secondary legislation (SEPA, BU, CMU).

#### Payment Area: SEPA

On 14 March 2012 the EU established a Single European Payment Area (SEPA<sup>6</sup>). The project aims to develop common Union-wide payment services to replace current national payment services. Currently, there are 36 members in SEPA, consisting of the 27 EU MS, the four EFTA countries, and the United Kingdom (also after Brexit). SEPA was introduced for credit transfers in 2008, followed by direct debits in 2009, and fully implemented by 2014 in the euro area (and by 2016 in non-euro area SEPA countries). On 26 October 2022 the Commission adopted a legislative proposal to make *instant (cashless) euro payments* in euro, available to all citizens and businesses holding a bank account in the EU and in EEA countries.

#### Banking Union

The Banking Union (BU) was initiated in 2012 as a response to the Euro crisis in 2010. It provides the essential underpinnings for financial stability and helps build crisis resilience and enhance risk monitoring and assessment. Moreover, the banking union addresses the fragmentation of financial markets within the euro area and contributes to breaking the negative feedback loop between bank debt and sovereign debt ("bank-sovereign vicious circle").

The BU was planned to have three pillars, of which the third pillar is still pending (Breuss et al, 2015):

- 1) *Single Supervisory Mechanism (SSM)* – grants ECB a leading supervisory role over banks in the euro area (in force 4 Nov 2013).
- 2) *Single Resolution Mechanism (SRM)* – including a Single Resolution Fund (SRF) (in force 19 August 2014).
- 3) *European Deposit Insurance Scheme (EDIS)* – no consensus yet reached.

#### Capital Markets Union

Already in 2015, the European Commission proposed as one of its goals to "upgrade the single market" the creation of a Capital Markets Union (CMU). The goal of the CMU is to create a truly single market for capital across the EU. In 2020 the Commission already published an CMU Action Plan, followed by the adoption of four legislative proposals for a true CMU:

- (1) The European Single Access Point (ESAP).
- (2) Review of the European Long-Term Investment Funds (ELTIFs).
- (3) Review of the Alternative Investment Fund Managers Directive (AIFMD).
- (4) Review of the Markets in Financial Instruments Regulation (MiFIR).

#### TARGET2

A specific instrument for the efficient capital movements within the Euro area is TARGET2, a real-time gross settlement (RTGS) system owned and operated by the Eurosystem<sup>7</sup>. Central banks and commercial banks can submit payment orders in euro to TARGET2, where they are processed and settled in central bank money, i.e., money held in an account with a central bank. TARGET2 settles payments related to the Eurosystem's monetary policy operations, as well as bank-to-bank and commercial transactions.

#### 3.1.5 Freedom of movement of people

The freedom of movement of people is not only ruled in the TFEU (Article 45), but also in other legal provisions, like the Charter of Fundamental Rights, and in the Schengen Agreement. Additional arrangement (e.g., for students and asylum seekers) complete this category of SM freedoms.

#### EU Charter of Fundamental Rights

Additionally, to the basic rights of free workers movements in the Single Market guaranteed by the TFEU, in the case of workers, also the law declared in the "Charter of the Fundamental Rights of the European Union" is important in the implementation of the workers freedoms (Articles 15, 16, 18, 31).

<sup>6</sup> See also: <https://www.ecb.europa.eu/paym/integration/re-tail/sepa/html/index.en.html>

<sup>7</sup> See ECB: <https://www.ecb.europa.eu/paym/target/target2/html/index.en.html>

#### Schengen Area

An additional impulse or improvement for the realization of the free movement of people is also the “Schengen Agreement” of 1985 (Protocol No 19 of the TFEU). The border-free Schengen Area guarantees free movement to more than 400 million EU citizens, along with non-EU nationals living in the EU or visiting the EU as tourists, exchange students or for business purposes (anyone legally present in the EU). Today, the Schengen Area encompasses 23 EU countries, except for Bulgaria, Cyprus, Ireland, and Romania (Croatia became a member in 2023).

#### Freer movement of Students and Researchers

Accompanying the measures for the free movement of workers, numerous initiatives were also started for students and scientists to use the free EU area more efficiently. For the students ERASMUS is a program for education, training youth and sport. In the area of Universities, a European Higher Education Area (EHEA) was launched in March 2010, during the Budapest-Vienna Ministerial Conference, on the occasion of the 10th anniversary of the Bologna Process. At the Western Balkan Summit in Berlin on 3 November 2022 further progress was reached in including the Western Balkan region.

#### Unsolved Asylum problem

The huge influx of migrants in 2015, following a new wave in 2022, partly caused by the Russian invasion of the Ukraine revealed the weaknesses of EU's policy concerning migrants and asylum seekers. The main problem is the still nationalistic attitudes of the MS when it comes to the distribution of migrants.

Here, Schengen plays a role together with the “Dublin Regulation” (Dublin III) which establishes which country is responsible for the asylum application process (as a rule the EU MS in which an asylum seeker enters the EU).

### 3.2 Effective while strong competition policy

TFEU regulates Common Rules on Competition in Articles 101. It lists all restrictions and incompatibilities with the internal market, like fixing prices, limit production, share markets etc. To enhance the importance of a strong competition policy to shield the internal market, the TEU and the TFEU has added Protocol 27.

The EU's competition policy is an important accompanying check that there are fair competitive conditions in the internal market. The European Commission is the competition authority of the EU. It ensures the correct application of EU competition rules. The competition policy instruments are: Antitrust, Cartels, Mergers, and State aid.

The EU competition policy is quite powerful. This is proofed in the case of antitrust and merger cases against the technology giants, like Apple and Google, which were punished with heavy fines<sup>8</sup>.

EU's fierce competition policy is praised even by the US authors, like Gutiérrez and Philippon (2018). They claim that European markets are more competitive than those in the United States.

#### Economic impact of more competition

The creation of EU's Single Market should have had an impact on competition and market power, revealed by a reduction in price mark ups. Mion and Ponattu (2019) find that the higher competition on the grand EU SM has reduced markups by around 2% (Germany) to 3 1/2% Austria. Cai et al. (2021, p. 12) demonstrate that EU's strict competition policy had a considerable impact on GDP. Accordingly, prices (GDP deflator) decreased by 0.2 ppts after 5 years and real GDP increased by 0.3 ppts.

### 3.3 Policies supporting the SM

The Single Market is the backbone of EU integration and has been reinforced – at least in those MS which have introduced the Euro – by a common currency. Furthermore, it is supported by the following policies:

- 1) Industrial policy (protection against unfair foreign competition)
- 2) Trade policy
- 3) EU Budget
- 4) The Common Agricultural Policy (CAP)
- 5) Regional or cohesion policy
- 6) Taxation (harmonization of indirect taxations). Direct taxation is still a competence of the MS.

#### Industrial policy – protection against unfair competition

Increased globalization - although it has slowed down due to the various crises (GFC 2008/09, COVID-19 pandemic 2020, Energy crisis 2022) – went hand in hand with unfair foreign competition. This hampered EU's SM and especially the export-oriented European industry. Industry and Single Market is combined at the website of the European Commission (“Internal Market, Industry, Entrepreneurship and SMEs”).

The European Commission, based on its “European Industrial Strategy” initiated several legal instruments to make the SM more resilient and shield its industry against unfair foreign competition; just to mention a view:

- Screening of FDI in the EU: Regulation (EU) 2019/452 of 19 March 2019
- White Paper on foreign subsidies in the Single Market: 17 June 2020<sup>9</sup>

<sup>8</sup> See the cases on the website: <https://ec.europa.eu/competition/elojade/isef/index.cfm>

<sup>9</sup> On 28 November 2022 the EU Council approved the Foreign Subsidies Regulation to tackling distortive foreign subsidies on the internal

market. (See: <https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-approval-to-tackling-distortive-foreign-subsidies-on-the-internal-market/>)

- Cyber security: proposal for a directive on measure for a high common level of cybersecurity across the Union of 16.12.2020.
- Proposal for a directive on corporate sustainability due diligence in case of global value chains: 23 February 2022
- Single Market Emergency Instrument (SMEI): 19 September 2022.

**Trade policy**

EU's common trade policy was from the beginning inherently linked to EU's Single Market.

On 18 February 2021, the European Commission sets course for an open, sustainable, and assertive EU trade policy for the coming years. This new trade strategy follows those of 2015, called "Trade for all" and those following the EU trade policy review of 16 June 2020.

In view of the ambitious EU climate goals in "Fit for 55" climate program, the EU must protect its Single Market against unfair climate competition from abroad. The Carbon Border Adjustment Mechanism (CBAM) should tackle this problem. On 15 March 2022, the Council reached agreement (general approach) on the CBAM regulation.

**The "Brussels Effect"**

The "Brussels Effect" - a phrase first coined by Bradford in 2012 - offers a novel account of the EU by challenging the view that it is a declining world power. According to Bradford (2020) the EU exerts global influence through its ability to unilaterally regulate the global marketplace without the need to engage in neither international cooperation nor coercion. In this way the EU sets international standards and leading to a notable Europeanization of many important aspects of global commerce. The EU has managed to shape policy in areas such as data privacy, consumer health and safety, environmental protection, antitrust, and online hate speech.

While Bradford (2020) argues in favor for the Brussels effect primarily from a legal standpoint, Christen et al. (2022) attempt to quantify the Brussels Effect from an economic point of view. However, the empirical study executed with a gravity model and a computable general equilibrium model deliver very moderate trade and welfare effects caused by the Brussels effect.

**Single Market in EU budget**

In April 2021, the Council and Parliament adopted the EU's single market programme for the years 2021 to 2027. The new programme consolidates a range of activities that were previously financed separately into one programme to manage them more efficiently. It also includes new initiatives to improve the functioning

of the single market. The programme's total budget is €4.2 billion. In the Multiannual Financial Framework (MFF) 2021-2027, chapter 3: Single Market totally amounts to €6.6 billion at current prices<sup>10</sup>. €4.2 billion are reserved for the Single Market Program (inclusive COSME<sup>11</sup>).

**4. The economic impact of EU's SM**

The SM project (SMP) together with the Euro project is the most complex economic integration project ever. It is therefore not surprising that not a one for all method is able to catch the whole range of implications of the SM plus the Euro.

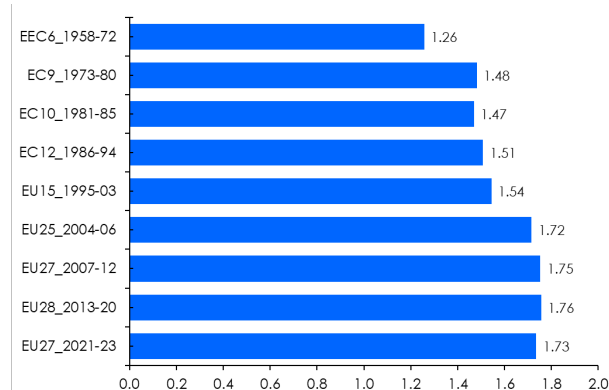
**4.1 The economic performance since the start of the SM**

The EU's SM is the world's largest interconnected market, comprising more than 500 million people and 27.5 million companies (European Commission, 2020A, p. 6). Today it is almost universal knowledge that the creation of the SM brought economic benefits and promoted prosperity. How much? This is an open question. Before turning to the estimates of SM effects, a short overview of the economic performance of the EU and its MS during the last three decades.

**Increased growth after enlargements**

When comparing EU growth rates over time one must take into consideration that the EU – due to the steady enlargements – increased its composition: more MS also meant a larger SM and more GDP. This is demonstrated in Figure 6.

**Figure 6:** EU economic growth changed after enlargements (average growth rates of real GDP<sup>1)</sup> in %: 1993-2023)



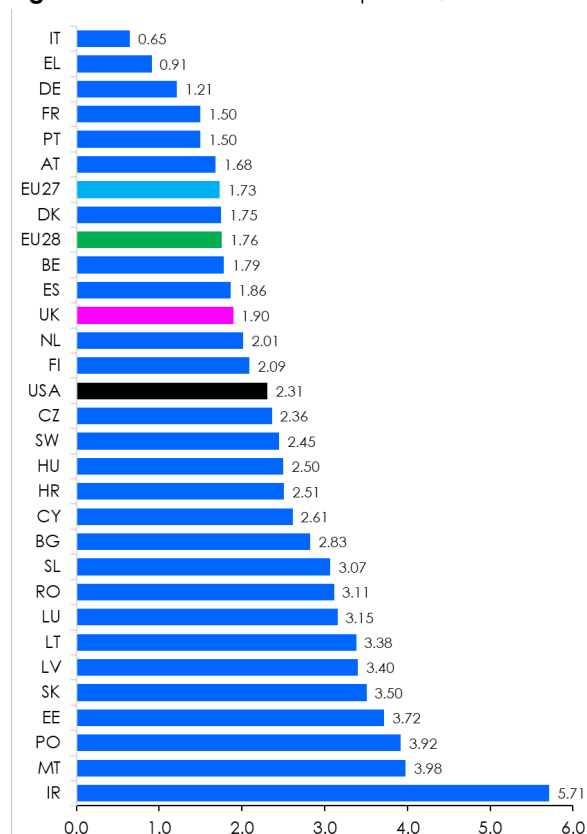
<sup>1)</sup> GDP, PPP exchange rate, real, US\$: 2015 Prices)  
Source: Oxford Economics

<sup>10</sup> See details in the MFF 2021-2027: [https://ec.europa.eu/info/sites/default/files/about\\_the\\_european\\_commission/eu\\_budget/mff\\_2021-2027\\_breakdown\\_current\\_prices.pdf](https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/mff_2021-2027_breakdown_current_prices.pdf)

<sup>11</sup> COSME – Europe's programme for small and medium-sized enterprises; see: [https://single-market-economy.ec.europa.eu/smes/cosme\\_en](https://single-market-economy.ec.europa.eu/smes/cosme_en)

The six founding EEC MS (EEC6\_1958-72) exhibit the lowest averages rates of growth of real GDP over the last 30 years. The EU28 (EU\_28\_2013-20) – before the Brexit – would have reached the highest average economic growth since 1993. The first jump in the growth rates occurred with the first enlargement 1973, when Denmark, Ireland, and the UK entered the EC (EC9\_1973-80). The second significant jump was after the grand enlargement in 2004.

Figure 7: Growth of real GDP<sup>\*)</sup> p.a. in %: 1993-2023



<sup>\*)</sup> GDP, PPP exchange rate, real, US\$: 2015 Prices)  
Source: Oxford Economics

**GDP growth varies across the EU**

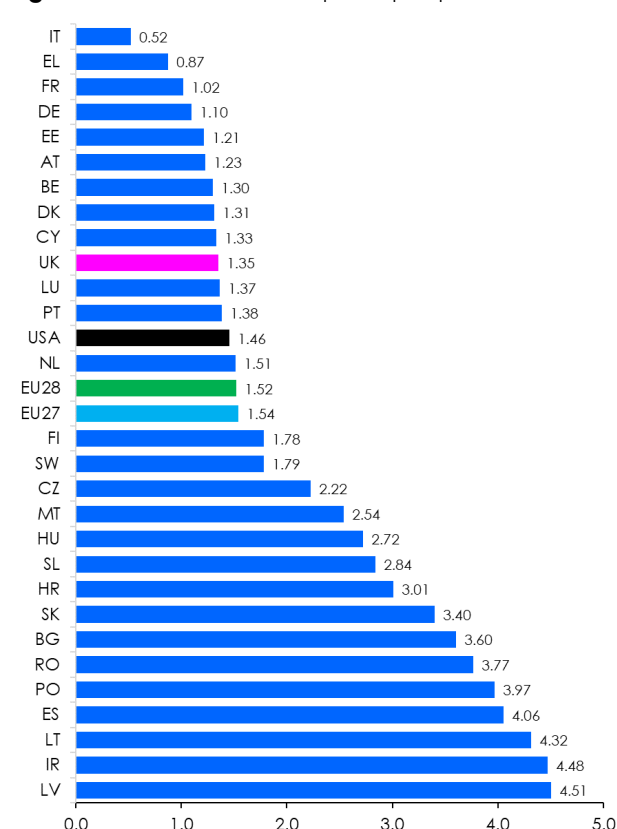
EU's real GDP increased by an annual growth rate of 1.7% since the inception of the SM (see Figure 7). However, there is a huge disparity. Italy with 0.6% experienced the lowest GDP growth rate, Ireland (+6%) the highest. Generally, the new EU MS which entered the EU only after 2004 grew faster than the incumbent MS. There is still a growth gap of ½ ppts between the EU and the USA.

Whereas in the period 1993 to 2023 average real GDP growth increased by 1/2 ppts faster in the USA than those in EU27, this growth gap nearly closes if one considers real GDP per capita (see Figure 8). The reason is that average annual population growth is much higher in the USA (+0.8%) compared to the EU27 (+0.2%).

**Convergence of income incomplete**

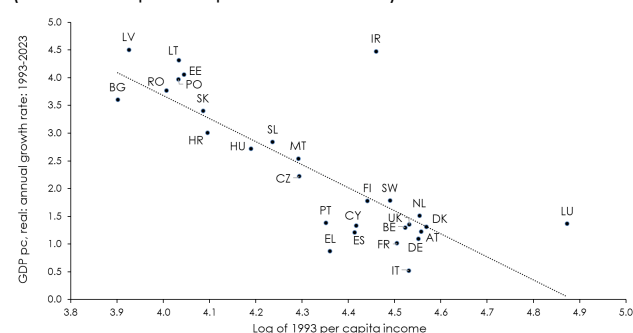
The EEC started with a rather homogeneous group of six countries. This pattern of development remained nearly unchanged until 2003. The big divide in the development occurred with the grand enlargement waves after 2004. Since then, the EU consists of rich MS in the west and poor MS in the east. Although the new MS continuously caught up with higher growth rates, the convergence of income in the EU is still not yet completed (see Figure 9) at a national level.

Figure 8: Growth of real GDP per capita p.a. in %: 1993-2023



Source: Oxford Economics

Figure 9: Convergence of income in EU member states (Real GDP per capita: 1993-2023)

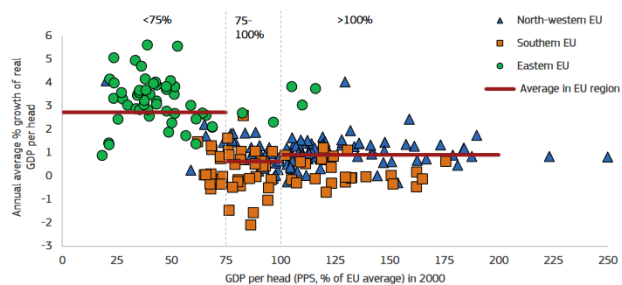


Source: Oxford Economics

What Figure 9 shows on a national level, illustrates Figure 10 at a regional level. Catching-up is incomplete.



**Figure 10:** Annual growth in real GDP per head in EU regions by level of development, 2001-2019



Source: European Commission (2022A), p. 36

In its most recent Cohesion Report, the European Commission (2022A) states that not all regions in the EU with a GDP per head below the average are catching up (see Figure 10). Many of the regions with GDP per head below 75% of the EU average in 2000 displayed strong growth over the subsequent 19 years, demonstrating rapid catching-up. These regions are mainly those in eastern EU MS. Conversely, many of the southern EU regions failed to achieve comparably high growth rates. A non-negligible number of southern regions experienced a reduction in GDP per head over the period, even if their initial GDP per head was below 75% of the EU average. Consistent with convergence theory, regions with above-average GDP per head in 2000 tended to have lower rates of growth.

### Convergence of price levels slowed down

If the Single Market of the EU would converge to a homogeneous market, the price levels of all (or most) goods and services should be the same in all EU MS. Then, the “law of one price (LOOP)” should apply. The LOOP states that in the absence of trade frictions (such as transport costs and tariffs), and under conditions of free competition and price flexibility (where no individual sellers or buyers have power to manipulate prices and prices can freely adjust), identical goods sold in different locations must sell for the same price when prices are expressed in a common currency. Such a market is the ultimate goal of EU’s SMP. As the SM is far from being near this ideal, there are still price divergences.

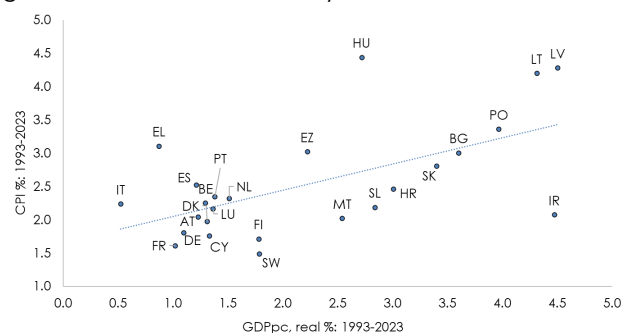
A growing EU through via permanent enlargements by – especially in since 2004 – only rather poor countries is increasing heterogeneity in income and prices. In this situation, the Balassa-Samuelsson (BS) effect (Breuss, 2003) is almost a necessary condition. There is a tendency for consumer prices to be systematically higher in more developed countries (the old EU15 MS) than in less developed countries (the new EU MS in Eastern Europe). This so-called “Penn effect” is explained by the BS effect: Accordingly, the greater variation in productivity between developed and less developed countries in the traded goods sectors which in turn affects

wages and prices in the non-tradable goods sectors (services).

The BS effect can be estimated by estimating an equation relating the logarithms of relative prices to the logarithms of relative GDP per capita. Own calculations with data from Oxford Economics for the 19 MS of the Euro area give the following results: in the year 1995 the elasticity is 0.74 ( $R^2=0.86$ ). In the year 2023 the elasticity goes down to 0.35 ( $R^2=0.62$ ). This means that in the Euro area a considerable catchup process has taken place in which the prices converged.

A correlate to the beta convergence of income (relationship between the income levels in 1993 and its growth rates since then) in the EU (see Figure 9;  $\beta = -0.01744$ ) is the convergence of price levels. Halka and Lesczczynska-Paczesna (2018) find that prices in EU MS of both tradable and nontradable goods (services) had a significantly lower dispersion in 2016 than in 1999. The convergence was faster in the case of countries with price level below the average, which the authors interpreted as catching up.

**Figure 11:** Faster growing MS exhibit higher inflation (Consumer price inflation rates vs GDP per capita growth rates in %: 1993-2023)



EU25 data = EU27 minus the outliers Estonia and Romania

Source: Oxford Economics

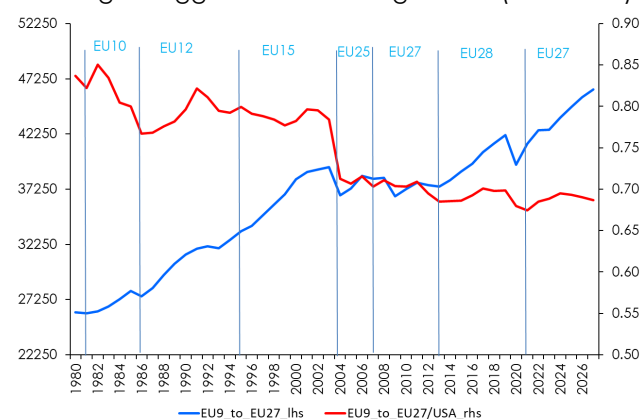
Due to a lack of data, it is difficult to evaluate the convergence or divergence of price levels in EU’s SM. It is easier to study the convergence of Inflation rates of consumer prices (CP). The average CPI inflation rate in EU27 between 1993 and 2023 (in the MS which entered the EU later from the date of EU membership) was 2.4%. In 2022, the year of the energy price crisis, the inflation rates jumped to the highest levels since the 1970s. In EU27 headline inflation reached 9.3%, of which the core inflation (without energy and food) was 5.8%. The highest rate exhibited the Baltic EU MS.

According to the BS hypothesis, there is a considerable correlation ( $R^2=0.32$ ) between inflation rates and per capita income growth over the period 1993-2023 with data for EU25 (EU27 minus the outliers Estonia and Romania) (see Figure 11).

### GDP gap with the USA widens with EU enlargements

A still unexplained phenomenon, called by Breuss (2014) the "EU Integration Puzzle" is the increasing opening of the income gap between the EU and the USA (see Figure 12). Europe, especially the EU, has been characterized - until Brexit - by a steady increase in integration (deepening and expansion) since World War II. According to the standard integration theory, that should have led to more growth. However, the United States, which did not have these growth-enhancing integration effects, still experience stronger economic growth. The growth gap vis à vis the USA widened considerably after the grand enlargements after 2004.

**Figure 12:** Income increase in EU, however gap vis à vis USA gets bigger after EU enlargements (1980-2026)



Left scale: GDP per capita: PPP exchange rate, real, USD 2015;  
right scale: GDP pc EU/GDP pc USA

Source: Oxford Economics

### 4.2 Model estimations of SM effects

A whole bunch of studies evaluated ex ante the deepening steps of European integration: the start with EU's Single Market in 1993, the creation of the Economic and Monetary Union (EMU) in 1999 with the introduction of the euro in 2002, and the possible effects of the grand enlargement of the EU, starting in 2004.

Before the start of the Single Market, the "Cecchini Report" commissioned by the Commission of the European Communities (1988, p. 197) postulated a total effect of the completion of the SM of cumulative 4.5 percentage points (with a range of 3.2 to 5.7 ppts) more real GDP after seven years and a decline of inflation of cumulative 6.1% (range -4.5% to -7.7%). The economic impulses stem from four integration effects:

- (1) Abolition of frontier controls (+0.4 ppts more GDP).
- (2) Opening up public procurement (+0.6 ppts).
- (3) Liberalization of financial services (+1.5 ppts).
- (4) Supply side (economies of scale) effects (+2.1 ppts).

After seven years it turned out that the expected growth effects could not be reached. Therefore, a new effort was made with the "Lisbon Strategy" (Lisbon European Council, 2000). It postulated a new growth strategy which should make the EU to the fastest growing economy in the world within a decade. Unfortunately, the global financial crisis 2008 with the following Great Recession in 2009 made it impossible to reach the Lisbon goal. In 2010, the EU announced a new growth strategy, "Europe 2020" for the next decade (European Commission, 2010). Again, the COVID-19 pandemic crisis prevented from achieving the ambitious goals.

In the planning phase of EMU with the aim of introducing a common currency, an extensive study, "One market, one money", commissioned by the Commission of the European Communities (1990) evaluated the benefits and costs of EMU. The study expected a stabilization of prices, the need for policy coordination, macroeconomic stability through fixing exchange rates. The study evaluated several aspects of the economy and policy needed for creating EMU, however, it did not deliver a single forecast about the GDP growth effects of EMU and the common currency.

Less studies cared about the outcome of these fundamental integration steps. This review describes only briefly the most important recent studies which primarily deal with the impact of EU's Single Market<sup>12</sup>. Similarly, to the ex-ante studies also those done ex post apply a variety of methods: model-based studies and econometric analyses. Whereas the model-based ex post evaluations of EU's Single Market find that the growth effects for trade and GDP are positive, econometric studies like those of Andersen et al. (2019) find no significant effect of European integration on economic growth<sup>13</sup>.

Table 1 gives an overview of the most recent estimations of potential economic effects of EU's SM. First, it shows the cumulative effects on real GDP or on real GDP per capita, followed (in parenthesis) by the annual growth rates (calculated by dividing the cumulative values with the number of years of the estimations). If the results are broken down into annual growth rates of GDP and GDP per capita, the following picture emerges: On average EU's SM led to more GDP growth in the EU, ranging from 0.1% (London Economics, 2017; Breuss, 2021) to 0.9% (in't Veld, 201). Felbermayr et al. (2018), Mayer et al. (2019), and Mion and Ponattu (2019) are with around ½% annual GDP growth in the middle.

Felbermayr et al (2018, 2022) evaluate a doomsday scenario, namely what would happen after "undoing Europe", i.e., if all integration steps of the EU since World War II (Customs Union, SM, Euro, Schengen, and other RTAs) would be reverted. Amazingly, for the EU on average the negative effects with an income loss of ½% per year would not be large. However, the separate

<sup>12</sup> Badinger and Breuss (2011) give an overview of the literature on studies, which quantify the effects of Post-War economic integration.

<sup>13</sup> According to the survey by ÖGfE (2022) in Austria primarily large companies profited from EU's SM.

integration steps have different effects. Overall, the breakdown of the EU's SM has the largest share for member states, followed by undoing Schengen and the Euro.

**Table 1:** The impact of EU's Single Market: Model estimations

Authors	Method	Scale	EU27	Austria	Germany
Cumulative increase in ppts <sup>1)</sup>					
1995 to 2017					
London Economics (2017)	Econometric estimations	GDP, real per capita	1.0 (0.05)	1.7 (0.08)	1.6 (0.07)
2000 to 2014					
Felbermayr et al. (2018)	ifo trade model	GDP, real <sup>1)</sup> per capita	6.6 to 8.6 (0.5-0.6)	6.2 to 8.0 (0.4-0.6)	3.9 to 5.2 (0.3-0.4)
2010 to 2016					
Mion-Ponattu (2019)	CGE model	GDP, real per capita	3.2 (0.53)	3.9 (0.65)	2.7 (0.45)
in the medium to long-run					
in 't Veld (2019)	QUEST DSGE model	GDP, real	8.7 (0.87)	11.8 (1.18)	7.9 (0.79)
in the medium to long-run: 2014 data					
Mayer et al. (2019)	Structural gravity model	Welfare <sup>2)</sup> (GDP pc)	2.0 to 8.2 (0.2-0.8)	2.2 to 9.6 (0.2-1.0)	1.3 to 5.7 (0.1-0.6)
in the medium to long-run: 2014 data					
Breuss (2021)	GTAP10 CGE model	GDP, real <sup>3)</sup> based on NIM effects	0.5 to 2.8 (0.1-0.3)	0.8 to 4.9 (0.1-0.5)	0.4 to 3.1 (0.0-0.3)
1993/95 to 2022					
Breuss (2022B)	Integration Macro-model	GDP, real <sup>4)</sup>	20.6 (0.71)	13.3 (0.46)	15.7 (0.54)

<sup>1)</sup> Numbers in parentheses are annual growth figures.

<sup>1)</sup> The from-to values relate to undoing the SM (low) and (high) if all other integration steps (Customs Union, Euro, Schengen, other RTAs) were reversed.

<sup>2)</sup> The from-to values relate to three scenarios: MFN (back to WTO rules), RTAs (regional trade agreements), and EEC (remove SM).

<sup>3)</sup> The from-to values relate to Armington (low) and Melitz (high).

<sup>4)</sup> EU27 is the arithmetic mean of the results of 10 EU MS.

### 4.3 The growth impact of cohesion policy

When one speaks of the EU Single Market, one means, on the one hand, a common market for all 27 EU MS. But the national markets are divided into regional units. And it is precisely to this topic that EU regional or cohesion policy is devoted.

In the preamble of the TEU the "internal market" and "cohesion" is mentioned in the same statement. Article 174 of the TFEU then rules the concrete design of policies concerning "Economic, social and territorial cohesion". The regional or cohesion policy based on these rulings by the primary law in TFEU is the second most important item in the EU budget (Chapter 1.2), alongside that for the CAP.

EU Cohesion Policy contributes to strengthening economic, social, and territorial cohesion in the European Union. It aims to correct imbalances between countries and regions. It delivers on the Union's political priorities, especially the green and digital transition.

#### What has cohesion policy delivered

In its 8th Cohesion Report: "Cohesion in Europe towards 2050" the European Commission (2022A) the

Commission recognizes advances in convergence, but they are - as explained earlier - still deficient.

Cohesion policy is the EU's main source of investment in economic and social development across the Union. It is financed by three funds, the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF).

According to model simulations of the European Commission (2022A) cohesion policy in 2014–2020 raised real GDP with a cumulative peak of 0.4% more real GDP. The effects then peter out to 0.2% after 30 years.

The question remains, how much of the results of this regional model simulations is implicitly included in the overall results reported in Table 1. Only one of the model simulations reported there, the study by Mion and Ponattu (2019) evaluates EU's SM for countries and regions. Regions within countries are asymmetrically exposed to trade integration, depending on their geographic position, competitiveness, size, and the country they belong to. The regional welfare gains resemble a pattern referred to in the regional research literature as the "blue banana". The participation in EU's SM has the highest welfare improvements in the regions along the Rhine in the West and in the new MS in the East.

## 5. The future of EU's Single Market

Reviewing EU's Single Market over the last 30 years have revealed its benefits and unfinished goals. The many crises of recent years have also shown that the EU is flexible when necessary. For example, when interpreting the competition rules and the strict fiscal rules. The EU and its institutions also jumped in when there was the risk that the "common" of the Single Market would be abandoned in favor of national action (e.g., in the last two crises, the COVID-19, and the energy price crises).

Over time several proposals have been made to permanently reform the SM (Single Market Acts) and to think about its future in scenarios (see the White Paper by Jean-Claude Juncker in European Commission, 2017A). The global financial crisis 2008 stimulated the thinking about the improvement and the resilience of EMU with a "New Economic Governance", proposed in the Five Presidents' Report (see Juncker et al, 2015) and in further suggestions (European Commission, 2017B).

The Single Market is still not perfect. In March 2019, the European Council has invited the Commission to identify obstacles that keep the SM from integrating further and from providing a level playing field to businesses attempting to benefit from it. In a thorough study the European Commission (2020A) listed all still existing barriers to the SM. And there are many more.

The SM Project has a moving target. Nobody knows exactly, where it should end. One benchmark is the SM of the USA. In comparison, EU's SM is still lacking some ingredients, which are: a common language, and a common currency which is applied by all 27 EU MS.

Moreover, one big difference remains: the United States are a federal state, while the European Union is just a union of states.

### Finetuning the SM with Acts I and II

The first thorough review of the functioning of the SM was made after seven years of its start with the "Lisbon strategy" (Lisbon European Council, 2000). While not fulfilling its goals, a new strategy, "Europe 2020" (European Commission, 2010A) followed. Both strategies failed to reach its goals ("to become the most competitive and dynamic knowledge-based economy in the world...") due to external crises: in case of the Lisbon strategy, it was the Great Recession in 2009, in case of the Europe 2020 it was the COVID-19 pandemic crisis in 2020.

*Single Market Act I:* Based on the proposals by Mario Monti (2010), in April 2011 the European Commission presented The Single Market Act I with 12 levers to further develop the SM. E.g., finance the SME; digital SM; social investment funds; easier business environment; public procurement.

*Single Market Act II:* In October 2012, the Commission proposed further actions (four drivers) to exploit the untapped potential as an engine for growth: (i) Fully integrated networks of transport systems: rail, maritime, air, energy; (ii) Mobility of citizens: access to finance; (iii) Digital economy; (iv) social entrepreneurship.

### Greening the SM

The new European Commission (President Ursula von der Leyen) started in 2019 with its 5-year mandate – besides the other five priorities (fit for digital age<sup>14</sup>, work for people, stronger Europe in the world, European way of life, European democracy) – with a new goal named the "European Green Deal" with a grand investment plan, the "NextGenerationEU<sup>15</sup> Recovery Plan". This ambitious plan got mixed up by two severe crises: the COVID-19 pandemic crisis in 2020-2021, followed by the energy crisis in the wake of Russia's invasion of Ukraine on February 24, 2022. One third of the €1.8 trillion (at 2018 prices) investments from the NextGenerationEU (NGEU) Recovery Plan, and the EU's seven-year budget will finance the European Green Deal<sup>16</sup>.

### More resilience in crises

Since the start in 1993, the EU and thus the SM have been shaken by three major crises:

- 1) The global financial crisis (GFC) in 2008, followed by the Great Recession in 2009 plus the Euro crisis in 2010.
- 2) The COVID-19 pandemic crisis in 2020/2021.
- 3) The Energy crisis in 2022, following the Russian invasion in the Ukraine on 24 February 2022.

The European Commission acted in each crisis quite flexibly. After the GFC a series of improvements have been proposed to deepen and strengthen EMU as mentioned earlier.

In the COVID-19 pandemic crisis, the major crisis-preventive measures were taken at national levels. At EU level three precautionary measures were taken to keep the SM working:

- (1) To enable MS to go beyond the limits of the Stability and Growth Pact (SGP) its rules were deactivated ("General escape clause")<sup>17</sup>.
- (2) Furthermore, the Commission had to grant exceptions to the strict competition rules ("Temporary Framework")<sup>18</sup>.
- (3) To avoid a backslide into national versus common actions the Commission initiated a joint vaccine procurement ("EU Strategy for COVID-19 vaccines"; European Commission, 2020C).

In view of the multitude of crises the Commission issued new proposals to make the SM more resilient:

- *Single Market Emergency Instrument (SMEI)*<sup>19</sup>: to provide a structural solution to ensure the availability and free movement of persons, goods, and services in the context of possible future crises.
- *Deepening the SM*: explore harmonization of standards for key business services, as well as strengthening the digitalization of market surveillance and other targeted measures for SMEs.
- *Monitoring the SM*: an annual analysis of the state of the SM, including across 14 industrial ecosystems.
- *Joint procurement of gas imports*<sup>20</sup> and a cap on gas prices.

"Well meant" is not exactly or necessarily the same as "well executed". Many observers criticized that after 30 years of a free SM, the Commission seems to turn the wheel back to a situation of a planned or semi-planned economy (see *Neue Zürcher Zeitung*, 20.09.2022, p. 25). However, the Commission seems to have looked at similar crisis systems in the United States.

<sup>14</sup> See European Commission's website "Shaping Europe's digital future": <https://digital-strategy.ec.europa.eu/en/policies/data-governance-act>; and the "Data Governance Act (DGA)" of 3.6.2022.

<sup>15</sup> See: [https://next-generation-eu.europa.eu/index\\_en](https://next-generation-eu.europa.eu/index_en)

<sup>16</sup> Studies on the economic impact of the NGEU in the euro area are made by Bankowski et al. (2021) and for Austria by Breuss (2022A).

<sup>17</sup> After the outbreak of the energy price crisis in 2022, the European Commission (2022C) announced in its "Fiscal policy guidance for 2023" that the "general escape clause" of the SGP will continue to apply in 2022. It was firstly applied during the COVID-19 pandemic crisis in 2020.

<sup>18</sup> After the outbreak of the COVID-19 crisis on March 2020, the European Commission (2020B) changed the state aid rules to allow the MS

to support the economy. On May 2022 the Commission announced that it will phase-out the state aid COVID "Temporary Framework".

<sup>19</sup> On 19 September 2022, the European Commission (2022D) presented with the SMEI a toolbox to preserve free movement and availability of relevant goods and services. See: [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_5443](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5443)

<sup>20</sup> The European Council on its meeting 20-21 October 2022 demanded a joint procurement of gas imports in EU (European Council, 2022). Details for this and a cap on gas prices should be worked out by the European Commission.

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