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Article

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Single Market Emergency Instrument – A Tool with Pitfalls

In reaction to disruptions of the Single Market, the European Commission put forward an emergency instrument. It proposes far-reaching measures in order to maintain the proper functioning of the Single Market and ensure the supply and distribution of goods and services. The dirigiste interventions in the market it enables warrant critical review, while better coordination and information exchange between the member states could be an added value of the Single Market Emergency Instrument.

The Single Market of the European Union (EU) is a significant achievement for member states and their citizens. The European Commission (2022a, 1) even describes it as the backbone of the Union's growth and economic well-being. Consumers benefit from the Single Market through more choice, better supply security and lower prices. Thanks to the Single Market, business models can be scaled up better and research efforts can be bundled, and this benefits companies (Busch, 2013; Busch and Matthes, 2020). This makes investments in any member state more attractive, thereby reducing the dependence on third countries. The Single Market also improves the negotiating position of the member states under the auspices of the EU, especially in international negotiations in trade and economic cooperation. However, for all the benefits achieved, it must be noted that the potential of the Single Market has not yet been fully exploited (Han-

dlar, 2022; European Commission, 2020) and the EU has fallen behind in competition with the USA and China in recent years (Bardt et al., 2022). In addition, border closures and other measures between member states at the onset of the COVID-19 pandemic in 2020 demonstrated that the Single Market is vulnerable and should not be taken for granted. Disrupted supply chains, lack of supply of some goods and services, and restrictions of the free movement of workers were the result. The war in Ukraine and the sanctions against Russia as well as the countersanctions have additionally shown that while the European Union is quite capable of co-operating in crises, the Union is still dependent on the supply of some goods from third countries.

In the autumn of 2022, the European Commission (2022c) presented its proposal for a Single Market Emergency Instrument (SMEI) in response to the lessons learned from the pandemic and the Russian war of aggression. According to the European Commission, the primary objective of the SMEI is to keep the Single Market functioning in times of crisis (European Commission, 2022a). This means ensuring the free movement of goods, services and persons. The aim is to prevent the Union from falling apart as it did at the beginning of the pandemic and to stop member states from acting unilaterally, encouraging them to coordinate their responses instead.

The disrupted international supply chains and the increased demand especially for semiconductors during the pandemic have shown that the EU and its member states are also dependent on the extra-EU supply of strategic goods. The Russian war of aggression in Ukraine has further underpinned this finding. Against this background, another important goal of the SMEI is the supply and distribution of goods and services affected by the crisis. The SMEI is intended to complement other crisis response regulations: it forms a general means of intervention, while other legal acts such as the proposed Chips Act (European Commission, 2022d) regulate specific areas. Accordingly, if there are no specific regulations in indi-

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vidual areas, the SMEI can be applied in crisis situations (European Commission, 2022a, 5).

Considering the far-reaching interventions that the proposal allows in the event of a crisis, this article has set itself the goal of analysing and examining the SMEI and its effects. To this end, the following section provides an overview of the SMEI. Subsequently, the article summarises economic relations within and outside the EU and assesses the SMEI in a well-founded manner.

Overview of the SMEI

On 19 September 2022, the European Commission presented its proposal for a regulation establishing the SMEI (European Commission, 2022a). The purpose of this emergency instrument is to prepare for and prevent “obstacles to free movement or shortages of crisis-relevant goods and services that can affect the functioning of the Single Market” (European Commission, 2022b). To this end, the proposal provides for a crisis response structure. This essentially includes four elements:

- an advisory group
- a framework for contingency planning
- a framework for Single Market vigilance mode
- a framework for Single Market emergency mode.

The SMEI advisory group is to counsel the European Commission on appropriate measures to prepare for or manage Single Market crises. Each member state sends a permanent representative. In addition, representatives of the European Parliament or interest groups, for example, may participate as observers. The Commission chairs the advisory group.

The framework for contingency planning makes it possible to establish preparations such as crisis communication systems, carry out emergency simulations or set up early warning systems in times without crises. There is no need to activate contingency planning.

In case of serious events, the SMEI provides for the vigilance mode. According to Article 3(2) of the draft regulation (European Commission, 2022a), such an event occurs when there is a risk of a significant disruption in the supply of strategically relevant goods and services that has the potential to escalate into a Single Market emergency within the next six months. The vigilance mode must first be activated. This is done by the European Commission, with the assistance of the advisory group, through an implementing act that is valid for a maximum of six months but can be extended or deactivated. In the vigilance mode, measures such as the monitoring of supply chains of strategically relevant goods and services and, if necessary, the build-up of strategic reserves are possible. For

example, the European Commission can use an implementing act to oblige member states to build up reserves if they fail to meet certain targets.

The final stage of the SMEI’s crisis response structure is the emergency mode, which can be activated in the event of a crisis with far-reaching effects on the Single Market, such as disruptions to essential supply chains or the free movement of goods within the Single Market. According to Article 13 of the European Commission’s draft regulation (European Commission, 2022, 38), the following indicators serve to determine an emergency:

- the crisis has already led to the activation of other relevant EU crisis response instruments
- an estimate of the number of economic transactions and users affected
- the importance of the affected goods or services for other sectors or the market position of the affected economic operators, considering the availability of alternatives (substitute goods, inputs or services)
- the impact in terms of magnitude and duration on economic and social activities, the environment and public safety
- the economic operators affected cannot find a voluntary solution
- the geographical area and impact on supply chains, if they are essential for vital activities in the Single Market.

Activation of the emergency mode requires a decision by the Council of the European Union based on a recommendation by the European Commission with the assistance of the advisory group. The Council adopts an implementing act, which must be decided upon by qualified majority (European Commission, 2022b). A qualified majority requires the agreement of at least 55% of the members of the Council, currently 15. At the same time, these Council members must represent at least 65% of the EU’s population. This is therefore also referred to as a double majority. A blocking minority in the Council requires the rejection of at least four member states. If the emergency mode is activated, the European Commission draws up a list of crisis-relevant goods and services by means of an implementing act. The emergency mode is also valid for six months with the possibility of extension and deactivation. The declaration of the emergency mode does not require the prior activation of the vigilance mode and can also apply in parallel to it. The emergency mode provides for far-reaching measures, which are outlined in various articles:

- Measures adopted by the member states in an emergency must be compatible with Union law. They must also be limited in time and avoid unnecessary administrative restrictions. In addition, information obligations

vis-à-vis all stakeholders involved must be complied with (Article 16).

- Member states are prohibited from restricting the free movement of crisis-related goods and services (Article 17). The exception to this is when it is a justified last resort.
- The European Commission can take supportive measures for the free movement of persons (Article 18).
- There is also an obligation for member states to notify potential new restrictions to the European Commission as soon as possible (Article 19). Article 20 provides additional notification obligations.
- Further provision is made for the creation of national and Union-wide single points of contact (Articles 21 and 22).
- In the event of crisis-related shortages, the European Commission may request companies to provide information on production capacities and possible stockpiles (Article 24). This information should be subject to confidentiality (Article 25).
- The European Commission may recommend that member states modify production lines and expedite approval procedures so that crisis-related goods and services can be provided (Article 27(1)).
- At the member states' request, the European Commission can take the central procurement of crisis-relevant goods in emergency mode (Article 37).
- Additional extraordinary measures may be adopted through dual activation in emergency mode. Dual activation requires a further implementing act by the European Commission (Article 23). Accordingly, it can require companies to comply with information obligations (Article 24) and, in exceptional circumstances, also make them give priority to crisis-relevant goods and services. In the event of a refusal, a company must provide serious reasons for this (Article 27(2)). If a company intentionally or negligently submits false information or fails to comply with a promised prioritisation of crisis-relevant goods and services, the European Commission can impose penalties (Article 28). In the latter case, fines may be up to 1% of the average daily turnover of the preceding business year for each working day of non-compliance.

Financial services, medical devices and equipment, and other medical countermeasures and food safety products are explicitly excluded from the scope of the SMEI, as separate regulations already exist for these areas. For example, there are already regulations addressing obstacles to the free movement of goods ((EC) No. 2679/98) or for common export rules ((EU) 2015/479), which allow the European Commission to monitor the EU's foreign trade and require export licenses. In addition, there are currently several initiatives for new specific crisis response instruments, such as the Commission's proposal on the European Chips Act (European Commission, 2022d) or on

the adaptation of the Schengen Agreement (COM (2021) 891 final). If there are specific regulations, these take precedence over the application of the SMEI (*lex specialis*).

A special case is Regulation (EC) No. 2679/98, as it also deals with the free movement of goods in the Single Market. However, the objective of this regulation was to address disruptions of trade caused by private actors (recital (2)). Additionally, this regulation only covers goods. The SMEI thus goes further by focusing on goods and services as well as persons. Also, the SMEI does not address disruptions by private actors only, but also directly addresses restrictions on the Single Market by state actors, as seen at the beginning of the pandemic. However, following an evaluation in 2019, Regulation (EC) No. 2679/98 is expected to be repealed, particularly due to low usage (European Commission, 2019, 9).

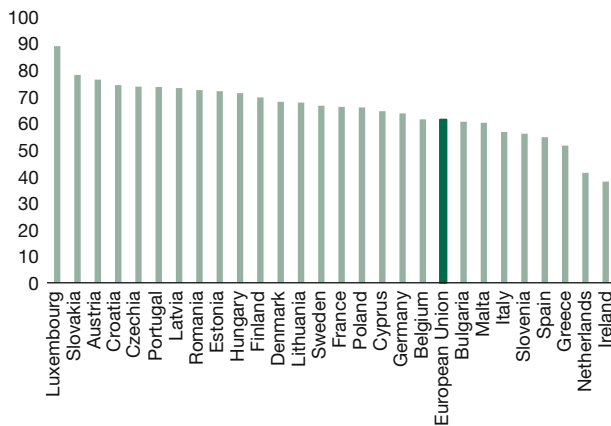
Another group of crisis response tools is more general in nature, such as the Integrated Political Crisis Response (IPCR) mechanism, which aims to facilitate information sharing and policy coordination among member states in complex crises such as cyberattacks, natural disasters or hybrid threats. The IPRC was used, for example, during the 2015 refugee crisis, after the outbreak of the coronavirus pandemic and the Russian war of aggression in Ukraine. There is also the Union Mechanism for Civil Protection and its Emergency Response Coordination Center (ERCC). It acts as the European Commission's hub for initial emergency response. It is also responsible for building strategic reserves for emergencies at the EU level, disaster risk assessments as well as prevention and preparedness activities.

The European Commission argues that the SMEI is necessary, despite the existing instruments, because there is currently "no horizontal set of rules and mechanisms which address aspects such as the contingency planning, the crisis anticipation and monitoring and the crisis response measures, which would apply in a coherent manner across economic sectors and the entire Single Market" (European Commission, 2022a, 8). Accordingly, the value added of the SMEI for the European Commission is to structure communication with the member states, to improve coordination and information exchange if the Single Market comes under pressure.

The European Commission's proposal for the emergency instrument is based on three articles of the Treaty on the Functioning of the European Union (TFEU): Article 114 (approximation of laws), Article 21 (free movement of Union citizens) and Article 45 (free movement of workers). The ordinary legislative procedure is applied, i.e. the European Parliament (EP) and the Council of the European Union (must) jointly adopt the Commission's proposal. The qualified majority applies to the Council's decision. As a rule, a simple majority applies in the EP.

Figure 1
Imports from the Single Market, 2021

in % of all imports



Source: Eurostat; own calculations.

EU's international trade

The European Union depends on international trade in two respects. On the one hand, the exchange of goods within the Single Market must work: only through cooperation as well as the exploitation of the opportunities of the Single Market can the EU represent an economic counterweight to the USA and China (Bardt et al., 2022). The European Commission (2019, 3) estimates that 25% of the EU's GDP is generated by the Single Market. Second, the EU as a whole is integrated into world trade and relies on trade with third countries. The SMEI is designed to ensure trade between member states but also to ensure the supply of essential goods and services, especially in times of crisis. Therefore, this section looks at both the integration of member states into the Single Market and interdependencies with third countries.

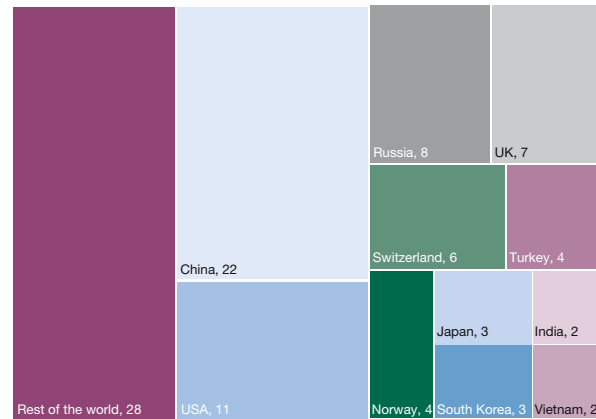
Import dependence on the Single Market

Figure 1 illustrates the dependence of member states on the Single Market. The indicator chosen is the share of imports from the Single Market as a percentage of all imports by each member state. This indicator can be used to estimate the extent to which a country's international supply chains depend on the functioning of the Single Market. On average in the EU27, the Single Market dependency is just over 60%. This shows that the Single Market is of great economic relevance to member states and that its smooth functioning is therefore of great importance.

Member states recorded imports of around €5.5 trillion in 2021 (Eurostat, 2022a). Of these, internal trade accounted for nearly €3.4 trillion, or more than 61%. The majority of the EU's international trade thus takes place within the Single Market.

Figure 2
Share of individual countries in the value of EU27 imports from third countries, 2021

in %



Note: The value of imports of EU27 countries in 2021 was around €2.1 trillion.

Source: Eurostat (2022b); own representation.

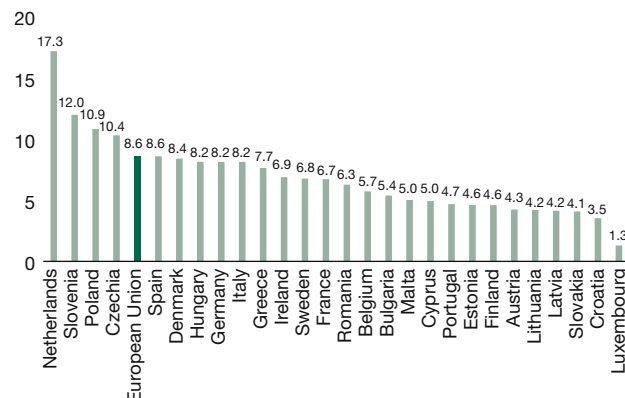
Nevertheless, there is still potential for expansion in the integration of the Single Market (for example, Handler, 2022, 146).

Businesses in the EU come to a similar conclusion: in 2018, 70% of participating companies said in a survey that the Single Market is not sufficiently integrated (European Commission, 2020, 1). In addition to this survey, the need for improvements also became evident in the fact that at the onset of the COVID-19 pandemic, supply chains and freedom of movement were severely restricted within the EU.

Import dependence on third countries

If more than 61% of EU trade is internal, this implies that nearly 39% of trade is with third countries. This corresponds to a value of goods of about €2.1 trillion in 2021 (Eurostat, 2022a). The importance of international trade for the EU has increased in recent years. This is demonstrated by Bardt et al. (2022) based on the degree of openness. The degree of openness is determined by the share of imports and exports in gross domestic product. For the EU, trade flows within the Single Market were not considered. In 2002, the EU's degree of openness was around 23%, and it peaked in 2019 with 29%. China's openness level has declined in comparison from its 2006 peak of 64% to nearly 32% in 2020. Thus, the importance of international trade has declined for China but has increased for the EU. The degree of openness has remained almost constant in the USA, with 17% in 2002 and 18% in 2020. Figure 2 shows the share of individual countries in extra-EU27 imports in 2021 according to Eurostat (2022b). China is the EU's largest trading partner with a share of 22%. The USA follows China with 11%, the Russian Federation comes in third with around 8%,

Figure 3
Imports from China in the EU27, 2021
 in % of all imports



Source: Eurostat; own calculations.

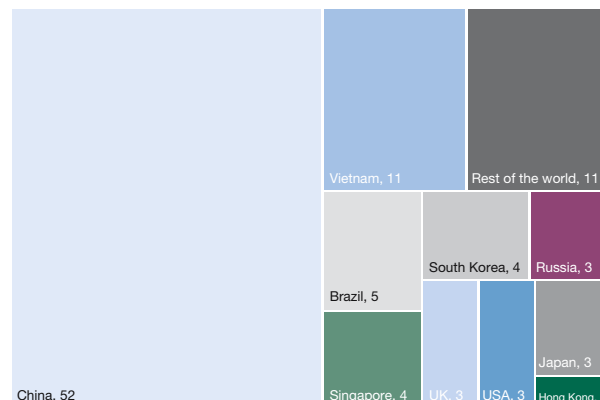
followed by the United Kingdom with 7%. Following the Russian war of aggression in Ukraine, the importance of Russia for the international trade of the EU27 declined considerably in 2022 (Eurostat, 2023). While the share in extra-EU27 imports was 9.5% in February 2022, it constantly fell to only 4.3% in December 2022. The share of extra-EU27 exports fell from 4% to 2% between February and December 2022. In summary, it can be said that the EU's import relations are internationally diversified, even though China is very important.

The importance of China as a trading partner differs between member states. This is illustrated by the share of imports from China in all imports of the member states in 2021 (Figure 3). On average, this share was 8.6% in the EU. Only four states have a higher value: the Netherlands (17.3%), Slovenia (12%), Poland (10.9%) and Czechia (10.4%). The high figure for the Netherlands is probably largely due to the port of Rotterdam, which is one of the most important trading hubs in Europe.

However, the diversification of trade with third countries and the fact that imports from China generally account for far less than 20% of all imports are put into perspective when considering trade in goods for which the EU is particularly dependent on other countries (Figure 4). The European Commission (2021, 20-27) has investigated the goods for which there are high dependencies from third countries. Three criteria were used for this purpose:

- *Concentration* is intended to cover goods for which the EU is dependent on a small number of suppliers outside the Union. Accordingly, the loss of even one supplier can have serious consequences.

Figure 4
Share of individual third countries in the value of trade in strategic products for the EU27
 in %



Note: Trade in 137 products for which the EU27 is strategically dependent on foreign suppliers. These 137 products were identified by the European Commission as products that are needed in sensitive areas of the economy, including, for example, aerospace and defense, health, renewable energy and energy-intensive industries.

Source: European Commission (2021), own representation.

- *Importance of extra EU sources* is primarily intended to capture goods for which the EU is dependent on external sources, because the production of the member states is rather small in relation to total domestic demand. The EU countries are thus dependent on a continuous supply from third countries to meet their demand.
- *Substitutability* is used to determine whether production capacities within the EU are sufficient to meet domestic demand in an emergency.

In total, 390 out of 5,000 goods could be identified that met these criteria (European Commission, 2021, 22). In a further step, only goods that are needed in sensitive areas of the economy (sensitive ecosystems) are considered. These include, for example, aerospace and defence, health, renewable energy and energy-intensive industries. As a result, only 137 of the original 390 goods are considered further, for which the European Commission (2021, 23) suggests a high degree of strategic dependence.

If the value of trade in these goods is considered, a high dependence on a few countries can be identified (Figure 4). China accounts for 52% of trade in these 137 products and Hong Kong, which has been a Special Administrative Region of the People's Republic of China since 1997, accounts for another 1%. Vietnam follows at a considerable distance with a share of 11%. Three percent of trade took place with the Russian Federation. Following the Russian war, the EU27 tries to re-

duce Russia's share in extra-EU imports. According to Eurostat (2023), for example, the share of coal imports from Russia dropped from 45% in 2021 to 22% in 2022, the share of imports in fertilisers dropped from 29% to 22%, and the share of petroleum oil-imports dropped from 28% to 21%. Even low percentages of trade in strategic goods in general can have serious consequences in the event of disruption because, as the example of coal imports shows, the shares in specific goods are considerably higher.

Discussion

As the economic heart of European integration, the Single Market has an importance for the member states and the EU that cannot be overestimated. At the same time, European economies are deeply integrated into the global economy, which is why trade with third countries is also significant. This integration has not only resulted in wealth gains but also risks, such as disruptions to market development, logistics and production, which can also be caused by the political abuse of market power, especially by China.

The SMEI aims both to maintain the Single Market in times of crisis and to supply the member states, and thus the population, with goods and services affected by a crisis. Maintaining the Single Market in times of crisis should be welcomed in terms of regulatory policy, as this benefits all stakeholders and is the only way to exploit the EU's economic potential. Figure 1 made clear how integrated the individual countries are in the Single Market and highlighted the importance of intra-European supply chains compared with trade relations with third countries.

The other focus of the SMEI, addressing the supply of crisis-affected goods and services, reveals a contradiction to the first focus: in times of crisis, the Single Market is to be maintained because this is how the decentralised distribution of goods and services via markets between member states can and should succeed. In times of crisis, however, far-reaching emergency powers are established that allow for dirigiste interventions in the market and thus at least partially suspend market coordination via the Single Market.

With its far-reaching measures, the emergency instrument raises regulatory issues that are discussed below. The fundamental question is whether the adaptability of decentralised control processes via markets is insufficient in times of crisis and needs to be replaced or supplemented by state regulations. Crisis situations are characterised by extraordinary and extremely critical scarcities – and the efficient handling of scarcities is precisely one of the great strengths of control via market prices. Thus, if a good can be produced and prices rise accordingly, the potential supplier will use this option. A “State specification/require-

ment” should be considered only if there are specific barriers to response, if a response cannot be made, or if the necessary price increases are not acceptable. In the first case, the primary government task would be to remove existing obstacles to adjustment. If, on the other hand, no reaction is possible, government requirements will not help either. Moreover, the distributional effects associated with price increases can be better compensated by direct payments than by intervention in the price mechanism.

The COVID-19 crisis showed that successful and rapid vaccine production was possible for two reasons. First, the success was largely based on private entrepreneurial decisions. Insights from the companies' years of preliminary work on vaccines against SARS and MERS could be leveraged, and a new basic technology was already ready for use. The prioritisation of companies on the development of these vaccine projects ensured, among other things, that they were developed in record time. On the other hand, regulatory authorities also prioritised vaccine projects, which shortened processing times, and policymakers, in collaboration with the companies concerned, provided support in developing and creating opportunities for the pre-production of vaccines. It should be noted, however, that government support measures have also targeted unsuccessful manufacturers.

Moreover, the European Commission itself made mistakes at the beginning of the pandemic. For example, Article 16 of the Northern Ireland Protocol should have been used to prevent the supply of vaccines from Ireland to Northern Ireland, and thus to the United Kingdom.

Furthermore, it should be noted that market-based mechanisms provide compensation for errors. When several companies operate in competition with each other in parallel, failures of individual companies can be compensated by the successful decisions of other companies. This effect does not come into play when government agencies impose guidelines on companies and steer production in one direction.

Another point of discussion is the criteria for activating the Single Market emergency (Article 13 of the European Commission's draft regulation; see above). They are rather vague and therefore leave a wide scope for interpretation. This, in combination with the partly unspecific measures, invites a creeping establishment and a tendency towards frequent use of the crisis emergency instrument. However, the risk of political intervention runs counter to the principles of the Single Market, which are protected, for example, by state actors' close self-commitment in state aid control.

The draft regulation allows strict information obligations to be imposed on companies. This may also lead to the dis-

closure of business secrets to the European Commission, which will ensure the confidentiality of this information. Still, this may constitute an interference with the property rights of the companies. Even more dramatic is a direct instruction to prioritise the production of certain goods. Without a strict self-commitment, there is a risk that these crisis economy structures – with private ownership but government control – will be seen as a normal instrument of policy.

It is also critical to note that the strongest interventions of the SMEI affect businesses, which may even be subject to penalties. However, in the COVID-19 pandemic, the real failure lay with the member states, which, for example, closed their borders and imposed export bans on medical products. In this way, the decisions of the member states disrupted the functioning of the Single Market. It is therefore logical that the draft regulation places the onus on member states to only take measures, if possible, that do not disrupt the functioning of the Single Market.

To mitigate supply risks, it is possible not only to intervene retrospectively, but also to take preparatory measures. Risk prevention involves weighing up the goods for which state-organised reserves must be set aside for emergencies. This applies in particular to disaster control, which should also include medical disasters, especially since health care is a special responsibility of the state. Not every risk can be covered in advance, especially if a widespread emergency such as a pandemic occurs. But there are products that are necessary for a variety of events, such as medical masks, syringes, gloves and possibly certain medications. Stockpiles should help bridge the gap until safe production can be established or acquired. Alternatively, government funds can be made available for the purchase option, which can be redeemed at any time. The example of masks has shown that this can happen quite quickly based on market processes. The sufficiently high price for masks, especially because of a purchase guarantee on attractive terms at the beginning of the pandemic, has led to the creation and use of corresponding production opportunities. If permanent competitiveness cannot be assumed, but production is only to be ramped up for a short period, corresponding price premiums are necessary and appropriate. In this case, the state, as the demand side, can provide for the corresponding favourable conditions. However, this precautionary requirement differs from a subsequent administrative production instruction to privately owned enterprises.

Conclusion

The beginning of the COVID-19 pandemic showed that the self-interest of the member states dominated, and decisions were made purely in the national interest. This could be remedied by the envisaged establishment of transparency and

coordination of the SMEI. As the pandemic has shown, it would have been helpful to have plans in place in the event of a crisis. The contingency planning measures envisioned could contribute to this end.

According to the European Commission, the draft regulation aims at the functioning of the Single Market. However, a crisis can also be triggered by insufficient supplies of imported goods from third countries. This is where the SMEI naturally reaches its limits. In the case of supply bottlenecks, it should be determined whether it is possible to substitute the lacking imports with domestic production; some critical goods can only be obtained from a few third countries. For example, the European Commission's list of critical goods (Figure 4) includes raw materials. This shows that the SMEI cannot fully prevent supply crises and that expectations should therefore not be too high. Rather, the potential added value of the SMEI lies in better coordination and information exchange between the member states, especially in strategic preparation for crises.

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