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Marek Dabrowski

European Single Market: The Unfinished Business

KEY MESSAGES

- **Despite almost four decades of building the Single European Market (SEM), its architecture remains incomplete, especially in the service sector**
- **For an economic analysis of the SEM, it is necessary to go beyond technical regulations related to the four freedoms and individual sectors. Equally important is the functioning of a common currency, open internal borders, external trade policies, competition policy, and others**
- **Historically the SEM expanded from ten founding members in 1985 to 27 EU member states (MS) currently and several associated and partial members. Brexit was a blow to the idea of a common market**
- **In the 2010s and 2020s, attempts to reverse the SEM rules became more frequent, partly due to unexpected shocks such as the refugee crises, the Covid-19 pandemic, and the energy crisis caused by the Russian aggression against Ukraine**
- **Several policy measures are necessary to complete the SEM project and avoid reversals, including completing and updating sectoral legislation, strengthening enforcement prerogatives of the European Commission and the Court of Justice of the EU, maintaining the Union's competencies in accompanying areas such as direct taxation, and continuation of open external trade policies**

The Single European Market (SEM) is a core European economic integration mechanism. It originated in the 1980s from the desire to remove non-tariff barriers (NTBs) to trade within the European Economic Community (EEC), the predecessor of the European Union (EU). NTBs were, in many instances, more trade-damaging than tariffs removed at the earlier stage of European integration (in the 1960s and 1970s). However,

over 37 years after the signing of the Single European Act in February 1986, the constituent foundation of the SEM, its implementation remains incomplete. Out of four declared freedoms of movement within the EU (of goods, capital, services, and people), only the first two are well advanced (although still incomplete), while the two others are much less advanced. Worse, the recent period – in particular the Covid-19 pandemic in 2020–2021, the finalization of Brexit at the

end of 2020, and a surge in energy prices caused by global inflation and the Russian aggression against Ukraine in 2022–2023 – brought several setbacks to the construction of the SEM.

CONCEPTUAL FRAMEWORK

Following Part III, Titles I–IV of the Treaty on the Functioning of the European Union (TFEU), the most frequent approach to SEM concentrates on removing cross-border technical and administrative barriers in the four areas of freedom mentioned above. However, suppose one thinks about the single market in broader terms: to equalize the actual easiness of cross-border movement of goods, capital, services, and people between member states (MS) with that within individual MS. In that case, more elements of the EU architecture and common EU policies must be considered.

First, the customs union is a natural companion arrangement to facilitate the free movement of goods and services. It shortens the time and decreases the costs of this movement by abolishing customs control at internal borders. It was founded in 1968, well before the adoption of the Single European Act. Today membership in it is mandatory for all EU MS, as is the case with the SEM. The same applies to a common trade policy, which regulates the EU's external trade and investment relations via the general rules of the World Trade Organization (WTO) and multilateral and bilateral trade agreements signed by the EU.

Launching a common currency, the euro, in 1999 was another integration step, which, apart from ensuring macroeconomic stability and harmonizing macroeconomic policies, decreased cross-border transaction costs in trade and investment, eliminated exchange-rate risk, and deepened a common financial market.

The interlink between the SEM and the Economic and Monetary Union (EMU) is best seen when one looks at the historical sequence of their adoption. After the unsuccessful attempts to implement the Werner Report of 1970,¹ the first blueprint for a monetary union, the adoption of the Single European Act in 1986 gave new impetus to the work on a single European currency. The latter was seen as a logical continuation of the former. The elimination of cross-border barriers to the free movement of goods, services, capital, and people could not be complete so long as each member state had its own currency, some with floating exchange rates. Unsurprisingly, the Delors report

¹ See <http://www.europarl.europa.eu/factsheets/en/sheet/79/history-of-economic-and-monetary-union> and Maes (2023).



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presented an EMU blueprint titled “One Market, One Money” (European Commission 1990).

Looking from another angle, the Schengen system of open internal borders and a control-free zone of travel – which was initially established in 1985,² entered into force ten years later, and was integrated by the Treaty of Amsterdam of 1997³ into the *acquis communautaire* – facilitated smoother cross-border movement of people and goods by abolishing border controls (Wolff 2016). In turn, the functioning of the Schengen area required deeper cooperation on justice and home affairs.

Other areas of integration and common policies are also crucial for the effective functioning of the SEM. Take the example of competition policy, including state aid rules. Its role is to ensure a level playing field for all participants in the SEM.

The same is true concerning minimal standards for the judicial systems in individual MS. Regardless of their legal tradition and institutional setups in individual MS (which are subject to national legislation), they must satisfy conditions of political independence, impartiality, professional competence, and honesty. Otherwise, property rights, business interests, security of economic transactions, and civil and political rights will not be sufficiently protected.

Apart from serving their purposes, the EU social, employment, environmental, and climate protection standards set common business conditions under which all SEM participants operate. However, in the social and employment spheres, EU regulations are relatively scarce, which is an effect of the limited competencies of EU governing bodies in these policy areas. Most regulations remain in the national domain, which results in very differentiated rules in individual MS (see below).

The above list is not complete. It serves just one purpose in our analysis: to see the SEM as a broader construction deeply interlinked with other components of the EU integration architecture rather than as a set of detailed technical regulations and standards in individual sectors (also crucial for the proper functioning of a common market).

GEOGRAPHICAL COVERAGE

When discussing and elaborating the Single Market concept (1984–1985), the EEC was a bloc of ten MS. In 1986, the year the Single European Act was signed, there were already 12 MS, and this number remained unchanged when the SEM became fully operational (in 1993). Then there were four rounds of EU⁴ enlargements (1995, 2004, 2007, and 2013) that increased the number of MS to 28.

However, Brexit, being the result of the June 2016 referendum in the UK and completed at the end of 2020, caused the departure of the second largest EU economy from the SEM and the common customs area. As a result of Brexit, the EU lost approx. 14 percent of its GDP in 2019⁵ in purchasing power parity terms and a very competitive and innovative economy, which undoubtedly weakened the SEM’s potential.

Looking to the remaining 27 countries from the broader conceptual perspective of the single market (see above), seven of them (Bulgaria, Czechia, Denmark, Hungary, Poland, Romania, and Sweden) remained outside a common currency area. However, Bulgaria and Denmark have permanently fixed exchange rates to the euro (both within the ERM2 arrangement), which diminish transaction costs and exchange rate risk. Four countries (Bulgaria, Cyprus, Ireland, and Romania) remain outside Schengen.

On the other hand, non-member countries and territories participate, to various extents, in the SEM. First, three member countries of the European Economic Area (EEA) – Iceland, Liechtenstein, and Norway – adopted all EU regulations related to the SEM (in its narrow meaning), competition policy, and state aid rules (see EEA 2013). The EEA Agreement, which entered into force in 1994, also covers several so-called horizontal policies such as consumer protection, company law, environment, social policy, and statistics, as well as flanking policies such as research and technological development, education, training and youth, employment, tourism, culture, civil protection, enterprise, entrepreneurship, and small and medium-sized enterprises. EEA countries are associated members of the Schengen area. However, they do not participate in the common agriculture and fisheries policies. They do not belong to the EU customs union. They conduct independent trade policies and have their own currencies (Dabrowski 2014).

Switzerland’s participation in the SEM is narrower than that of the EEA countries and is based on over 100 bilateral agreements with the EU in various sectors and policy areas.⁶ The main difference concerns the free movement of services, in which Switzerland has failed to reach a comprehensive agreement with the EU. Switzerland also does not apply the EU’s state aid rules. Furthermore, the system of bilateral agreements does not include a mechanism for their dynamic updating (along with new EU legislation) as in the case for EEA members. Like EEA countries, Switzerland is an associate member of the Schengen area. It has its own currency.

The European microstates – the Principality of Andorra, the Republic of San Marino, Monaco, and the City of the Vatican State (the Holy See) – depend

² <https://www.schengenvisainfo.com/schengen-agreement/>.

³ <https://www.europarl.europa.eu/about-parliament/en/in-the-past/the-parliament-and-the-treaties/treaty-of-amsterdam>.

⁴ The EEC was renamed into EU as result of the Maastricht Treaty, which entered in force on 1 November 1993.

⁵ Calculation made on the basis of the IMF World Economic Outlook database, April 2023.

⁶ <https://www.eda.admin.ch/europa/en/home/europapolitik/ueberblick.html>.

totally on trade and infrastructural links with the EU. However, their relations with the EU have been shaped case by case, and their participation in the SEM is only partial. As a result, their cooperation with the EU is only partial and based on bilateral sectoral agreements of varying thematic scopes and integrational depths (see European Commission 2012 for a detailed overview). All microstates use the euro, have open borders, and accept Schengen rules. Monaco and San Marino have full customs unions with the EU, while Andorra and the Vatican have only partial ones (Dabrowski 2014).

Partial participation in the SEM also concerns 13 EU Overseas Countries and Territories, which remain in political dependency on Denmark, France, and the Netherlands.⁷ However, most enjoy wide-ranging autonomy in economic and social policy, trade, and customs arrangements, so their links to the SEM are not strong. Their geographical location in the Atlantic, Antarctic, Arctic, Caribbean, and Pacific regions often cause gravitation to other economic partners than the EU.

The EU concluded over 40 trade agreements with 70+ countries worldwide.⁸ These agreements represent various degrees of depth and cover different sectors. All of them provide external partners with partial preferential access to the SEM and, by reciprocity, they also offer EU economic agents similar preferential access to external markets.⁹

The Stabilization and Association Agreements (SAAs) with the Western Balkan countries, Deep and Comprehensive Free Trade Agreements (DCFTAs) with Georgia, Moldova, and Ukraine, and EU-Turkey Customs Union deserve special attention. SAAs and DCFTAs offer partner countries partial access to the SEM and encourage them to adopt EU regulatory standards in several policy areas. The SAAs explicitly facilitate the EU accession process of Western Balkan countries by gradually adopting economic and trade-related *acquis*. Two countries (Kosovo and Montenegro) unilaterally introduced the euro as a national currency.

The DCFTAs were part of association agreements with three EU Eastern neighbors signed well before offering them the EU integration perspective. Nevertheless, they played an equally instrumental role in helping them adopt various pieces of the EU *acquis* (Dabrowski 2022).

The EU-Turkey customs union¹⁰ (limited to industrial and processed agriculture goods, except coal and steel products), the 1963 association agreement (the Ankara Agreement), and the Additional Protocol of

1970 were also designed as steps toward the future EU accession process. However, due to autocratic drift in Turkey, its accession process was suspended in 2019. For the same reason, the discussion about extending and modernizing the existing customs union was frozen (Stanicek 2020).

Finally, a post-Brexit EU-UK Trade and Cooperation Agreement¹¹ retains wide-ranging provisions regarding the free movement of goods and capital and partial access to the service markets. However, it does not continue the previous free movement of people. Northern Ireland remains partly in the EU Customs Union and continues to apply the SEM regulations regarding trade in goods.¹²

THE INCOMPLETENESS OF THE SINGLE MARKET

Despite almost four decades of implementation, the SEM architecture remains incomplete both *de jure* and *de facto*. Even the movement of goods across internal borders is not entirely free. Take, for example, energy goods. According to Article 194, paragraph 2 of the TFEU, MS retain the right “to determine the conditions for exploiting its energy resources, its choice between different energy sources, and the general structure of its energy supply.”

The EU market for goods does not present the same degree of homogeneity as the national market in the United States and other large countries or within individual EU MS. This sort of segmentation along national borders is caused not only by language and cultural differences but also by legal, regulatory, and institutional factors. These differences result from the framework character of many EU directives and regulations (which are then given concrete form by national legislators), non-compliance of some domestic rules with the European ones (the large number of infringement procedures initiated by the European Commission¹³), varying quality of public administration and judicial system, etc. Furthermore, the essential pieces of social and economic legislation – for example, labor law, social protection, and direct taxation – remain primarily in the hands of national authorities. As a result, several pan-European companies prefer to have a local subsidiary in each/most MS to deal with various local regulatory and policy challenges.

The situation is even worse in services. First, the single market for services has always had only a partial character. The Services in the Internal Market Directive of 2006 (popularly called the Bolkenstein Directive) and Professional Qualifications Directive of 2005 opened national service markets only partially to providers from other MS. Markets for several ser-

⁷ https://www.eeas.europa.eu/eeas/overseas-countries-and-territories_en.

⁸ <https://trade.ec.europa.eu/access-to-markets/en/non-eu-markets>.

⁹ The unilateral trade concession provided by the EU to low- and lower-middle-income countries under the Generalized System of Preferences (GSP, GSP+ and Everything but Arms) are the exception to the reciprocity rule.

¹⁰ <https://trade.ec.europa.eu/access-to-markets/en/content/eu-turkiye-customs-union>.

¹¹ <https://trade.ec.europa.eu/access-to-markets/en/content/eu-uk-trade-and-cooperation-agreement>.

¹² https://commission.europa.eu/document/download/f6e5886e-edb9-4d09-bdea-8bdbfcd750f7_en.

¹³ https://commission.europa.eu/law/application-eu-law/implementing-eu-law/infringement-procedure/2021-annual-report-monitoring-application-eu-law_en.

vices – for example, transportation, postal services, energy services, legal services, architects, and civil engineers – remain restricted.¹⁴ Beyond market entry regulations, language, cultural and legal differences play an even more prominent role than in markets for goods.

Integration of financial and capital markets (free movement of capital) has also not been completed despite ambitious projects of the Banking Union (BU) and Capital Market Union (CMU). In the banking sector, despite the Single Rulebook of 2009,¹⁵ Single Supervisory Mechanism (within the European Central Bank), and Single Resolution Mechanism (the latter two limited to the euro area), the role of national supervisory authorities and national regulations remains significant. The European Deposit Insurance System, the third pillar of the BU, is still a subject of professional and political debate (Beck et al. 2023).

The situation is even more complicated with the implementation of CMU (Demertzis et al. 2021), where differences in national legal frameworks and institutions (for example, company law or bankruptcy law) create obstacles that are difficult to overcome. As a result, financial and capital markets in the EU remain segmented along national borders.

The free movement of people also meets several obstacles originating not only from language, cultural, and legal differences but also from various national social, health, and tax regulations and limited portability of social benefits.

REVERSALS AND CHALLENGES

The history of SEM registers several cases of reversals in the common market rules and policies. The financial crisis in the euro area periphery led to the introduction of capital controls in Cyprus in 2013 (Wolff 2013) and Greece in 2015. Cyprus lifted these controls in 2015, while Greece did so in 2019.

The refugee crisis of 2015–2016 resulted in the reintroduction of selective internal border controls by several MS, some of them prolonged for the next few years. Traffic jams created by these controls demonstrated the role of open borders for the smooth transportation of goods, tourist services, and daily cross-border work commuting.

However, an even more significant challenge came with the Covid-19 pandemic in 2020–2021, when several MS just closed their borders and heavily restricted the movement of people, suspending international flights and train connections. While these drastic measures did not stop the spread of infection, they constituted a heavy blow to all kinds of cross-border economic links within the EU and with the outside world. At the same time, the European

Commission relaxed competition and state aid rules,¹⁶ creating more room for protectionist interventionism.

The next challenge came in 2022 when the Russian aggression against Ukraine and Russian cuts of natural gas supply to Europe caused a drastic increase in gas and electricity prices. Individual governments introduced compensatory measures for the population and businesses, which were incompatible between countries (Sgaravatti et al. 2021). Furthermore, the scale of these interventions depended on the fiscal space in individual countries, creating an unequal level playing field across the SEM. The European Commission's attempts to put these national interventions in the common EU framework largely failed.

Finally, the United States Inflation Reduction Act (IRA) of 2022, which offers subsidies to US producers of green-energy-related goods and technologies, triggered the temptation to create a similar mechanism in the EU (Tagliapietra et al. 2023). Given the limited resources in the EU budget, it would be up to national governments to provide such support, threatening a further fragmentation of the SEM.

POLICY CONCLUSIONS

After almost four decades of its implementation, the SEM project is not only far from being completed, but also under the constant risk of disintegration. The incompleteness has been caused not only by the numerous sectoral loopholes in technical legislation and the necessity to catch up with technological innovations and new challenges (such as digital services where the EU governing bodies have been able to adopt the meaningful legislation package). The obstacles also come from the imperfect EU integration architecture, which leaves regulatory decisions in many vital spheres as well as most budgetary resources in the hands of national governments (Dabrowski 2016). The latter's preferences often differ significantly from those of the EU governing bodies. Furthermore, protectionist interventionism is the frequent reaction to unexpected shocks.

Several actions are needed to complete the SEM and avoid its potential reversal. First up is the continuation of removing cross-border regulatory and administrative barriers to the free movement of goods, capital, services, and people. This is crucial for services, which contribute the largest share of the EU's GDP. Second, the existing regulations should be regularly updated to keep up with innovations and new challenges. Third, the enforcement prerogatives of the European Commission and the Court of Justice of the EU should be strengthened to minimize cases of rule infringements. Fourth, continuing external trade liberalization and defending the WTO global rules against increasing protectionist pressures supports the SEM by making it more competitive. Fifth, expanding the

¹⁴ https://single-market-scoreboard.ec.europa.eu/business-framework-conditions/services-markets_en.

¹⁵ <https://www.eba.europa.eu/regulation-and-policy/single-rule-book>.

¹⁶ https://competition-policy.ec.europa.eu/state-aid/coronavirus/temporary-framework_en.

EU budget and strengthening the EU competencies in accompanying social and economic policy areas, such as direct taxation, could help eliminate tax loopholes and hidden state aid and ensure a level playing field within the SEM.

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