West European Politics

ISSN: 0140-2382 (Print) 1743-9655 (Online) Journal homepage: https://www.tandfonline.com/loi/fwep20

Why the single market remains the EU's core business

Jacques Pelkmans

To cite this article: Jacques Pelkmans (2016) Why the single market remains the EU's core business, West European Politics, 39:5, 1095-1113, DOI: 10.1080/01402382.2016.1186388

To link to this article: https://doi.org/10.1080/01402382.2016.1186388

Published online: 16 Jun 2016.

Submit your article to this journal

Article views: 2638

View related articles

View Crossmark data

Citing articles: 4 View citing articles

Full Terms & Conditions of access and use can be found at
https://www.tandfonline.com/action/journalInformation?journalCode=fwep20

WEST EUROPEAN POLITICS, 2016
VOL. 39, NO. 5, 1095-1113
http://dx.doi.org/10.1080/01402382.2016.1186388

Routledge
Taylor & Francis Group

Why the single market remains the EU's core business

Jacques Pelkmans

ABSTRACT
This paper examines the centrality of the single market to the EU. Its main conclusion is that the single market will remain central to the Union in future and that although it is not immune to crises, because it is the Union's hard core and has powerful governance, serious erosion is unlikely. The paper examines the centrality of the single market by analysing in-depth the functional logic of market integration and the progress and deficits that characterise the Union's market regime. The paper then explores the meaning of the internal market for EMU and argues that the single market is the 'E' in EMU. The issue of the euro 'ins' and 'outs' is addressed. The paper ends by asking if the single market is resilient against crises and concludes in the affirmative.

KEYWORDS Single market; free movement; market integration deficits; EU regulation; functional subsidiarity test; economic union

The internal market was and is the hard core of the EU. In the shadow of the Great Recession, the eurozone crisis and its multi-fold repercussions for European integration, the question is whether the single market will remain so central – indeed, the foundation of the EU also tomorrow ? We shall answer this question affirmatively and set out why. Indeed, the robustness of the single market is likely to have mitigated the overall economic impact of the Great Recession for the EU. The single market is not necessarily immune to crises but as it is the EU's hard core and its powerful governance render serious erosion unlikely.

Before addressing why the single market remains the EU's core business, even in the aftermath of a deep crisis, it is critical to first discuss what the single market is, and is not, and why it is so central. Subsequently, the rigorous logic of market integration in the EU will be explained, a permanent potential source of functionalist deepening and widening (of scope). We shall stylise how the EU has 'established' the internal market over time, how the EU attempts to ensure its 'proper functioning' and what the 'regulatory logic' of the single market is. A brief exposition of the progress of EU market integration up to today is given, again in a stylised fashion in terms of policy accomplishments, followed

CONTACT Jacques Pelkmans jacques.pelkmans@gmail.com

© 2016 Informa UK Limited, trading as Taylor & Francis Group

by a discussion of how the internal market and EMU are related, both the 'soft' Economic and Monetary Union (EMU) of all 28 member states and the 'hard' EMU in the form of the eurozone of 19 EU countries. It is crucial to focus on the single market of all 28 countries at all times. The debate here is complicated as the single market has been deepened during the crisis but there is also a lingering fear that the eurozone's deepening (e.g. with the banking union) might inflict a bias against a truly single financial market (e.g. for the 'outs'). In any case, further deepening is to be expected, if not already under way, with new single market strategies recently initiated. The penultimate section finds that the single market is resilient against crises; and the final section concludes.

Why the single market is accepted as the 'hard core' of European integration

Building up the internal market – what the treaty calls its 'establishment' – and having it 'function properly', is supposed to serve the aims of the Treaty on the Functioning of the European Union (TFEU) treaty. This was even more clearly the case for the four economic objectives of the Rome treaty.[1] Indeed, the internal market is the *principal* means serving these objectives. Although the treaty (now the TFEU) has become far more complicated, and a separate EU treaty is formulating or overarching all that the EU stands for, the internal market has remained the foundation for by far the larger part of substantive EU activities. Meanwhile, the internal market also serves as the foundation of EMU, especially the eurozone with 19 EU countries. It is therefore not comparable to 'yet another' policy domain in European integration. On the contrary, many policies 'piggyback' on the single market in its widest form. On the one hand, the EU would signify rather little economically and/or politically without maintaining a single market – in the worst case, it might dissolve into a kind of customs-union-plus of the 1970s, or allow costly forms of fragmentation. In the process, many other EU policies, which essentially constitute derivatives of the single market (see below), would be at risk of erosion as well. EMU or the eurozone would also lose its foundation, with the 'E' (economic union) melting away gradually. EU countries without exception regard the single market as the overriding reason why they have become a member of the Union, besides values and a sense of 'soft security'. A community of values without the single market risks being an elevated Council of Europe. On the other hand, EU and non-EU countries routinely signal how critical the single market is for them. A few examples will clarify this. The UK might take a BREXIT decision but its entire strategy rests on staying inside the single market – even though the UK might end up as a non-EU country, it counts on staying in the single market and PM Cameron is adamant that this ought to be possible.[2] New EU members, when still candidates, have consistently expressed a strong preference to become part of the single market, for the purpose of stimulating growth

and companies' competitiveness. The three European Economic Area countries of the European Free Trade Association (EEA-EFTA) countries and (for the most part) Switzerland essentially live in the single market – indeed, the EEA Agreement and the many sectoral bilaterals with Switzerland are almost all about the single market. But the strength and depth of the single market is equally decisive for the Trans-atlantic Trade and Investment Partnership (TTIP), Comprehensive Economic and Trade Agreement (CETA) and EU trade and regulatory negotiations with Japan.

Should the single market be redesigned in the light of the recent crises in order to render it more resilient and/or to respond satisfactorily to signs of dissatisfaction among grassroots in the European electorates? 'Rethinking' market integration has been done several times in the nearly 60 years of EU history. The current 'rethink' of the single market is only very partially a response to the crisis and the Great Recession because most of the upgrading prompted by the crisis has already been accomplished in the regulation and supervision of financial markets as well as by adopting a centralised bank resolution regime. The strategic single market debates of today[3] contrast sharply with the turmoil and hectic EU decision-making about crisis measures for and urgent 'repairs' of the fault lines of the not-so-genuine EMU.

However, it would be a great mistake to conclude that there was and is no politics to the single market. The history of the single market has had its occasional turmoil and hectic political discourse or decision-making. It began in 1958 with French monetary reform (by Rueff). Had this drastic removal of export subsidies and extra import charges – a de facto devaluation, combined with a 'new' French franc – failed, the EEC would never have taken off in the first place. The empty chair in 1965 was about the politics and decision power over the agricultural policy, the (costly) underpinning of the single market for agricultural goods. The removal of vetoes led to the first ever referendum on the single market (in Denmark in 1992). More recent instances of profound political conflict on aspects of the single market include the three years of turmoil in the EP on the horizontal services directive[4] and the simultaneous deep quarrels (with open letters from some PMs to Commission President Prodi) about the new chemical regulation in Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH). Finally, much of single market high politics was channelled into debates over treaty changes which comprised, for example, Qualified Majority Voting (QMV) in more and more instances and gradually stronger powers for the EP.

The functional logic of EU market integration

Defining EU market integration

EU market integration has to be 'established' (treaty language for 'realised' by law) and it has to 'function properly'. Already in the Rome treaty one can

discern that establishing the internal market is the result of two policy processes: cross-border intra-EU liberalisation in several market types (like goods and services) and what is termed 'harmonisation' or approximation of national laws. The first process is essentially 'market access' inside the EU, be it in a very demanding form of non-discrimination in (numerous) national laws, an almost unconditional right of access called 'free movement' (and the right of establishment of a company or an independent) and strong disciplines for the minimisation of distortions (negative integration). However, in many markets it is dysfunctional or even impossible to solely rely on 'negative integration', because there are 'market failures'. It is pointless or (in terms of 'welfare') counterproductive to do so since these market failures are usually addressed at the member state level and will have to be addressed in some way at the EU level for the internal market to function properly. Not doing so will make it impossible for member states to agree with open access, hence justifying regulatory or technical barriers, fragmenting the internal market. Joint forms of addressing such regulatory needs and the institutions required are called 'positive integration'. Many degrees of ambition of positive integration can be envisaged, from consultation and coordination (whatever that might mean), to joint (i.e. EU) regulation in many forms, joint funds or, in the extreme, common bodies with the task of regulating themselves, within a commonly agreed EU framework. Nearly 60 years after Rome, this positive integration, with various manifestations of EU market regulation (also in common policies), is perhaps the most conspicuous aspect of the EU internal market. To put it simply, the day-to-day core business of the EU is to 'regulate'. Surely that was not what the founding fathers (see the Comité Intergouvernemental 1956 report) would have expected, or at least certainly not to this extent, in so many areas and so intrusively. The functional rigour of the internal market logic was only gradually discovered and understood.

Stylising how the EU pursues market integration

The internal market serves the (economic) treaty objectives. The left-hand side of Figure 1 is 'negative market integration', starting with the customs union (removing intra-EU tariffs; the common external tariff is part of common trade policy on the right-hand side), complemented by free movement[5] and the right of establishment. Negative integration has turned out to be ambitious, taking generations to establish, even in goods – the first market type that was tackled seriously. Without the Single Act, the internal goods market would never have enjoyed general free movement as it does today. This was mainly due to three critical reforms in or stimulated by the Single Act. First, the 'area without frontiers' encompassed regulatory and fiscal frontiers, not just customs frontiers. This had fundamental consequences for the ambition of new Commission programmes, known later as EC-1992. In one stroke it undermined many lobby and protectionist strategies in goods and services

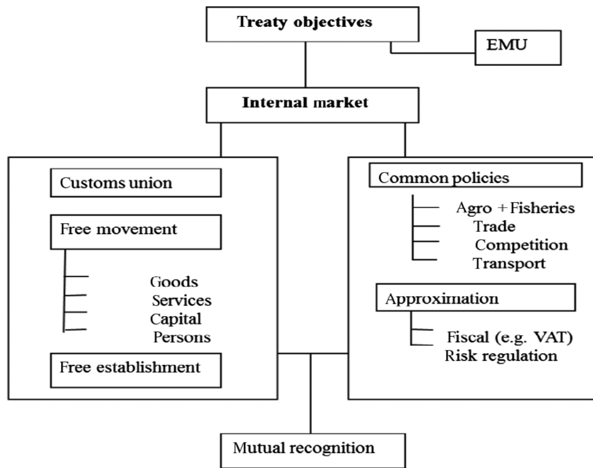

Figure 1. Internal market regime.

sectors so far still heavily fragmented. Second, many internal market questions came under QMV, which effectively meant that countries – if against – had in turn to construct blocking minorities, often leading to partial concessions of an integrationist character and/or to 'better' solutions more acceptable to some member states. In numerous other instances the Council (then still dominant) could focus on sound proposals or well-justified amendments, which increased the speed of decision-making and enabled the member states to revisit proposals or ideas that, before, proved to be impossible due to vetoes. Third, the Single Act coincided, but not by chance, with several reforms, which had the double dividend of improving the quality of EU regulation and facilitating the adoption of 'lighter' regulation, without undermining objectives (mainly of risk regulation). The example par excellence is the new approach of removing technical barriers to trade in the Union but one can also cite the new approach to (more horizontal) food regulation, the timid breakthrough in mutual recognition in professional qualifications (late 1980s), the radical reforms in EU transport policy (after the 1985 conviction of the Council by the Court of Justice of the European Union [CJEU]), the 'simple' removal of frontier controls on the roads and the partial acceptance of 'home country control' in EU financial services regulation. Another reform which suddenly became acceptable consisted in the removal of all exchange controls in the EU-12, the idea being that sound macro-economic policy was in the enlightened self-interest of every member state, so that there was simply no case to introduce or maintain restrictions in the internal market in order to protect bad national policy.

The real challenges of the next episodes were found in services, an amalgam of areas and sectors with very distinct characteristics, and in intellectual property rights (IPRs). Below we will briefly describe the progress in services.

IPRs were regarded as an issue of 'national ownership' (given the Rome treaty article 222, now article 345, TFEU). The huge vested interests in this area[6] and the technicality of the issues (in other words, the great asymmetries of information between the specialists and political decision-makers) provided endless opportunities to prevent or slow down the Europeanisation of IPRs. Also this episode is now largely over with the arrival of the European Unitary Patent, a significant breakthrough for EU-driven innovation.

The right-hand side of Figure 1 is about positive integration. In essence, this is about EU regulation in common policies (trade, competition, transport, agro-fisheries) and EU regulation as 'approximation'. The latter is overwhelmingly in risk regulation, and to a small extent in fiscal (VAT, excises, some minor issues in corporate taxation and interest taxes). Risk regulation in the single market is the dominant regulatory activity of the EU. It stands for all regulation based on the objectives of safety, health, investor/saver, environmental and consumer protection. Risk regulation is about correcting or at least reducing the impact of market failures, so that free movement is combined with the appropriate EU regulation. This allows member states to agree to lift restrictions, first kept for reason of an EU regulatory 'gap'. Risk regulation should be distinguished from 'economic' regulation where markets may not work well for economic reasons, and hence might have undesirable effects. A 'natural monopoly' (like rail track infrastructure) is likely to have undesired effects and hence has to be regulated. But of course the term 'undesirable' is not necessarily derived from economic analysis only. Thus, the common agricultural policy is a form of economic regulation where market outcomes – especially for certain types of farmers – were long regarded as undesirable and policy/regulation as well as EU money were employed to correct such outcomes. Although nowadays the EU hardly intervenes in agricultural markets, other than by general farm-based income grants, the EU tariffs in some agro-products are still very high indeed. Such economic regulation is quite different from risk regulation in agro-goods. The latter is what in the World Trade Organisation (WTO) is called SPS[7] regulation, for health and safety in food, animal feeds and plants. The EC-1992 programme included some 160-plus directives on SPS measures inside the internal market. At a later stage the full consequences were drawn by further centralising risk assessment for food[8] and introducing reforms leading to a value-chain approach called 'from farm to fork', which can only work if EU institutions, transparency and disciplines are powerful.

The proper functioning of the internal market

There are three important aspects to 'proper functioning'. The first one is about the core of the single market. Figure 2 provides a simplified picture of how the EU single market is organised to make it function properly. Also here, the EU is ambitious. No other regional economic grouping would allow this combination

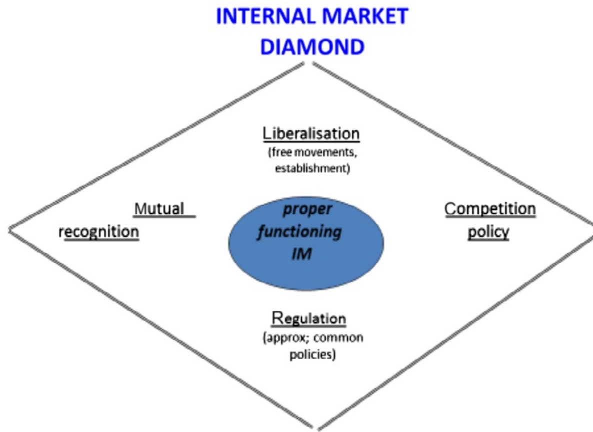

Figure 2. Internal market diamond.

of far-reaching and intrusive instruments to govern the internal market, and thereby override member states.

One may see Figure 2 as a rewrite of Figure 1, but the idea behind it is different. The picture is suggestive of how the four sides of the rhombus influence the functioning of the internal market simultaneously or interactively. Thus, no free movement would be expected to come about as long as market failures (or, rarely, other reasons in the EU public interest) have not been addressed by the lower side of the rhombus. Even if that is accomplished, EU competition policy is critical to avoid market distortions caused by market power or (say) state aid distortions. In some cases, typically network industries, EU competition policy is ex ante rather than ex post, because otherwise proper market functioning would almost certainly not come about, at least not initially.[9] Moreover, EU regulation should only be employed where necessary; at times, no EU rules are needed and mutual recognition between national regulatory regimes can be sufficient; but, in turn, that requires a carefully constructed regime of procedural mutual recognition.[10]

The second aspect of proper functioning is the mutual entanglement and intense interaction between most common EU policies and the internal market. In fact, what have long been known as common policies are nothing else than sectoral single market regulatory regimes for transport, agro and fisheries, or aspect-based regulatory regimes (trade, environment, regional, industrial). What is known as EU energy policy is in fact a combination of gas and electricity internal market regulations and some climate-based regulation. With the so-called 'energy mix' still remaining sacrosanct for individual member states, no true EU 'energy policy' is feasible. Even infrastructural aspects in energy, or indeed in several other markets, are hardly EU-based. It is little recognised that labels on EU policies (for each Commissioner or Directorate-General or,

for that matter, for many committees in the EP and in the Council) may be good for associating people with concrete policy activities, but conceptually they are all internal market aspects, and, more often than not, also legally based on the single market.

The third aspect of proper functioning is modern and credible enforcement. This sounds obvious but has proved to be an endless steeple chase of problems, often closely related to what is – rightly or wrongly – regarded as national policy autonomy. Enforcement has become far more disciplined and professional in the internal market than 25 years ago, but there are still problems which affect the internal market negatively (for example, foot-dragging on large packages of regulation in network industries, like the third energy package or the first rail package). Nevertheless, what is more important for the longer term is to make enforcement less legalistic as well as more effective, cheaper and faster. Pelkmans and Correia de Brito (2012) show at great length and in many different ways empirically that the EU has finally embraced such 'modern enforcement'. The critical factor here is not to regard the member state as a 'sinner', which the Commission must approach in a policing manner, as it has traditionally done, but as a partner in making the single market work better. Only when member states remain recalcitrant or are convinced that a CJEU judgment is needed can one fall back on classical (but very expensive and slow) infringement procedures. Since about 2009, after the late 2007 single market review proposals to this effect, member states have begun cooperating on a structural basis, and it works.

The proper functioning of the single market is crucial for the EU objectives to be served well. An ill-designed EU regulation, a free movement with many exceptions, a mutual recognition frustrated by member states, weak enforcement or too lax EU anti-trust nullify or at least reduce the possible economic gains from enjoying a single market.

Functional subsidiarity test indispensable for a better single market

Subsidiarity is, by its very nature, a functional principle: it implies an analytical approach to identify the level of government where a policy or a competence is most effective. It is also a two-way principle: dependent on the outcome of the subsidiarity test, powers can go to the EU or indeed remain with or go back to EU countries. The more functional subsidiarity is approached, for instance, in impact assessments of proposed EU regulation, the better it will be for the internal market because the best design in terms of levels of government can then be followed. This is welfare improving. However, in many cases one runs into political sensitivities or 'red lines' drawn in the sand by leaders of member states. This might concern the tightening of enforcement of the posted workers directive, or the (greater) autonomy of an EU agency, or proposed EU regulation on the corporate tax base (highly distortive at the moment, and a

clear disadvantage compared to the uniform corporate tax base in the US), or perhaps even the language of the European patent. A most painful example of a missed opportunity of properly applying a subsidiarity test is the hopelessly fragmented bank supervision in the EU internal market for financial services up to 2008 or even later. The political neglect of functional subsidiarity led to three failings: the quest of many exceptions in the so-called common rules (some 150 in 2008), the impossibility to transcend narrow national (bank) interests in EU-wide supervisory committees that could only 'cooperate' without bite, and the complete failure of fully and credibly informing one another on bank problems as a corollary of the home country control principle. The second of these failures was always defended with the excuse that the EU had no 'fiscal capacity' to rescue a bank or bring it into 'resolution', so the national level was inevitable. This is turning subsidiarity on its head: the test would clearly show that such a capacity would have to be created at EU level, so that the regime can be optimised.

Applying a functional subsidiarity test carefully does *not* mean that a wave of centralisation would follow. But the arrangement has to be credible and effective and, in several areas, that does require an EU regime, possibly with agencies with some centralisation (operating in an EU regulatory framework, of course). Banking supervision and resolution has, in principle, nothing to do with the eurozone; it is no more than the indispensable positive integration of an internal market for banking services. The degree of centralisation is relatively high because, apart from the assurance of having sound banks, there are possibly serious implications of 'systemic risks' and contagion between big banks all over the EU, and even loading sovereigns with high debt, in other words, for financial stability. The enormous consequences of endangering EU-wide financial stability are now better appreciated.

In network industries, especially those with large sunk costs in physical infrastructure (i.e. rail freight, gas and electricity, eComms), the internal market has still not been achieved after 25 years of rather frantic work, with successive 'packages'. Here a major problem is that member states have national regulatory authorities (NRAs) under EU law but the EU internal market itself does *not* enjoy regulatory agencies which could ensure the fully fledged internal market in these network industries as well as its proper functioning. NRAs (and sometimes the Commission) use the Meroni doctrine as the formal excuse for not having such agencies.[11] Pelkmans and Simoncini (2014) make the case that the Meroni doctrine has 'mellowed' with the ESMA case[12] and, if handled properly, is no longer a barrier to setting up independent EU agencies where needed.

EU market integration: progress and deficits

For the purpose of this paper, sketching progress in EU market integration is done in three ways. First, a concise summary of the main elements of the

Table 1. Market integration deficits in services, 2014.

	Main areas	Annotations
Horizontal regimes	• Services directive, a range of follow-ups on 'fitness' for specific sectors, legal form, insurance, etc. • Public procurement in services and concessions, based on 2014 rewrite • Infrastructures, often a binding constraint	• No. of barriers for trade and FDI in services can be reduced much more • 'Concessions' new in dir. 2014/23, still many issues • Network industries can only enjoy a true single market if infrastructures can be better governed (and co-financed) at EU level; huge investments are required in rail, gas and electricity, eComms
Sectoral regimes	• 4th generation of financial services regime (2009–2014) better, but still not complete and not fully tested • Professional services exchange in the single market requires easier market access, blocked or made more difficult by lack of recognition • Electricity and gas single market does not yet exist though progress has been made • Rail freight market hopelessly fragmented; freight corridors initiative positive but long term • eComms >> no such thing as a single electronic communications market	• Today's fragmentation hinges partly on (mis)trust, new regime not complete • Professional qualifications under national powers; mutual evaluation ongoing via public interest tests • Mixed: insufficient interconnectors, national 'energy mix' and huge distortions renewables • Nine EU-wide freight rail corridors will help in the medium run; ERA and regulatory regime too soft • Essentially due to NRAs and lack of EU solutions; huge price disparities (see Maincent *et al.* 2013)
Cross-cutting regime	Retail; slow increase of competitive exposure, restrictive local rules Logistics Digital single market	• 'Economic needs' test gone, subtle barriers remain; touches various policies • Modern logistics critical for competitiveness (e.g. in value chains); links with transport and digital • Digital Agenda of June 2013 had 132 items, showing the diversity and complexity (including private law issues, copyright, etc.); now DSM

Note: ERA = European Rail Agency; NRA = national regulatory authority; DSM = digital single market.

successful EC-1992 programme will be provided. Second, the progress of the single market between 1993 and 2010 will be highlighted. Third, Table 1 summarises 'market integration deficits' in services in 2014.

The achievements of the EC-1992 programme are amazing. Starting in mid-1985, and given that the 7.5-year period comprised two commissions and also one European election, not to speak of all the national government rotations or changes, the prospects for such an ambitious undertaking would not be considered good. Yet EC-1992 was a resounding success. It would seem to defy all routine political expectations about lobbies and EU countries resisting such deep reforms (think of insurance, airlines, the car industry with its quotas vis-à-vis Japan, many SPS measures, abolishing frontiers). The success rate of the White Paper's Annex by the end of 1992 was around 95 per cent of the 284

measures (and many others were taken as well). In the process, a number of regulatory and other reforms were incorporated in the proposals.

The EU decisively moved into services, beginning with transport, financial services and, more hesitantly, professional services, followed later by network industries. These areas were less well understood and certainly full of resistance, be it out of fear of liberalisation or for other reasons. Also capital market liberalisation was accomplished fully (and enacted in the Maastricht treaty). The first taboos in IPRs were reduced as well. Free movement of goods was 'cleansed' of some protectionist exceptions (e.g. cars, clothing) and an entirely new system of animal health controls as well as other SPS provisions were rapidly enacted. The transformation of EU industrial policy, whether at national or EU level, caused it (from late 1990 onwards) to move away firmly from interventionist and sectorally specific policies (again codified in the Maastricht treaty).

Following the EC-1992 programme, the single market became subject to a 'brick-by-brick' approach until the Monti report in 2010 (Monti 2010). Despite the lack of a blueprint or a long-run programme, the functionalist pressures arising from the internal market logic remained at work, but in a highly splintered manner. The areas with the greatest potential long-run impact are the services directive 123/2006 (and the 'ownership' demonstrated by the member states in the early implementation phase) and network industries. Nevertheless, a lot more has been accomplished: the 2008 goods package, including much-improved conformity assessment, the setting up of quasi-regulatory agencies (medicines, chemicals, food) and transport safety agencies (rail, air, maritime), the Emission Trading System, addressing barriers in stock exchanges and progress in other IPRs (e.g. trademarks) illustrate the continuous activity of deepening the single market.[13]

It goes without saying that the implicit EU agenda for services in the internal market is incredibly ambitious and partly medium if not long term. The treaty is to some extent ill-designed for this agenda: for example, copyright is often still national and causes fragmentation (e.g. geo-blocking) to harden, whilst infrastructure is barely an EU competence and enjoys only minimal funds, with ad hoc supplements like the Juncker plan.

The meaning of the internal market for EMU

The single market can also be seen in a wider context than pure market integration. Ever since Balassa (1961), the first 'higher' stage than the 'common market' was to be 'economic union'. But economic union is a stage without agreed definition. Also the TFEU or Maastricht treaties do not define economic union anywhere.

One would assume that, in any event, the E of EMU must have the internal market as its centrepiece although the TFEU does not say that. In the eurozone, the 'economic union' was long de facto regarded as budgetary discipline

of national governments, because loose debt and deficit disciplines might sooner or later lead to pressures on the European Central Bank (ECB) to relax monetary policy, and/or generate negative cross-border fiscal spill-overs (e.g. higher interest rates caused by less disciplined countries). In other words, although national budgets are not 'monetary' but 'economic', budgetary disciplines directly serve the proper functioning of monetary union. However, this seems to be an inappropriate notion of economic union.[14] Articles 120/121, TFEU address 'economic policy coordination' without giving much detail. It is sometimes suggested that these two articles are the 'economic union' articles. However, the term economic union is nowhere to be found. The only link with EMU is found in Article 121/4, which argues that if national economic policies are not consistent with the Broad Guidelines, they 'risk jeopardising the proper functioning of EMU'. Altogether, looking pragmatically at 'economic union', one may reasonably suggest the EU's economic union to consist of (i) the internal market, (ii) economic policy coordination, (iii) budgetary disciplines for the member states and supervised by the Economic and Finance (EcFin) Commissioner, under the treaty rules, (and for the eurozone) under the SGP, and two- and six-pack regimes. The economic rationale of having (i) and (ii) for all member states is the realisation that a very deep internal market generates such a significant economic interdependence that national 'economic policies are a matter of common concern' (Art. 121/1), whilst at the same time national policies may distort or be in the way of further developing the deep internal market. The core problem is that the relevant national economic policies at stake here are under the autonomy of the member states. One might call this the 'soft economic union'. The 'hard' economic union, in contrast, adds item (iii) fully, together with the awareness that the eurozone countries jointly own a 'collective good' called the euro. It is in their joint interest to pursue policies and disciplines at two levels of government (EU, ECB; member states) which maintain a high level of currency quality. Thus, apart from sound monetary policy, it is essential that the underlying eurozone economy is flexible and can adjust swiftly and relatively painlessly via the proper functioning of competitive goods, services, labour and capital markets and their (relative) pricing. This is the more important as other adjustment mechanisms (internal exchange rate adjustments; fiscal transfers) are not available; only relatively short-run net capital flows to finance current account imbalances are available, which are no panacea for the underlying problems. It is especially here that (a) a very deep internal market, including all types of markets, is helpful; (b) further reaching and more intrusive policy coordination as a form of joint 'management' of the eurozone economy is indispensable.

Nevertheless, the financial and sovereign debt crisis demonstrated that this modern version of linking the internal market with the E and the M of EMU is not necessarily wrong, but naively assumes away the underlying problems of a mistaken design of the internal market. The story is broadly correct if, and only

if, the positive integration of the internal market of financial services is properly designed. However, that was clearly not the case. Two profound flaws caused both EMU not to function properly at all, when it was most needed, and the internal market for banking services to falter, if not to fail. First, the internal financial market was never designed on the basis of a functional subsidiarity test, for the simple reason that member states drew 'red lines' for political reasons. When large banks are Europeanising via subsidiaries and via assets (e.g. holding bonds from many EU governments), prudential supervision has to be centralised to a decisive degree, including the sensitive aspect of bank resolution, with the relevant funds ('fiscal capacity') to do so effectively and immediately when needed. This was taboo. Instead, a weak and cooperative system of intergovernmental supervisory committees, with a mutual information obligation, was set up – a system which failed utterly. At the same time, supervision should not only be based on prudential directives, but also on fully uniform application in a single rulebook: not 150 exceptions to these rules serving any wish of almost every member state. Rules should also not be 'light touch' where risks do not allow this. The recent drastic 'repairs' of the positive integration of these markets are a major improvement, although European Banking Authority (EBA) is still too intergovernmental and the toughening up had to come from the banking union initiative with full centralisation where justified. Second, the repercussions of a faltering internal financial market for systemic financial stability were totally ignored before the crisis. Again, this link calls for at least some centralisation in a eurozone context, although this should benefit non-eurozone countries as well. The so-called macro-prudential watchdog is the European Systemic Risk Board (ESRB), established in the ECB, although of significance for the entire EU. It is an information and analysis system, with advisory functions; it can give warnings and recommendations too. Its advantage is that the sole focus on budgetary disciplines is a thing of the past, thereby reducing the risks of 'bubbles' and helping to prevent the build-up of distortions (e.g. in housing markets) or longer-run deficits on current account. Once systemic risks start undermining trust in financial markets, the damage may be very great due to 'sudden stops' of finance or the drying up of daily interbank markets, not to speak of quickly rising risk premiums in interest rates of sovereign bonds from (EU) countries which are seen as vulnerable. It has also led to a sharp fragmentation of financial markets in the EU, at least for some four years or so.

The present paper does not cover banking union and its corollary, the so-called fiscal union. The essence of the banking union is merely and simply the required positive integration to make the single market for banking services function properly. This may be demanding and somewhat centralising (a problem for the 'outs' and the EEA-3 countries which are in the single banking market) but functionally this is appropriate. Given the heavy reliance on banking when demanding capital in the Union, a banking union is also

more likely to pre-empt a renewed fragmentation of financial markets. The principle of 'bail-in', now enacted in the Single Resolution Mechanism, gives the right incentives not to assume excessive risks in the single market for banks and, in any event, to minimise or effectively prevent a negative fall-out for the sovereigns (i.e. taxpayers). The crisis has therefore forced the lifting of taboos, which enabled the building of a far stronger and more resilient single market for financial services. The only lingering anxiety on the part of the 'outs' is whether the further deepening of the eurozone towards a 'genuine EMU' might, in the margin, be at the expense of the single market, in particular for the 'outs'. However, there are clauses that ensure the internal market's integrity cannot be affected by the banking union and its specific application to the 'ins'. The UK is particularly sensitive about it given the very strong position of the City in financial markets. But the 'outs' have obtained a double majority in the EBA – that is, of 19 eurozone countries and of the 9 'outs'. There is an issue about limits on how much a bank can lend to its own government: the UK argues that the case for strict limits is less strong for the 'outs'. The problem in economic terms here is that financial stability is part of the regulatory regime of the single market and of the eurozone. Given that such limits are never the result of exact science, there must be compromises that remove this anxiety.

Is the single market resilient against crises?

The EU single market has emerged largely unscathed from the Great Recession. Indeed it has gained in strength and depth and a renewed impetus for further deepening and redesigning appears under way. It is also likely – but harder to prove – that the relative immunity from the crisis (except for the temporary damage to financial markets) has helped the EU to recover despite a huge debt overhang and no budgetary possibility to stimulate the economy beyond the 'automatic stabilisers'. But that was not immediately obvious. In early October 2008 President Sarkozy gave an aggressive (election) speech with a long list of interventionist, if not protectionist, policy ideas to fight the upcoming crisis (after the collapse of Lehman Brothers), and summoning French automotive investors in the Czech Republic to return to France. If Sarkozy had tested the water, he must have swiftly realised that it was ice-cold. Not only did he prompt a storm of protests from other EU government leaders, the European Commission kept a low profile, merely announcing that each and every measure announced would have to be assessed and justified according to single market rules. In a little noticed Commission Memo 09/90 of 28 February 2009, one finds confirmation that the support to the French car industry remained what had long been agreed, and the other Sarkozy measures vanished. This demonstrates that an effective bastion exists against erosion in times of crisis. The bastion consists first of all of quasi-constitutional EU rules and powerful principles underlying the single market, complemented by strict surveillance

of state aids. But if the going gets rough, also peer pressure at the highest level provides clear political signalling that the single market cannot be undermined by short-run and national 'quick fixes'. Later, the European Council declared that the single market, not implying any budgetary outlays, should be seen as a robust 'protection' against too much weakening of overall demand.

During the crisis, the single market for financial services went through an overhaul, once the taboos had been swept away by the extreme circumstances. The rules for financial services and capital were decisively improved. Later, the banking union added centralised and fully neutral, technical (ECB) supervision of large banks, and a safeguard for small bank failures if and when appropriate. The 'fiscal capacity' was installed at EU level on the basis of funds, to be built up via contributions from the banks themselves. The banking union could be more robust still, for example by accepting an EU deposit insurance system as an underpinning of fiscal capacity.

In other words, the routine incremental improvement of the single market never ceased while the Great Recession was causing a loss of demand and jobs. The third gas and electricity package as well as the 2009 telecoms package and the 2010 Digital Agenda, plus an overhaul of European standardisation in 2012, illustrate the dichotomy between the macro-economic policy environment and single market policies. In 2015, plans for the Digital Single Market, the EU Energy Union and the Capital Market Union were added to this ambitious approach as well as a host of smaller propositions. Also, the external dimension of the single market – EU trade policy –was framed as a remedy for at least some growth, without any cost to budgets; hence, CETA (with Canada), TTIP (with the US), Free Trade Area (FTA) negotiations with Japan as well as FTAs with some Association of South East Asian Nations (ASEAN) countries. This does not guarantee that the single market is immune to crisis. Erosion is always a possibility, in particular if large member states would no longer treat the single market as a common asset, to be protected and managed well for the common good. However, the depth of the single market makes that prospect ever more unlikely as the stakes have grown so high for all involved. The response to BREXIT by all EU leaders is a clear case in point.

Conclusions: rethinking market integration?

The single market is the hard core of European integration but receives relatively little attention in high politics (beyond obligatory statements). Nevertheless, it has proceeded far, and is much deeper and wider in scope than could have even been dreamt of in the EC-1992 period, the only period when the single market was popular. Already for many decades, one hears soundings from scholars and others that, *so far*, the internal market has been relatively easy but the future issues will be far more intrusive for member states and more sensitive socially and politically. The EU nevertheless went on deepening and, where relevant,

widening the scope. The long-run pattern is that what was sensitive or 'impossible' (a core item of 'sovereignty', whether the frontiers and their national customs, a flag-carrier in airlines, national energy strategies, bank resolution with national fiscal capacity, public procurement, exchange controls, or indeed the national currency) eventually lost its taboo status. Moreover enforcement has been tightened significantly and grown more and more into a joint responsibility. These developments have facilitated a deep internal market in 2015 and will help to pursue further improvements in the near future.

Precisely because of this intrusive single market, the EU must take great care in making the case for more and better EU regulation (via impact assessment) and ensure as much as possible its political legitimacy in formal and substantive ways. Indeed, most people might often not even realise that it is really the single market they deal with. This is largely due to the prominence, by now, of EU regulation, mostly risk regulation. These rules reflect policy concerns of many parties, including lobbies and citizens. Therefore, much of what in the present paper is presented as single market questions shows up in 'Brussels' as 'better' food regulation, climate policies, banking union, energy strategy, or product safety. The pursuit of the single market is ultimately driven by functionalist and market pressures, but, as alluded to several times, this does not mean that it is a-political. There is surely scope for policy choices up to a degree. However, it is mistaken to attribute too many of Europe's or national problems to the single market. For example, issues such as income distribution are essentially national issues subject to national political processes (one only has to verify the disparities in income distribution indicators in the EU, not to speak of the US, Brazil or China) and the speed and nature of adjustment of workers and enterprises can only be influenced at EU level in the margin (that is, most means are national, and some pressures have to do with autonomous technological progress and with global competition by developing and emerging economies seeking their place in what used to be an Organisation for Economic Co-operation and Development (OECD)-dominated world economy).

A careful application of a functional subsidiarity test is critical because there is little support for an ever more centralising EU. The single market needs selective centralisation via its rules, and sometimes via EU agencies. It also requires stronger powers and more funds for infrastructure. The banking union even disposes of a (not so large) rescue fund and a resolution fund is built up with contributions of the banks themselves. One can justifiably defend more independence for EU agencies in those network industries having large sunk costs (rail, gas and electricity, eComms) but this should not be read as if (regulatory) agencies keep on multiplying. The benefits of each case should carefully be spelled out and the costs of the alternative of inefficient and slow inter-governmentalism have to be verified.

Therefore, EU market integration does not need a wholesale 'rethinking' but, rather, a faithful and functional pursuit of the realisation of a 'genuine' single

market, with appropriate degrees of selective centralisation. The single market idea needs to be modernised, as markets are changing rapidly and digitalisation is reaching all services, including the 'sharing economy' and other new business models, as well as advanced industrial production processes. This redesigning and deepening is inevitably slow and uneven. The agenda for deepening the single market for services remains a tall order. Political legitimacy has to be 'conquered' time and again. It will also have to be accepted that the single market is not the slogan that moves voters, yet it will always remain the common 'asset' of the EU that makes it a magnet for candidate countries or the EEA-3, or Switzerland or defectors from the EU. This asset ought to be well 'managed' and, if possible, increased in value and dynamic opportunities.

Notes

1. For an extensive analysis of the internal market as the principal means for the EEC to pursue the four economic objectives of the Rome treaty, see Pelkmans (2006: ch. 2) for the Rome, Single Act and Maastricht treaties.
2. Note that the detailed Single Market Review (in the UK Competences review) found almost no instances where the single market was to the detriment of the UK, or, significantly over- or mis-regulated.
3. The two strategic single market documents are: (1) the European Commission Strategy in COM(2015)550 of 28 October 2015, Upgrading the Single Market – More Opportunities for People and Business; this proposal has to be understood in a broader strategic context for the overall single market, with three other proposals, i.e. COM (2015) 192 of 6 May 2015, A Digital Single Market for Europe; COM(2015) 80 of 25 February 2015, Energy Union Package – A Framework Strategy for a Resilient Energy Union with a Forward-looking Climate Change Policy; COM (2015)468, Capital Markets Union Action Plan ; (2) the European Parliament's Report of the High Level Panel, A Strategy for Completing the Single Market: the Trillion Euro Bonus, 14 January 2016, see http://www.europarl.eu/thinktank.eu/thinktank.eu/document.html?reference+EPRS_STU(2016)558772
4. A powerful reason also for French voters to reject the draft European Constitution in 2005.
5. This should include the free movement of codified technology (e.g. IPRs etc.).
6. Case law and other literature strongly suggests that internal market fragmentation was strengthened by IPRs and provided highly profitable instances of price discrimination.
7. Sanitary and phyto-sanitary regulation.
8. In EFSA, the European Food Safety Agency.
9. A referee queried why competitiveness is not found in Figure 1. Competitiveness of firms in the EU is, insofar as the single market can influence that, a *result* of the better functioning of the single market, in turn resulting from a proper application of the regime as depicted in Figure 1.
10. Finally achieved after many problems in Reg. no. 964/2008, shifting the burden of proof largely to member states.
11. The Meroni doctrine, named after an old ECSC case (of 1956), essentially says that, since member states have delegated regulatory (hence law-making) powers

to the EU level, the Commission or the Council cannot delegate such powers to an independent agency/regulator without having an explicit legal base in the treaty.

12. ESMA is the European Securities and Markets Authority, an agency dealing with regulation and supervision of capital markets in the EU. The ESMA case C-270/12, brought by the UK, challenged the ESMA power to forbid short-selling as a violation of the Meroni doctrine. The ruling on 22 January 2014 dismissed all four aspects of the UK government's case. Pelkmans and Simoncini (2014) show that this ruling has general validity for all EU agencies, not just for ESMA.
13. It is also possible to verify progress in market integration in purely economic terms. The literature finds trends of price convergence and a lessening of 'home bias' (the propensity of buyers to purchase at home), both signs of increasing market integration. Indirectly, the increasing gains from deepening market integration also point to this: ranging from the Cecchini report (Emerson *et al.* 1989) of some 4.5 per cent increase in GDP due to the full implementation of EC-1992 to, for example, Campos *et al.* (2014) finding an increase in GDP attributable to EU membership (mainly the single market) of some 12 per cent since 1973. Note that the present contribution cannot deal with the growth and productivity effects of the single market in any detail. Up-to-date summaries of the state of the art are in the High Level Panel report of the EP (see note 3) and, for example, in Mariniello *et al.* (2015).
14. It should be remembered that neither Ireland nor Spain had a deficit or a debt ratio problem until 2008.

Disclosure statement

No potential conflict of interest was reported by the author.

Notes on contributor

Jacques Pelkmans is a Senior Research Fellow at the Centre for European Policy Studies (CEPS) and has been a Professor at the College of Europe in Bruges since 1992. He has authored many publications on various aspects of European economic integration and on international trade policy and investment. His most recent contributions include *The Contribution of Mutual Recognition to International Regulatory Cooperation* (OECD Regulatory Paper no. 2, 2016, with Anabela Correia de Brito and Celine Kauffmann) and *What Strategy for a Genuine Internal Market?* (2016, CEPS Special Report no. 126). [jacques.pelkmans@gmail.com]

References

Balassa, Bela (1961). *The Theory of Economic Integration*. Homewood: Irwin.

Campos, Nauro F., Fabrizio Coricelli, and Luigi Moretti (2014). 'Economic Growth and Political Integration: Estimating the Benefits from Membership in the European Union Using the Synthetic Counterfactuals Method', IZA Discussion Paper no. 8162.

Comité Intergouvernemental Créé par La Conférence de Messine (1956). *Rapport Des Chefs de Déléfation aux Ministres Des Affaires Entrangè*. Report of the Heads of Delegation of the Foreign Ministries. Brussels.
Emerson, Michael, Michal Aujean, Michel Catinat, Philippe Goybet, and Alexis Jacquemin (1989). *The Economics of 1992: An Assessment of the Potential Economic Effects of Completing the Internal Market of the European Community*. Oxford: Oxford University Press.
Maincent, Emmanuelle, Dimitri Lorenzani, and Attila Eordogh (2013). 'Market Functioning in Network Industries – Electronic Communications, Energy and Transport', *European Economy, Occasional Paper*, 129, 1–121.
Mariniello, Mario, Andre Sapir, and Alessio Terzi (2015). 'The Long Road towards the European Single Market', *Bruegel Working Paper*, 2015:1, 1–36.
Monti, Mario (2010). *A New Strategy for the Single Market: At the Service of Europe's Economy and Society*, Report to the President of the European Commission, 9 May.
Pelkmans, Jacques (2006). *Economic Integration, Methods and Economic Analysis*, 3rd ed. Essex: Prentice Hall Financial Times an imnprint of Pearson Education.
Pelkmans, Jacques, Anabela Correia de Brito (2012). *Enforcement in the EU Single Market*'. Brussels: Centre for European Policy Studies.
Pelkmans, Jacques, and Marta Simoncini (2014). *Mellowing Meroni: How ESMA Can Help Build the Single Market*. Brussel: Centre for European Policy Studies.