

## **What strategy for a genuine single market?**

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### **Abstract**

This strategy paper focuses on making the most of the EU single market. The EU should pursue a genuine single market, and treat it as a common asset of all its citizens, economic operators and member states. The economic case to be made on behalf of the genuine single market is powerful, even more so due to the findings of recent empirical economic research. However, only the genuine single market can realise the expectations of such large gains. Weak, 'feasible' action plans cannot!

The strategy is based, first of all, on a clear design of the genuine single market and subsequently concentrates on 'what it takes'. Ten types of actions sum up 'what it takes': five at the EU level, four at the EU-member state interface, and finally, the realisation of legitimacy and acceptance. The five types of action at the EU level include cluster strategies (e.g. digital single market; energy union); actions for cross-cutting economic activities (e.g. [r]etail and logistics); horizontal approaches (e.g. public procurement, especially more credible national enforcement; consumer protection); a more detached application of EU better regulation and finally alternative design of segments of the single market (e.g. capital markets union and the Unitary Patent). The four types of action at the EU-member state interface are based on the premise that member states ought to exercise their powers in ways that minimise or avoid negative effects on the single market. The actions include the pre-emption of the exercise of national powers hindering the functioning of the single market (e.g. major distortions, lowering costs of regulatory heterogeneity), optimal centralisation of powers in four EU network industries and in financial markets, member states acting as good custodians of single market functioning in their own country and effective enforcement and market surveillance. Finally, legitimacy of the single market has been negatively affected in a few sectors such as road transport, horticulture, construction and aspects of tourism. Legitimacy is of the essence for any single market strategy worthy of the name, implying that more firm measures to end adverse developments hitting a small segment of the working population must be taken.

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# What strategy for a genuine single market?

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## 1. Purpose and thrust of the single market strategy

This strategy paper is focused entirely on making the most, and nothing less, of the EU single market. This has far from having been achieved, however, which in itself is remarkable. The single market route, which started early in the 1980s,<sup>1</sup> is littered with plans and strategies full of acts of cross-border liberalisation, initiatives for EU regulation and modest adaptations of EU governance. But the distance between the gradual build-up of the internal market, piece by piece and over decades, and the creation of a truly single market, is still quite long.

Making the most of the single market, and nothing less, is based on the powerful idea that the single market is a common asset of all EU citizens and member states. *Our* asset. *Our* single market. And this potentially valuable, common asset is being badly managed; it is seriously underperforming. Making the single market work (function) effectively as intended by its intrinsic logic and for its fundamental aim, amounts to *joint* asset-management by all member states and the EU bodies, rewarded by valuable long-term economic and other gains. Each time a member state or certain political forces pre-empt a fundamental deepening, they are damaging their *own* asset and, in the process, also negatively affecting the value of the common asset for all others in the EU. And if all member states act individually as if each one of them can find exceptions or define 'red lines' where not justified by single market logic (read: distortions or deficits), the single market would be hollowed out or erode quickly. Fortunately, free movement is hard EU law, backed up by a European supreme court; otherwise unravelling would have happened long ago. All EU countries want the single market, but then again they all act like trade negotiators trying to 'bring something home' or define defensive interests, thereby reducing step-by-step the single market accomplishments or preventing those from being realised. Defensive interests against what? Against their own asset? This makes no sense, whether from a long-term economic perspective or from a single-market logic. All the common-asset holders jointly enhance the value of their shared asset. Of course, this asset is a very long-run asset, yielding over time, and not always a 'quick buck' tomorrow morning.

The present strategy paper is not, first of all, an economic paper, but rather is focused on the overriding aim, called a "genuine single market", and a strategy to realise it. The economic case for such a genuine single market has received a lot of attention recently, also from the

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<sup>1</sup> When the European Economic Community (EEC) finally began to think of an internal market instead of a mere customs-union-plus, work submitted by the European Commission to the newly created Internal Market Council of Ministers in 1982 and 1983 showed a serious lack of knowledge and facts. Another wake-up call was the Albert & Ball report (1983) for the European Parliament. These 'discoveries' inaugurated a tradition of regularly returning advocacy of deepening and widening (the scope) of the internal market based on long lists of measures.

present author.<sup>2</sup> The case is powerful. The core problem of any serious single-market strategy is to overcome the cleavage between the attractive economic potential of a genuine single market and the overwhelming, although ill-considered tendency to search for what is politically 'feasible'. Going for the latter will continue the pursuit of a non-design 'by the piece', without yielding much of the prospective gains. The economic gains will be used as an argument, but such strategies cannot possibly deliver them, and indeed cannot come even anywhere near. The aim of the present paper is to address the cleavage, taking the rough contours of the economic gains for granted.

## 2. A genuine single market forms the foundation of a genuine EMU

The analogy with the euro and the eurozone is much closer than many realise. In EMU, the first (Maastricht) design centralised monetary policy and set up an independent central bank, but it did not yet express the notion that EMU would create a collective good ('club' good), with all the consequences that this implies. Namely, joint management, joint decision-making, joint disciplines, all for the quality of one's own collective good, the euro. As we now realise only too well, the entire financial services and capital markets and institutions for financial stability were either lacking or severely insufficient; now they are largely centralised and with tougher quality criteria. And economic policy coordination as well as reforms have become to some degree Europeanised or even eurozone-ised. Under the slogan: this is what a genuine EMU requires.

Is it so different for the single market? We are so accustomed to thinking of the single market as the addition of numerous specific measures and regulations/standards that we tend to think it is very different in the single market. This is severely mistaken. It would only be defensible if one regards the single market as whatever the politics of the moment allows the single market to be, with all the shortcomings and distortions as a result. In other words, such a single market amounts to what is a politically feasible collection of accomplishments, disregarding or denying the single market's intrinsic functional, regulatory and economic logic. If ad-hoc, politically convenient incompleteness and lingering distortions are accepted rather than firmly addressed, one acquires anything but a genuine single market. Such a far-from-single and ill-functioning EU market is very different from the eurozone with a single currency: after all, one cannot have two-thirds or half of a single currency and this has major implications. In contrast to the politically feasible far-from-single market, the genuine single market is a radical, highly productive idea, very similar to what it takes to enjoy the genuine EMU. The deeper the single market is in the five component market types,<sup>3</sup> and the more numerous the overlapping, cross-cutting and horizontal links (see below), the more the genuine single market will assume the characteristics of a highly valuable joint asset that every member state would want to benefit from as well as protect against erosion, bad management or the search for exceptions or opt-outs. When comparing with EMU, why would Europe have its current political ambitions of arriving at a genuine EMU (for 19 EU countries) and not very similar political ambitions of arriving at a genuine single market (for all 28) in the longer run, based on a clear concept, performance-based designs and action plans? Not only that, a genuine EMU has to be designed with the (genuine !) single market (as part of the 'E'). Indeed, a genuine single market makes for a more superior EMU too.

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<sup>2</sup> The main source is the wide-ranging EP's Costs of Non-Europe project (see further). See also Pelkmans (2006), Pelkmans (2011b), Straathof, Linders, Lejour & Moehlmann (2008), Campos, Moretti & Coricelli (2014) and Mariniello, Sapir & Terzi (2015).

<sup>3</sup> See section 5 and Figure 1.

### 3. A genuine single market requires an ambitious strategy

The genuine single market needs a strategic paper drafted by ‘the presidents’ of EU bodies (except perhaps the ECB president) just as much as EMU does. And a far more ambitious backing in the European Council than it has hitherto received. That is a logical consequence of having and better managing ‘our’ single market, our joint asset. And just as – in the case of the euro – it took (what were seen by member states as) radical measures such as centralising bank supervision and bank resolution (with EU money if bail-in is not enough), the genuine single market will require degrees of joint management that, today, may sound as hardly feasible or far-fetched. A genuine single market goes to the hard core of European integration: the single market was, is and will remain the primary reason of attraction of the EU for members and candidates alike. Unlike EMU, it concerns *all* EU countries (and the EEA-3 countries). Moreover, the single market is profoundly wanted by the UK, too, otherwise hesitating whether to stay in as EU member. This most explicit UK preference shows the joint asset value better than anything else. However, the single market the UK wishes to keep is, today, a very incomplete and underperforming single market. It could be so much more attractive for all, including the UK. Decisively enhancing this economic attractiveness is what a single market strategy should be all about.

### 4. Two core questions

The core questions about the EU single market have always been and remain:

- a) What is the single market actually?
- b) How is it best used, as *the* major means in the treaties, for the effective pursuit of the EU’s leading economic aims?

When posing the core questions, one finds a striking difference with the debate on the genuine EMU, in that the latter has generated numerous papers and reports on what exactly is a genuine EMU and hence what it requires, whereas that is hardly or not the case at all for the single market.<sup>4</sup> Indeed, the single market is not discussed in terms of arriving at a genuine single market. But it should be. *Only the genuine single market can match the expectations about large economic gains* that been calculated in many recent reports, not to speak of the qualitative but nonetheless important dynamic economic effects. These prospective economic gains of some 5-8% of EU GDP, if not higher still, *cannot* be extracted from weak or politically convenient so-called strategies. These gains simply pre-suppose the genuine single market in the form of assumptions about what the ideal scenario might be. The EU cannot go on underpinning analytically and ever more convincingly that overcoming many and deep market integration ‘deficits’ will yield enormous economic gains, and yet not act in earnest. That is, only promulgating highly selective, relatively soft and incomplete reviews or mini-strategies with long lists of small items, without first being clear what the genuine single market is *and* what it takes. Since 2000, the European Council has declared numerous times that the internal market should be further improved in various ways. No doubt, something of these intentions has been accomplished,<sup>5</sup> but there is a severe risk of undermining credibility, if not de facto allowing the fundamental priority of the single market to be dismissed or quietly shelved time and time again, while acknowledging it on paper.

<sup>4</sup> The report by Mario Monti (2010) revived the internal market debate in the EU, but its follow-up in the two Single Market Acts was rather modest and selective.

<sup>5</sup> An accessible overview of what has been achieved e.g. in the periods between 1985 and the end of 1992, as well as between 1993 and 2010, is provided in Pelkmans (2011a).

## 5. What is the single market actually?

The basic idea of the single market is simple: it consists of the Europeanisation of the five types of markets, which together<sup>6</sup> serve as the foundation of every modern economy. In other words, goods, services and factors of production (labour, capital and knowledge and codified technology) should be free, allowing for actual and credible potential mobility across intra-EU borders. Since markets are often regulated, in different degrees, and other interventions take place at the national (or even regional) level, a single market requires: i) that free movement and the right of establishment have to be unrestricted, ii) that EU regulation takes over, where appropriate and justified by market failures, or mutual recognition is accepted and iii) that other interventions in 'national' markets either have to be non-distortive or trivial for the EU economy, or ought to be combined in some effective way at EU level, whatever is appropriate.

In the EU, even after nearly six decades of market integration, this basic idea has gradually come closer, but it is still quite far away. This is not always understood. The famous 1985 Commission White Paper "Completing the internal market",<sup>7</sup> setting in motion the EC 1992 process, has rightly been praised at the time as a courageous strategy, but its flaw was hardly ever pointed out: the title. Since the paper did not even offer a definition of what a 'completed' internal market was, how could it suggest that EC 1992 was all about 'completing' it? Nowadays, more than two decades after the successful 'completion' of EC 1992 – *not* of the internal market! – many citizens and journalists still think the single market was then 'completed'<sup>8</sup> and was no longer a leading problem after 1992. Since the early 1990s, single market policy proposals are perceived as 'technical maintenance' or slight modernisation of highly specific areas, but rarely as EU issues of prime importance.<sup>9</sup> Nor has the EU, ever since 1993, provided a strategic vision on what the ultimate single market would eventually have to be, and why.

## 6. Single market, the basics of a modern design

The single market has an intrinsic logic that is purely functional, not political. This is reflected in the basic design. Once the basic design has been realised, a second set of design issues follows in order to ensure that the EU makes the most of its immensely valuable common asset. The basic design is discussed in the present section, the supplementary design requirements will be set out in the remainder of this strategy paper.

As Nobel Laureate Jan Tinbergen (1945 and 1954) already clarified early on, modern market integration necessarily combines what he denoted as 'negative' and 'positive' integration. It is the proper combination of the two that will ultimately allow optimum market integration.

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<sup>6</sup> The market for land is not included here, as it is of course not mobile. But it matters for the free movement of persons and for the right of establishment of companies. Ignoring transition periods, in the EU this market is essentially free.

<sup>7</sup> COM (1985) 314 of 14 June 1985, "Completing the internal market".

<sup>8</sup> In fact, these mistaken perceptions are bolstered by seminars and other activities, carrying titles referring to 20 years of the single market (by the European Commission), and the like. Again, all that happened at the end of 1992 is the completion of the 1992 programme of more than seven years, a great accomplishment to be sure, but nothing like the 'beginning' of the single market. For (the many) details, see Pelkmans (1994) and Pelkmans & Sutherland (1990).

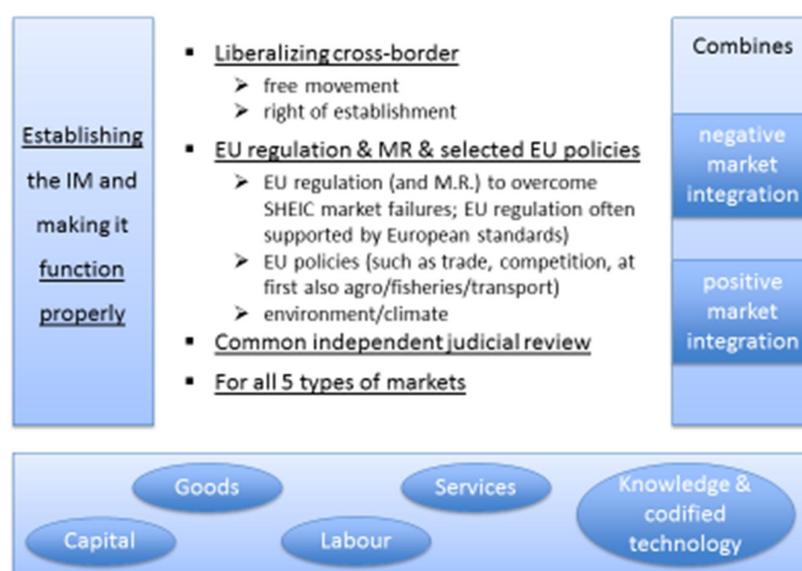
<sup>9</sup> With the probably exception of the services directive, although most of the tumultuous debate was not on the single market virtues of the proposal but about fears of a social nature.

‘Negative’ integration refers to the removal of intra-EU border and other barriers that hinder or prevent free movement and the full exercise of the right of establishment. This is a necessary but insufficient condition for market integration, let alone for the proper functioning of a single market. For the latter, also ‘positive’ integration is required, pre-empting or removing distortions in that single market by means of e.g. common competition policy and other common powers (such as a common trade policy), as well as by solving or overcoming market failures no longer at national but at EU level. Positive market integration tends to rely heavily on EU regulation (in various ways) and other common policies such as agriculture (given its heavy interventionist nature at first) and fisheries, transport policy and (later) environment. What exactly is done in common and to what extent is ideally determined by a functional (not a political) subsidiarity test.<sup>10</sup> As with all markets, the appropriate market institutions will have to be common as well, where and insofar as justified.

The treaty traditionally speaks, first, of the ‘establishment’ of the internal market, which refers to the realisation of free movement and the fully-fledged right of establishment, and, second, of its ‘proper functioning’.<sup>11</sup> This comes close to the Tinbergen approach and has proven to be extremely useful in the competent hands of the Court of Justice of the European Union (CJEU).

The fundamentals of the basic single market design are brought together in Figure 1 below.

Figure 1. Fundamentals of single market design



Notes: M.R. = mutual recognition; SHEIC refers to market failures related to Safety, Health, Environment, Investor and savers’ protection, and Consumer protection.

Market integration ‘deficits’ remain if cross-border liberalisation is incomplete due to ‘carve-outs’ from free movement and the right of establishment, and if EU regulation, mutual recognition and common policies remain incomplete to pre-empt distortions and/or fail to

<sup>10</sup> See Pelkmans (2005a and 2005b).

<sup>11</sup> Nowadays in the TFEU, Art. 26/1, the text simply reads “functioning”. The CJEU might therefore be somewhat less strict, in theory, but this textual approach still leaves much scope for proper functioning.

overcome (all) market failures, and finally when EU institutions cannot exercise all required functions or remain incomplete in their remit to ensure proper single market functioning.

The Costs of Non-Europe project of the EP is inspired by these fundamentals and has successfully identified, in a series of in-depth reports, many market integration deficits and their approximate costs for the EU (where quantifiable) as well as various qualitative drawbacks of these deficits.<sup>12</sup> The assembled empirical economic evidence is impressive, both qualitatively and quantitatively. The compelling inference is that a genuine single market would generate enormous economic gains. If it were possible – but that is a very tall order – to introduce all these quantified gains in a suitable CGE model, the general equilibrium economic effects are likely to be (much) greater still. Never mind the qualitative aspects that would also benefit the EU economy.

The aim of the single market, from the Rome Treaty until today and tomorrow, is to generate additional growth beyond what individual member states could achieve, without this deep integration and cooperation.<sup>13</sup> The potential gains as reflected in the Costs of Non-Europe project and the already realised gains are the central motivations for a single market strategy. This strategy is logically oriented towards making the most of the EU internal market as a common, valuable asset: a genuine single market.

## 7. Towards the genuine single market

The proper functioning of the single market has received increasing attention over time from EU decision-makers. Treaty revisions, the rise of EU regulation to jointly overcome market failures, the retreat of costly and distortive large-scale interventionism in areas such as agriculture and the six modes of transport, the much more liberal EU trade policy, the wider scope of EU competition policy and the single-market-promoting role of CJEU case law in many areas, including services, IPRs and of course mutual recognition, have all played their part. Undoubtedly, the single market today is much deeper and wider in scope as well as functioning more effectively than it was 30 or 40 years ago.

Nevertheless, the Costs of Non-Europe project and many other sources have shown that the enormous single market glass is at best half-full. Getting the most out of the single market for the EU economy requires a rethink and a preparedness to act as a good joint-asset manager.

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<sup>12</sup> A summary of the Costs of Non-Europe project and the economic gains simulated or projected is found in Zsolt Pataki (2014), “The Costs of Non-Europe in the Single Market, Cecchini revisited: An overview of the potential economic gains from further completion of the European Single” ([http://europarl.europa.eu/RegData/studies/STUD/2014/510981/EPRS\\_STU\(2014\)510981\\_REV1.E N.pdf](http://europarl.europa.eu/RegData/studies/STUD/2014/510981/EPRS_STU(2014)510981_REV1.E N.pdf)); this refers to a series of research reports on the free movement of goods (by Marco Hafner, Enora Robin & Stijn Hoorens of RAND Europe ; study no. PE 536 353), on the EU consumer acquis (by Mark Peacock of GHK, study PE 536 357), on the Digital Single Market (by Wojciech Paczynski of GHK), on the single market for services ( by Jacques Pelkmans, Federica Mustilli & Jacopo Timini of CEPS, study PE 536 354), on public procurement and concessions (by Chris Smith and Andrew Lilico of Europe Economics, study PE 536 355), and three studies on several modes of transport and tourism [summarised in Monika Nogaj (2014), “Single Market in Transport and Tourism”, study PE 510 985, October, European Value Added Unit, EPRS, European Parliament]. The easiest search for all these and related reports is via [www.europarl.eu/thinktank](http://www.europarl.eu/thinktank).

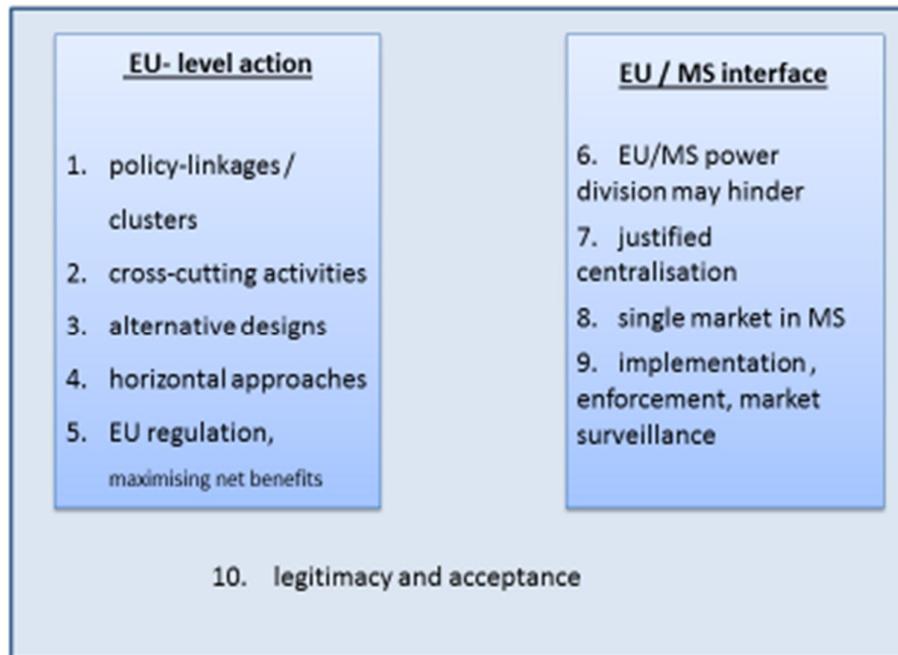
<sup>13</sup> See also Campos, Moretti & Coricelli (2014) for a pathbreaking attempt to empirically verify exactly this via a control group approach. They find that the EU (mainly the single market in the sense of Figure 1) on average has enjoyed extra gains of some 12% of GDP. In an ex-post simulation, Straathof et al. (2008) find some 10%.

With 28 EU countries, of course, this is not easy. But strategy formulation should not be affected by whether it might be easy, but rather by the magnitude of the economic gains and the proper focus on what to do. Moving towards a genuine single market, which makes the most out of the internal market, requires ten types of policy action. The many market integration 'deficits', as identified in the Costs of Non-Europe project and elsewhere, can all be addressed within these ten types of action.

The ten types of action are listed in Table 1 and elaborated in the remainder of this paper.

Table 1 first distinguishes two blocks of actions, one for five actions at the EU level and another for four actions on the EU/member states interface. In addition, a genuine single market requires legitimacy with and acceptance by the European citizenry, political forces and workers. Altogether, the ten types of action amount to a formidable agenda and major challenges of the Union's leadership. One inference can already be drawn here: the potential gains of the genuine single market are enormous, but what it takes to reap these gains is equally enormous, both for EU bodies and for member states! There is no 'free lunch'.

*Table 1. Types of actions for a genuine single market*



The corollary is critical, too: it is illusory, if not hollow, but in any event futile, to let the communication heralds announce, time and time again, that the single market is taken serious by the EU leadership if EU decision-makers are not prepared to undertake the types of actions listed in Table 1. No such joint asset can be expected to generate large gains if an endless series of restrictions, exceptions, red-lines, collective action problems, resistance to centralisation (where justified) and refusals to incorporate 'our' single market into domestic politics, are not addressed in earnest.

## 8. EU-level types of actions

The five types of action *at the EU level* are all driven by the overriding ambition of getting the most out of the single market and in this way serve the socio-economic objectives of the Union. Permanently. This is why EU countries are in the EU in the first place, so the paper merely elaborates what it takes!

*8.1 The first set of actions concerns cluster strategies or policy linkages.* In some sub-markets or policy domains, for the single market to become effective and more deeply integrated, intra-EU barriers cannot effectively be addressed and common intervention cannot be effectively pursued if approached in a too-fragmented fashion. In some instances, it is likely to be much more effective to set up policy strategies in a cluster or based on a well-coordinated linkage with one or more other areas. This sounds abstract until one studies telling and significant examples such as the digital single market and the energy union. In the Costs of Non-Europe project, one digital single market contribution has studied only three economic activities (cloud computing, payments, parcel delivery as a corollary of e-commerce) and it might yield between €36 billion and €75 billion in gains.<sup>14</sup> However, the digital single market as a whole is regarded as a ‘blockbuster’ for economic gains (once said to generate an extra 4% of GDP<sup>15</sup>) with recent research suggesting a possible economic gain of some €415 billion.<sup>16</sup>

Its substance is spread over many areas; in other words, it is not just about apples and pears but an entire fruit basket.<sup>17</sup> It comprises telecoms issues (where the market is fragmented and the industry cannot consolidate at EU level, not even when mergers are checked by DG COMP; but it is also about roaming, etc.), extended into wider and unnecessarily sensitive spectrum questions, new-generation infrastructures, cybersecurity questions (with many aspects), removing barriers to intra-EU e-commerce and enjoying wider choice, copyright (including geo-blocking, the antithesis of a single market for consumers, but also the remuneration model for content creators, yet in turn undermining competitiveness by fragmentation), financial services issues (e.g. paying with bankcards and credit cards), contract law, competition policy (e.g. the e-commerce Inquiry launched by DG COMP) and consumer redress across intra-EU borders. Moreover, it is firmly linked with items 5, 6 and 7 in Table 1, which need to be approached much more with a view to the effective working of the (here, digital) single market – and that is not the case right now. Moreover, the digital single market also implies the transformation of e-markets and e-activities which is taking place. In other words, it is not only about integrating existing national markets but also about allowing if not facilitating disruptive innovation, the ‘sharing economy’ and new business models, to be exploited throughout the Union. This requires easy entry in markets and better access to venture capital, a perennial underperformer in Europe. These prospective dynamic gains (which, of course, do not solely depend on the single market) cannot be estimated quantitatively, yet they are essential for the vitality of the European economy and indeed for visions like European Industry 4.0.

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<sup>14</sup> Paczynski, op. cit. footnote 12.

<sup>15</sup> CopenhagenEconomics (2010).

<sup>16</sup> See Pataki (2014, in footnote 12). For further work, see the SWD quoted in footnote 17.

<sup>17</sup> See e.g. COM (2015) 192 of 6 May 2015, “A digital single market strategy for Europe”; and the SWD on economic analysis and empirical evidence (see SWD, 2015, 100 (same date). For a non-technical but enlightening comment, emphasising the dynamics and wider economic context in which these proposals ought to be assessed, see Blackman (2015).

The ‘energy union’ combines three policy domains, namely energy, climate strategy and innovation. The Commission, in its proposal,<sup>18</sup> further distinguishes the three well-known components of the energy leg: energy security, the fully integrated European energy market, and energy efficiency (as a means to moderate demand), but of course these three are closely intertwined. Narrowing down the energy union to the single energy market, within the ‘energy package’, the simulated economic gains might still classify it as a blockbuster, with some €70-plus billion. These ‘narrow’ gains are far from easy to acquire, as a single, telling quote from the Commission proposal shows: “Today, the EU has energy rules at the EU level, but in practice it has 28 national regulatory frameworks. This cannot continue.” Nevertheless, difficult as one element might be, the notion of an Energy Union is precisely to go beyond the narrow single market set-up, and to approach these domains together. These policy-linkages would endow it with true blockbuster properties, with attention to the dynamics in these markets or induced by these policies, which unfortunately are exceedingly hard to quantify at this stage, if ever.

These two major examples of a policy-linkage approach are the fruit of an attempt by the Juncker Commission to work in teams-of-Commissioners: no less than eight for Digital and seven for the Energy Union. In the past, such ‘joint ownership’ of a cluster so crucial for the single market was absent. The Commission is therefore to be complimented. Of course, having a team does not automatically make it effective, and whether this ‘joint ownership’ is going to be matched in the Council and the EP with their splintered Committee structures, remains to be seen as well. Both have a great responsibility to think and act strategically, and avoid ripping the packages apart, eroding their utility.

8.2 *A second set of actions relates to cross-cutting economic activities or markets.*<sup>19</sup> Cross-cutting market activities cannot easily be classified or addressed in a single area, but – unlike policy linkages – they require highly specific and targeted actions in the various areas, with a view to facilitate such economic activities. Examples include logistics – an important sector in Europe and for globalisation, but hardly recognised as such – and retail. Whereas retail is well organised in the EU and several plans have been pursued, a ‘genuine single market’ is not yet experienced in this sector. There is a strong link with items 6, 8 and 9 in Table 1. A revealing exercise recently undertaken in the Benelux found that, even in this microcosm of the single market, mutual retail market access via establishment is de facto, and partly de jure, made rather difficult and costly. The European logistics sector runs into more or less similar problems and it seems hard to tackle them in earnest. The 2012 EU High Level Group on Logistics apparently never really worked well and no final report was published. In both cases, and possibly in other such examples, what matters for exploiting commercially the single market is the option for European companies to employ their business model throughout the Union without any problem.

8.3 *Horizontal approaches consist of related measures to be applied to a single area, which itself is horizontal in nature.* Typical examples include public procurement and consumer protection. Both are half-way houses in the EU. The new 2014 public procurement regime is less cumbersome and includes innovations such as ‘competitive dialogue’ between selected companies (focused on the quality, best-fit or innovativeness rather than merely a low price)

<sup>18</sup> COM (2015) 80 of 25 February 2015, A framework strategy for a resilient Energy Union with a forward-looking Climate change policy

<sup>19</sup> Note that the Commission employs the term “cross-cutting” on its website for policies such as sustainable development, better regulation and strategies to overcome the financial crisis. Our text refers to economic activities or markets which “cut across” traditional divides in the internal market.

and the ‘partnership’ procedure for new goods that not available on the market. Also the new concessions Directive may be seen as an improvement in transparency and bidding ‘for’ the market. But member states flatly refuse (so far) to revise, tighten and largely harmonise national remedies and institutions under the 2007 Remedies procedure. Ironically, the legalistic reasons behind that refusal to improve enforcement and access-to-justice for bidders have the effect of continuing a hopelessly divergent, inefficient and ineffective system, which de facto has a strong chilling effect on potential bidders from other member states. This severely undermines the credibility of protecting new (especially foreign EU) entrants in public procurement. Even a simple overview of how public procurement enforcement and judicial review inside member states takes place, and how dramatically it differs, demonstrates the failure of the last leg of the EU procurement regime.<sup>20</sup>

Consumer protection used to be dominated by disparate national measures and procedures. It happened that so-called consumer protection actually helped to keep foreign entrants out of the local market (e.g. via retail banking and advertising). Recently, a greater Europeanisation has been witnessed, as a result in part of the consumer rights Directive. And much EU SHEIC regulation, in fact, protects consumers (and workers) on the basis of EU objectives in directives or regulations, complemented by European standards. Nevertheless, consumer protection still differs considerably across the member states and e.g. product liability – although based on strict liability due to a basic EU directive – procedures and outcomes are highly divergent. Consumer protection can be one reason why business models in (r)etail are prevented from being rolled out over the single market. After decades of experience, one wonders whether distinct details in national consumer policies reflect genuine variations in the level of protection, which would render harmonisation problematic.<sup>21</sup> More often than not, it is merely national traditions grown over decades that would have to be modified with harmonisation, without really affecting the level of consumer protection.

*8.4 The most general and widely applied EU instrument for the single market is of course EU regulation.* The Union has embraced a Better Regulation philosophy and agenda for at least the last decade, if not longer.<sup>22</sup> Although Better Regulation has sound bureaucratic and political motives as well, the fundamental argument for Better (EU) Regulation of markets is that SHEIC regulation<sup>23</sup> should preferably maximise net benefits (where quantifiable). Regulation is always about *benefits first* – it is impermissible, indeed, costly, to regulate when there is no market failure; hence there is no benefit in overcoming it. And benefits of EU regulation always have to be spelled out first, if necessary with extensive field research or quantification efforts. If regulation is justified by benefits, one subsequently has to show that the costs are lower, preferably much lower. Even when not quantifiable, (EU) regulation should seek to minimise the costs for achieving well-specified objectives. Another fundamental premise is that (EU) regulation ought to be efficient and effective in pursuing the objective. Of course, this is another way of saying that the costs are minimised for *realising* a given objective. Without Better Regulation, there is a serious risk that the economic gains from deeper market

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<sup>20</sup> See Pelkmans & Correia de Brito (2012, ch. 7) for details.

<sup>21</sup> Since harmonisation in the presence of genuinely distinct preferences may well lead to a lowering of welfare for some in the Union.

<sup>22</sup> Already in the Member States’ Declaration 18 of the Maastricht Treaty, the costs and benefits are said to be taken into account when writing EU regulation. Impact assessment, a key element of Better Regulation, has been formally applied to all Commission initiatives since mid-2003.

<sup>23</sup> The overwhelming majority of EU regulation is about SHEIC objectives, driven by market failures.

integration would be eroded or eliminated by non-evidence-based regulation without regulatory disciplines, which is always unnecessarily costly.

EU Impact Assessment has become quite sophisticated, even when further improvements can be made. The Better Regulation package is a serious attempt at doing the latter.<sup>24</sup> But this is only about the Commission's role. The roles of the Council (where impact assessment is absent and the Commission's results receive too little discussion) and the EP (where timid attempts are now being made and it is unclear still how little or much MEPs care) are not always geared to Better Regulation disciplines – when the going gets hard, 'politics' reigns. Costly and overly complex EU regulation may actually emerge from the EU legislature, not necessarily the Commission. Another major issue for 'good' EU regulation is how to get rid of 'bad' regulation. Bad regulation is not efficient or effective (or both) in attaining the SHIEC objective(s), as long as it is generating high costs. Therefore, it lowers or annuls the net economic gains of the single market for all. However, one has to realise that bad regulation at one point in time had enough support to pass the EU legislature; in other words, such convictions might linger for years.

The question is whether empirical evidence may sway EU lawmakers to improve on it radically enough to generate net benefits. Although the REFIT programme has several purposes of a more technical nature, it is possible to 'read' in its (somewhat vague) remit that ex-post evaluation, fitness tests, etc. should identify unsatisfactory, if not 'bad', regulation and improve on it or remove it where no solid case for maintaining it can be made. Analytically, this seems the proper route, but that it is typically not what happens in the Brussels EU circuit. What happens is, first, that consortia of NGOs are founded, e.g. the 'Better Regulation watchdog' as a network to protect citizens', workers' and consumers' rights.<sup>25</sup> The consortia then attempt to prevent certain parts of EU regulation to be the subject of scrutiny, thereby violating the very principle of evidence-based EU regulation in the first place. They do this not so much as an ordinary way of lobbying, but starting from the premise that REFIT is an ideological instrument.

Other networks act similarly with respect to the environment, e.g. attempting to obstruct the scrutiny of the Habitat Directive (an extremely problematic piece of EU regulation, and not because of its aims!) and the Birds' Life Directive. Yet another case is the very costly REACH (chemicals) Regulation, which pre-empts [since 2007] any initiative to improve the regime until at least 2019 if not later, given its procedures about registration and costly testing. Again, this is not about the objectives of REACH, which are widely shared in the EU. Preventing new EU laws to be 'bad' regulation is thus not the only issue of Better Regulation. Getting rid of *past* mistakes by practicing lessons from the EU's recent experience with Better Regulation seems far more difficult, even when the aims of such regulation are not at issue! One confuses *aims*, to which many are attached, with the techniques and *instruments* of regulating properly. This lowers the gains from the single market.

Another major obstacle to Better Regulation in the EU is the handling, or rather the lack of proper handling of the Precautionary Principle (PP). For some in the EU, bringing this up is

<sup>24</sup> COM (2015) 215 of 19 May 2015, Better regulation for better results, and a host of accompanying documents with background evidence or ancillary proposals. For a detailed and authoritative comment, see Renda (2015).

<sup>25</sup> See [www.beuc.eu/publications/beuc-x-2015-047\\_upa\\_better\\_regulation\\_watchdog\\_founding\\_statement\\_and\\_members.pdf](http://www.beuc.eu/publications/beuc-x-2015-047_upa_better_regulation_watchdog_founding_statement_and_members.pdf); for an example of how the European labour unions look at REFIT ('threat to the social *acquis communautaire*'), see Schoemann (2015).

largely taboo. Calling for the application of the precautionary principle as a basis for EU regulation can be justified, but such calls must be very carefully assessed before accepting them. One important reason is that PP-based regulation tends to be costly, indeed possibly very costly.<sup>26</sup> Another reason rarely made explicit is that, once the PP has been accepted as the basis for EU regulation, the disciplines of ‘good’ regulatory practices typically weaken, as the evidence-base is by definition not available or insufficient. De facto, therefore, with the PP, it has turned out to be easier to make more extreme demands or impose extra costs on market participants precisely “because one cannot be sure”. Schools of thought have emerged setting out what numerous operational consequences a ‘good’ application of the precautionary principle must imply, which tend to raise costs even higher.

There are two ways of approaching this dilemma. One is to attempt to impose legal disciplines for the eventual application of PP, with tests. This is made extraordinarily difficult because some political forces do not primarily regard the PP as a principle with disciplines, and even resist its application being subjected to impact assessment (although the CJEU has insisted on this). More often than not, efforts at making the application of PP so difficult are framed as tactics originating from business lobbies, rather than detached attempts to arrive at better EU regulation. Nevertheless, it would be great progress to ensure that the case for using the PP would have to be made on scientific grounds, as much as possible, and not on a-priori political preferences. Such decisions should be scrutinised by competent independent outsiders, too.

The other way is to inspect how EU regulation based on the PP *actually works*. It is precisely where strong a-priori political preferences played a role that EU regulation based on the PP has been badly crafted, with unnecessarily high costs, and/or (sometimes) without well-defined objectives. One of these purely political motives without any rationale is the tendency to favour hazards above risks as a basis for regulation: focusing regulation on hazards (rather than risks) is unlikely to bring any more SHEIC benefits, but it does hugely augment the costs. Of course, proponents do this because it may be very difficult to establish firmly ‘the risks’ in certain instances. In preparing regulation, one ought to narrow down which risks are or can be known and which cannot, and avoid assuming a wholesale approach *only* because some ‘risks’ are not (yet) identified. Ideas such as i) no-data-no-market (as in REACH, irrespective of whether or not there is any, even slight, indication of risk for many thousands of substances; for the large majority of substances, there are no indications of any risk or the risks are already known, hence there is no reason to subject them to heavy and costly testing<sup>27</sup>); ii) the extreme regulatory priority given to renewables in electricity generation (after first having been subsidised as well for enormous sums and causing disruption of generation markets in Europe and major losses for gas-based generation providers<sup>28</sup>) and iii) the imposition of protecting the habitat of birds and wildlife in Europe without first having a clue (for over a decade after the adoption of the Habitat Directive!) where the lines of these habitats would be drawn, what the

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<sup>26</sup> See e.g. Gollier & Treich (2003) and Majone (2002).

<sup>27</sup> Even if one were to modify REACH by subjecting as many as (say) 5,000 chemical substances to testing, where possibly in some evidence or anecdotes a risk might be surmised or suspected, it would still mean that some 25,000 substances (of the famous 1981 list of existing substances) could merely register without such heavy testing, as no risks whatsoever exist. It is true that in the Classification & Labelling Inventory, some 120,000 substances have at least one identified possible hazard. A light and proportional approach is to subject substances not known to have any risk nonetheless to a first expert judgment based on these reported hazards. That would be a light and rapid procedure clearing many, if not most, substances from further testing.

<sup>28</sup> At the same time that coal, which emits much more CO<sub>2</sub>, can increase its share in generation!

rules would be and what the costs, not to speak of the excessively vague objectives representing the benefits, let alone the idea of thinking in terms of alternative policy solutions. One can of course frame these critical remarks as ‘political’ but they are not: better regulation is functionally in the European interest of all. Once the objectives are set politically, one needs to be sure that they are sufficiently precise and operational, and employ ‘Better regulation’ methods that are cost-effective.

*8.5 Submarkets of the EU single market need not always be slavishly integrated by pure extension of what was first a set of fragmented national markets.* In some prominent cases, it might be far better to re-design or invent new designs for the relevant segment of the single market. These *alternative designs* should be taken seriously when they significantly enhance the economic gains, both static and dynamic, enjoyed from a single EU market. Of course, this does not occur every day. But the EU should consciously avoid getting trapped into a common market design that is merely the European successor of an outdated or inferior national design. Two examples come to mind: the (what is now called) capital markets union and the Unitary Patent.

The capital markets union boils down to a new design of a European capital market, the basics of which already exist via unrestricted free movement (and no exchange controls since 1988), EU regulation, an EU agency (ECMA), some standards for clearing/settlement/custody in stock exchanges as well as common securities market arrangements (e.g. in cooperation with the ECB). However, the EU capital market is a modernised EU framework of what already existed at the national level. Nevertheless, the internal market for financial funds does not function properly. A deep, very liquid market for funds at European level is a strong advantage if properly regulated (where there is a need) and tightly supervised (*idem*). What has become clear is that the European tradition of bank-based funding dominating everything else has serious drawbacks. The crisis was so deep because banks were/are so central (and overbanking has pro-cyclical effects) and no substantial alternative funding streams such as equity were available [and they would not dry up during a banking crisis, as shown by the US experience]. With equity capital employed more systematically, the first advantage is that there are two channels for monetary transmission, not just one. A second advantage is the availability of more and a variation of funds: in the EU, sources for long-run capital are of course available but the incentive structure is weak (if not, at times, adverse, as in the case of tax treatment of debt vs. equity) and a capital markets union could alter this [e.g. the Commission is analysing long-run investment funds, ELTIFs].

There are other advantages to creating a capital markets union in the sense of setting up or strengthening equity alternatives to bank funding.<sup>29</sup> There are sensitivities (e.g. securitisation has a bad-image problem, but the ECB has carefully analysed exactly what the issues are /were in securitisation, and found that simple, transparent securitisation is blameless and has great advantages) and, in any event, this type of ‘union’ is all about the long run, requiring profound changes in tax and bankruptcy laws, if not others. What matters here is that this new design adds value to the potential of the single market to better serve treaty objectives.

The same is true for the fifth ‘freedom’ in the EU, not specifically mentioned in the treaty, that of ‘knowledge’ in the wide sense. Knowledge, codified in a protected format, or tacit, should flow as freely as possible in the Union. It is a critical factor of production and of innovation, hence, ultimately also of competition and competitiveness inside and outside Europe. This, too, relates to knowledge workers as well as to knowledge networks and their financing, which

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<sup>29</sup> See e.g. Veron & Wolf (2015); Anderson et al., (2015); and COM (2015) 63, Green Paper on Building a Capital Markets Union, February.

are very often national without much of a view on the European aspects or even shielding local ones. The (too?) slow Europeanisation of knowledge creation and related aspects is a concern. In this economic activity, there is actually no old design of a single market but a lack of design, only slowly tackled by the academic community and business.

The neglect of this 'fifth freedom' is most pertinent in the Rome Treaty's article on 'ownership'. Art. 345, TFEU, unchanged from Rome, declares matters of ownership to be a question of the member states. This is a drafting flaw and the costs for the EU have been very high indeed. The original idea was that this would refer to land and state-owned enterprises, but it was hijacked by patent lawyers and kept on fragmenting the single market by blocking (or hindering, at least) free movement in patented goods, by practising highly effective price discrimination and greatly dis-incentivising patenting in the EU.

The Unitary Patent (UP) is, in the same way as the capital markets union, a re-arrangement or reform or an acceptance of centralisation [call it what you will] that is going to change, indeed greatly improve, the role of the single market for innovation. And it will do this probably far better and more effectively than many subsidy programmes, with their red tape [to keep the Court of Auditors at bay], uncertain outcomes and dubious verification of 'additionality'. The UP is fundamentally a single market instrument, for the first time.<sup>30</sup> In economics, it is long known that market size is a very powerful incentive to innovate and subsequently also to patent. So, at the very least, there is a positive 'double whammy' prompted by the UP, after a lag of a few years: i) the price of patenting has been drastically cut and becomes interesting for many SMEs, and no less for MNCs [think of 80-85% price decrease, or even more]; and ii) one obtains automatically one patent, identical also in enforcement (a huge problem before) for at least 25 EU countries at once, and probably all 28 soon. All this amounts to a regime change, if not a different 'design', and should be expected, other things equal, to provide a lasting boost to invention and innovation in the single market.

## 9. Actions on the EU / member states' interface

The proper functioning of the single market hinges to a significant extent on the appropriate *multi-level governance* for the sake of getting the most from the single market. In other words, the good functioning of the single market cannot only be arranged or guaranteed in or from Brussels. The member states are crucial for the genuine single market also *after* they have passed EU legislation in the Council, and, to some extent, *even quite apart from* implementation and enforcement of EU law. Sadly, this is rarely appreciated. It is perhaps possible to provide detailed advice on how some critical issues ought to be dealt with at the EU-member state interface; indeed, we shall indicate some such aspects briefly. However, such advice is futile if member states' actions are not driven by the firm conviction in each and every member state that the single market is a joint asset and that each member state (and *not* only the 'other ones' or Brussels) has to exercise sound and pro-active ownership of the relevant issues in the interface so as to maintain, if not enhance, the value of the joint asset. Not pro-actively exercising 'ownership' – perhaps for the sake of short-term gains or the avoidance of adjustment or merely due to disinterest – has a cost in damaging one's own joint asset! There

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<sup>30</sup> However, due to the clumsy formulation in the treaty, the UP amounts to what is called "a bundle of nationally enforceable patents" which is equally enforceable in the entire group of 25 member states. The incredible inefficiency is exemplified by e.g. Spain filing a series of CJEU cases, all dismissed (as recently as 5 May 2015). And this after more than 50 years of haggling (the first attempt by the Commission was in 1962).

are four types of actions that need to be addressed effectively for the purpose of a 'genuine single market' (see Table 1).

Before doing so, a fundamental issue has to be brought up: the importance of recognising that the division of powers between member states and the EU level is and remains a rather sensitive question, only discussed in earnest when drafting a treaty revision. That is how it should be. This is central to all federations as well.

However, safeguarding the existing division of powers, in particular, powers that have to do with the single market (mainly, regulation and occasional subsidies), does not say much about whether and how member state conduct (may) affect(s) the proper functioning of the single market. In between treaty revisions, the relevant question is: *Do member states exercise their powers in such a way as to minimise or avoid negative effects on the single market?* This is not a legal question, but an economic and a policy matter. At the moment, explicitly posing this question is sensitive, but is not this sensitivity misplaced? Because the single market is a joint asset of the member states, it follows directly that applying national powers ought not to affect that joint asset negatively. Unfortunately, the treaty is less than clear about it. One can argue that Art. 120, TFEU [Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Union as defined in Art. 3 TEU.], Art. 121/1, TFEU [Member States shall regard their economic policies as a matter of common concern.] and Art. 121/4 [Where it is established ....that the economic policies of a Member State... risk jeopardising the proper functioning of the economic and monetary union..., the relevant procedures can lead to a recommendation] lay a solid basis for the EU to begin to ensure that member states cannot exercise their powers retained under the treaty so as to 'jeopardise' the proper functioning of the single market, the hard core of the economic union.<sup>31</sup> In any event, the proper functioning of the single market would be greatly helped if member states would develop mechanisms, possibly in cooperation and/or with the EU level as well, ensuring that the design and effects of national measures under their powers would be tested on avoiding or minimising any (negative) impact on the single market. Ideally, this should be done by member states themselves (acting as a guardian of the joint asset) but of course all of them, all of them in the same way and with full transparency. In actual practice, it might be necessary e.g. for credibility, that in some cases this is better assigned to the EU level, for example with state aid. The four types of actions will now be discussed briefly with the above considerations in mind.

*9.1 The first type of action relates to instances where and when member states exercising powers might hinder the functioning of the single market.* We shall discuss two categories of issues: first, where member states generate distortions that lower the gains from the single market and which should ideally be corrected; second, where member states exercise their powers in a non-controversial fashion, but where non-trivial costs for single market participants nevertheless

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<sup>31</sup> So far, it would seem that Arts 120-121 have not been applied to the single market directly. However, this is curious, to say the least. For present purposes, the two key words in the treaty quotations above are 'objectives of the Union' and 'economic union'. Art. 3/3, TEU establishes an internal market, no issue there. The Maastricht Treaty gives no definition of the 'economic union' (see Pelkmans, 1991); nor does the TFEU give a clue. But the economic literature leaves no doubt that the single market is the hard core of an economic union. The term is also employed in Canada, where the basic idea is much the same (Pelkmans & Vanheukelen, 1988). A careful inspection of what the genuine EMU should consist of strongly suggests that the E of EMU comprises three components: single market, economic policy coordination and budgetary discipline.

arise. One could suggest that the former is an integration 'deficit', whereas the latter calls for effective inter-member state cooperation in order to minimise those costs.

9.2 *One set of issues emerging from national regulatory policy-making is concerned with distortions in the single market.* Most state aid that actually or potentially distorts competition in the single market is, by now, effectively addressed by the EU state aid regime – a huge improvement over (say) 25 years ago. But the few exceptions turn out to matter a great deal. Probably the most prominent one is the enormous discretion given member states to subsidise renewables. Not only have entire new (e.g. wind) industries been built on these national (!) subsidies precisely by EU countries having insisted strongly on a strict stance against (distortive) EU industrial policy in the treaties.<sup>32</sup> At the same time, the formidable distortions, caused by the favourable treatment of renewables in national electricity generation markets, have forced huge losses on owners of perfectly efficient low-emission gas turbines. It has prompted mothballing of new state-of-the-art turbines and closures of others; worse, some EU countries now run into serious capacity problems (especially for winters) and face the risk of black-outs.<sup>33</sup>

Another less acute but seriously distortive behaviour of member states is reflected in the highly disparate national track access charges [TACs] for freight trains. Rail freight is by its very nature and cost structure a *European* business – national rail freight only pays off in larger EU countries but even then its potential is limited. Indeed, developing European rail freight in earnest is another blockbuster gain of the single market,<sup>34</sup> but the numerous obstacles and distortions are discouraging. The large disparities in TACs are mainly caused by the great differences between member states in the recovery rates for (the very high) infrastructure costs of rail transport, including passenger services. For passenger rail this is hardly a problem as very little cross-border traffic is demanded (and some of that is on fast-rail networks). But the single freight market is severely underdeveloped, despite its great potential to improve European competitiveness in a range of industrial sectors and its potential to shift freight from road haulage (with high external costs) to 'green' rail. With common TACs for freight or at least TACs all based on similar recovery rates, a major distortion would be out of the way. A third highly distortive practice by (some) member states consists of the extreme manipulation of the application of the corporate tax base, often on an individual basis. As early as 1992, the Ruding report<sup>35</sup> was very critical of these distortions. The main problem with corporate tax competition is not in the rates, despite all the publicity, but in the endless variations in playing with elements of the tax base, the subsequent complexities of transfer pricing and other consequences. If a low common rate were agreed,<sup>36</sup> levied on a common tax base (as the US has for both federal and state corporate tax), tax competition on the rates would probably be healthy, transparent and barely or non-distortive. Drawing red lines around national tax power, untouchable for the EU, is acceptable, but it cannot be an excuse for maintaining major

<sup>32</sup> Art. 173/3, TFEU on 'industry' reads: "this... shall not provide a basis for the introduction by the Union of any measure which could lead to a distortion of competition."

<sup>33</sup> Auverlot et al. (2014), Joskow (2011) and ECOFYS (2014).

<sup>34</sup> See Steer, Davies, Gleave (2014), "Costs of Non-Europe in the Single Market in Transport: Road transport and railways", European Parliament, EAVA, June. Based on (limited) current plans and the nine freight rail corridors, the expected gains amount to €50 billion. With adequate (and much needed) reforms and the required infrastructure investments, the gains grow to some €500 billion.

<sup>35</sup> Ruding et al. (1992).

<sup>36</sup> If 12.5% would be agreed as a minimum rate, almost no changes would be needed in national tax laws.

distortions in the single market and a wasteful contest between national tax exemptions for larger investors.

9.3 *Although the exercise of national powers is usually innocuous in the EU, it may entail considerable drawbacks for economic agents trying to exploit the potential of the single market.* Such drawbacks are particularly cost-raising for traders, production companies and consortia – sometimes for value-chains – trying to do business on a truly European basis or compete on the basis of a single business model. The problems might also pre-empt or severely discourage the initiation of a European business strategy. The drawbacks can be summed up as, first and foremost, the costs of the *cumul*, i.e. the total costs of all (cumulated) regulations a firm is subject to, determined by local, regional, national and EU regulations and, second, the costs of regulatory heterogeneity. Thus, the assertion that the EU is overregulated is, to an unknown extent, attributable to layers of regulation other than the EU level itself.<sup>37</sup> To the present author's knowledge, virtually no empirical research has been undertaken, other than in case studies. Also, the EU or the collection of member states has no mechanism whatsoever with which to consider or address this problem.

Another problem often mentioned is *regulatory heterogeneity*: rules and red tape differ between many or all member states, despite the existence of EU regulation and numerous European technical standards.<sup>38</sup> There is a suspicion that regulatory heterogeneity is more costly for services than for goods but so far, this remains a conjecture. Again, there is no EU or inter-member state mechanism to address the costs of regulatory heterogeneity. At fairly high levels of aggregation of product markets, empirical economic analysis suggests that the objections of business in Europe would seem to be justified: the costs of regulatory heterogeneity are high and its reduction can yield major economic gains<sup>39</sup> via a better exploitation of the single market potential. The economic problem of regulatory heterogeneity at the individual firm level consists of the repetitive fixed costs of entering one national market after another, which hinders companies from achieving minimum scale in many national markets.

De facto, regulatory heterogeneity therefore acts as an entry barrier that will be lower the lower the degree of heterogeneity is. However, for member states, there is nothing peculiar about all this and they are of course right. All they do is to regulate the way their parliaments want. But many of these national rules and procedures have little or nothing to do with genuinely diverse preferences between member states. Only some are truly based on diverse preferences and subsidiarity suggests that this autonomy is precious and ought to be protected. In numerous other instances, voluntary cooperation between EU administrations about mutual acceptance of forms or common multi-lingual formats should be very helpful. Mutual recognition beyond what the EU is doing can be useful, too. Member states could organise themselves in what US states call (voluntarily concluded but binding) 'compacts' between willing states, here EU countries.<sup>40</sup> The idea is that member states act in the spirit of making the most of 'their' single market and its practical functioning, without any need to involve the

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<sup>37</sup> This is not to say that the EU is overregulated. It is not even clear what 'overregulated' means, let alone that one can measure it properly and subsequently compare objectively.

<sup>38</sup> Indeed, Fournier (2015) shows empirically that regulatory heterogeneity inside the EU is smaller than amongst OECD countries.

<sup>39</sup> Kox & Lejour (2006), Nordas & Kox (2009) and Fournier (2015).

<sup>40</sup> US states have concluded over 1200 compacts on an incredible variety of regulatory and administrative aspects. These compacts do not, as a rule, include all States, although their membership often grows over time.

EU level. Member states might be interested in organising this more systematically, with consumers and business being given a voice as well.

9.4 *On the EU-member state interface, one encounters regular frictions about the appropriate degree of centralisation for the purpose of a better functioning of the single market.* Any notion of centralisation as a remedy for solving specific single-market issues or the better functioning of certain submarkets ought to be subject to a serious subsidiarity test. For the sake of the proper functioning of the single market, however, the subsidiarity test must be *functional*, that is, analytically based on the criteria in the treaty (scale and cross-border spill-overs) and effectiveness, *not political*. But this is not happening. The centralisation issue is only critical in a few markets, mainly those of network industries with very large sunk costs, and financial markets. But these are exactly among the blockbusters in the Cost of Non-Europe exercise!

There are four network industries characterised by large sunk costs: (freight) rail,<sup>41</sup> gas, electricity and telecoms/digital. These are typical markets where *all* OECD countries and many others have independent regulatory agencies, ensuring better functioning markets. *Not so* for the EU. It is not surprising that these four 'single' markets do not function well and also remain fragmented,<sup>42</sup> given the absence of independent EU agencies. Nor can it be surprising that these four markets are amongst the blockbuster gains of a genuine single market. The full recognition of this flaw in designing these EU network markets is still absent, although a slow recognition of the added-value of cooperative networks of national agencies has emerged (e.g. BEREC; ACER; network of rail agencies). The problem is partly one of 'sequencing': by first establishing national regulatory authorities (NRAs) in these network markets, based on EU regulation, but *without* the overriding obligation to serve the EU single market, and national market functioning *within* this EU framework, member states have created a natural resistance and vested interests against justified and proportionate centralisation.

Moreover, the Commission is of two minds as well, because it risks losing influence if not power when such EU independent agencies would be established. Until recently, the Commission and member states have been hiding behind the Meroni doctrine, which would prohibit such independent agencies at EU level, as the delegation of powers to the EU level (i.e. the Commission) could only be re-delegated further to such agencies when explicitly allowed in the treaty. However, the logic of Meroni has melted away under the Lisbon Treaty and recent CJEU case-law.<sup>43</sup> What remains is a *political* resistance to centralisation by member states (and their NRAs) which requires great caution when addressing such resistance step by step. In the meantime, the single market in these network industries employs second-best approaches to accomplish better functioning, but even those are not to much avail. This centralisation taboo has to end and the blockbuster gains should be reaped. This is not to suggest that the integration deficits in these four network markets are solely due to the lack of an independent EU regulator, but without the latter, one should not expect to arrive at effective market integration.

A more or less similar state of denial by national regulators/supervisors has long lingered for banking, insurance and capital markets. A properly functioning single financial market

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<sup>41</sup> As noted, passenger rail across intra-EU border is marginal, and an increasing share of it is offered on high-speed networks. As far as the latter is concerned, market conduct is shaped by intermodal competition. Infrastructure and standards are harmonised.

<sup>42</sup> For detailed empirical evidence, see Pelkmans & Renda (2011), Pelkmans & Luchetta (2013), European Commission (2013) and Pelkmans et al. (2014) for the European Parliament.

<sup>43</sup> For elaboration, see Simoncini & Pelkmans (2014) and the recent literature quoted therein.

requires common supervisors with joint rules, including what is called fiscal capacity (to conduct bank resolution with full credibility). It took a severe financial crisis, in part caused or worsened by the lack of a common and credible regulatory and supervisory regime in the single market, before three EU agencies were finally set up. Resistance is so strong that member states still have a disproportionate role in the working of these agencies, causing slowness and inefficiencies. Only the eurozone and selected member states on a voluntary basis have gone the extra mile with centralised quality supervision of (large) banks. Indeed, the banking union has been agreed to as well, but the third leg (a common deposit insurance system) may not come about for years. If a very costly financial crisis can just barely convince EU member states to accept centralisation, one must fear that a functional subsidiarity test for the single market will often be avoided. Yet, this damages the joint asset, and hence, one's own single market.

There is also the obverse of the above reasoning on the functioning of the single market: Are member states *good custodians of single market* functioning *inside* their own countries? This query goes beyond the treaty role of member states with respect to implementation and enforcement and is also not concerned with regulatory heterogeneity. Member states have retained residual or full powers in many areas the use of which, often inadvertently, may affect or make more difficult the conduct of cross-border exchange in the single market. This might take the form of infringing EU law which, if discovered or reported, will be remedied by the several stages of infringement procedures.

But this is not what is meant here. Much national or regional legislation, including technical implementation or administrative execution, is drafted *without* having the single market in mind. Since all member states do this all the time, it may make the practical execution of many small business decisions in the wider single market more difficult, without there being a deeper rationale. This is done inadvertently. There is empirical evidence for one set of regulatory actions of member states, falling under the 98/34 Committee overseeing notifications. The Committee and its procedures are concerned with national technical regulations and decrees on goods in areas not harmonised by the EU. This relates to roughly 20-25% of traded goods in the EU; the rest is either harmonised or unregulated. The idea is that mutual recognition should apply, or, at least that equivalence clauses, and European standards where available, are incorporated in national law.

What emerges from the wealth of data and reports published over more than 25 years<sup>44</sup> is an astounding mass of national regulation, year after year,<sup>45</sup> and a stubborn propensity to ignore or take lightly some of the basics of the single market. The latter propensity has decreased somewhat over time. But this watchdog and correction mechanism has proven that it is indispensable for a proper functioning of a segment of the internal goods market characterised by only relatively light (national) regulation. There is no other such mechanism in other markets. I do not suggest establishing one. Rather, also here, it would be far superior to let *all* member states set up a domestic mechanism to test national draft legislation with respect to not just the legality but also their practical effects on the functioning of the single market in its own economy. This is best done in the framework of national impact assessment, which should include a 'single market test', with explicit consultation of business and other stakeholders. Solid impact assessment, so far practised seriously in only half a dozen EU countries, is in the enlightened self-interest of all EU countries. And to incorporate a single market test would be

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<sup>44</sup> See the data and references in Pelkmans, Vos & di Mauro (2000) and in Correia de Brito & Pelkmans (2012).

<sup>45</sup> In this limited area, the annual number of national laws/decrees amounts to around 700.

helpful for member states to assume responsibility for their own role as custodian of the single market, with respect to their own laws. Consultation on the single market test ought to be possible in English, besides the national language.

Finally, on the EU-member state interface, the issues of *implementation of EU laws, their effective and credible enforcement and, for some areas, market surveillance* have long featured on the EU agenda and much progress has been made in the last few decades. What has not changed are the frequent calls for 'better' implementation and enforcement by member states being made all the time. The 2007 Single Market Review proposed that the Commission would form an implementation 'partnership' with the member states so as to enhance ownership and thereby raise its effectiveness, increase the speed and lower the costs. By mid-2012, this seemed to have paid off to some extent.<sup>46</sup> One remarkable score is the record-low percentage of non-implemented directives in the Single Market Scoreboard since 2013.

But the anecdotes about understaffed SOLVIT centres, the major problems and delays with large EU legislative packages,<sup>47</sup> the number of second CJEU rulings of non-compliance with daily fines for member states, the uncertainties about some aspects of the services Directive 2006/123, the endless foot-dragging on the European air traffic control system, etc. continue to weaken the trust in whether member states are good and willing implementers of what they vote for in Council. That member states behave differently in Brussels than at home is unacceptable. For decades it has been lamented that national civil servants who negotiate EU directives sometimes abandon the area and move to other duties, as such behaviour instantly lowers the human capital needed for complex implementation issues. But on the other hand, there is also good news. The drastic shift from (single market-related) directives to EU regulations since around 2000, has clearly been supported by member states, which in and of itself constitutes a significant contribution to reducing implementation issues.

On enforcement by member states – their duty under the treaty and critical for the confidence of business and consumers when seeking to exploit the single market – less systematic knowledge is available (as far as the present author is aware). When EU directives are implemented, they become national law and enforcement becomes a linear function of the general effort to enforce laws properly in the country. These efforts differ between member states. Therefore, it may seem a bit hollow to call for better enforcement in countries that exhibit a lower inclination to enforce their own laws. There might also be issues with the national legal system: if that is regarded as inefficient and slow, such efforts are discouraged in the first place. The reliance on 'mutual recognition' should now be enforced much better with the 2008 Mutual Recognition (procedural) regulation but doubts are reported regularly. Here, member states ought to be disciplined in a matter of days, if only to enhance the trust in the business world that mutual recognition can be the basis for their strategies in the single market.

However, there is one area where enforcement assumes a special form: market surveillance, e.g. in the case of several New Approach directives and for products subject to type-approval (e.g. cars and motorcycles). Since the 2008 New Legislative Framework, market surveillance has come under stricter obligations for member states (e.g. sufficient resources [which nobody in the market believes]; closer cooperation inside national administrations and with the customs – with incessant complaints that the latter surveillance is far too lax). A good

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<sup>46</sup> For the empirical evidence, see Pelkmans & Correia de Brito (2012), chapters 5–8.

<sup>47</sup> Such as the first rail package, the second and third gas and electricity packages and a few other instances, leading to massive infringement cases before the CJEU.

development is the closer inter-member state cooperation among market surveillance authorities, which are all in the common business of making the single market function properly on this aspect. On the whole, however, European business is not convinced that market surveillance works well. Orgalime (machinery and electrical/electronic equipment) claims that distortions, via illegal imports (even via the internet) that escape market surveillance, are increasing steadily but hard evidence is scarce.

## 10. Legitimacy and acceptance

The single market has gone through cyclical fluctuations in terms of support or resistance from the European population, or segments of it. In 1958, support in France for the brand-new EEC was so strong that Finance Minister Rueff could introduce a sweeping monetary reform combined with the removal of export subsidies, tariff surcharges and the gradual dismantling of 'indicative planning'. But only nine years later, *Le Défi Américain*<sup>48</sup> generated renewed interventionist policies for industry, now seen as 'national champions'. During the second oil crisis, EU countries took no interest in the common market and demonstrated little preparedness to deepen it. On the initiative of Commissioner Narjes, the German presidency began with a new Internal Market Council in November 1982, followed by an alarming Albert & Ball report<sup>49</sup> to the EP in June 1983, introducing the notion of the 'costs of Non-Europe'. Only five years later, in 1988, the first sensational cross-border mergers – notably, the intended purchase of Société Générale by Suez – and the well-publicised popular version of the Cecchini report – prompted a short-lived 'europhoria' about the single market.

But for decades, the internal agro market could only be accomplished by means of heavy common subsidies and distortions, and high tariff walls, facilitating secular adjustment processes to efficient modern farming, at huge costs to society. Judging by the propensity to demonstrate and protest, however, it never seemed to be to the satisfaction of the farmers. With the two Eastern enlargements, the single market became the subject of profound ambiguity: popular as an opportunity for workers and business established in or attracted to the new member states, and a rising concern for some specific (especially low-skilled) segments of the workforce in other parts of the Union. The referendum in France on the draft European Constitution in 2005 was, rightly or wrongly, all about the lack of legitimacy of the single services market, symbolised by the Polish Plumber and a false presentation of the essence of the proposed services Directive.<sup>50</sup> Nowadays, the (un)popularity of the single market has come to be mixed up with the very negative fall-out of the eurozone crisis, payments to the Greeks (who first cheated, a deadly sin in this respect), the rise of Eurosceptic parties and the overall rise of immigrants and asylum-seekers.

The single market as it stands today has to be made acceptable to large majorities of the European population. This cannot be accomplished by 'communication'. It requires forms of political debate and representative structures through which voters recognise the main

<sup>48</sup> *The American Challenge* published by Jean-Jacques Servan-Schreiber in 1967.

<sup>49</sup> Albert & Ball (1983).

<sup>50</sup> Interestingly, the NO in the Dutch referendum was not at all related to the framing of the draft services directive and hardly with posted workers. It was suggested that the Netherlands would be 'sold out' and one opposition party scored well with a poster showing Europe, with the Netherlands cut out! In the Netherlands, political research later showed convincingly that much was due to the incapability of the political leaders to explain in simple terms the rationale and the essence of the treaty to the people. Hence, it was dubbed an elitist project without legitimacy. In the same year, the Eurobarometer showed that the Dutch people still supported the EU relatively strongly!

features of what is at stake and observe, time and time again, that such debates reflect the issues they are deeply concerned about. That is what legitimacy is all about. No single market strategy is feasible without this fundamental prerequisite. The genuine single market must be a legitimate one, acceptable to large majorities.

The literature typically speaks about “input legitimacy” (representation of concerns of voters in debates and as an input to decision-making) and “output legitimacy” (voters’ satisfaction based on results of policy-making). To simplify, the EU has traditionally leaned far more on output legitimacy than on input legitimacy. Therefore, a host of proposals to improve on the latter has been made<sup>51</sup> and these may well be useful. It is unlikely, however, that they will be sufficient because they do not address the root of the problem.

Today’s legitimacy problem of the EU is inextricably linked with two key issues affecting the grassroots: first, the negative impact of forms<sup>52</sup> of worker mobility across intra-EU borders on wages and jobs of specific segments of the workforce, and in some specific sectors; second, the lasting negative fall-out of the crisis and the harsh eurozone budgetary approach framed as a rescue of bankers at the expense of workers or voters/taxpayers more generally. Both generate a strong sentiment that the single market (and the eurozone, to some extent) systematically *decreases* incomes and job prospects for certain segments in society and/or lead to the erosion of the welfare state, which these workers crucially rely on. Of course, such sentiments became more powerful during the (Great) recession, but they will linger when the economy is in an upswing, if nothing is done about it.

At times, there are additional fears that globalisation (and some parties take the view that the ‘open’ EU single market is a mere manifestation of globalisation) systematically disadvantages low-skilled workers, an inference for which the empirical economic literature provides some support. Eurosceptic parties thrive more easily in this climate and resistance by labour unions hardens in the process. The strong increase of euro-sceptical parties in the EP can be attributed to several other reasons, but the single market, basically supported even by British conservatives or UKIP (albeit under certain conditions), should serve as a reason to stay in, not to exit or seek selective exemptions. The underlying problem ought to be addressed more seriously. One might recognise elements of plain protectionism in the reactions of some parties or labour unions, but this is not a sensible solution. Before rejecting this tendency in a Pavlovian reaction, it is good for political legitimacy to recognise as well that a structural adverse shift in income distribution – affecting certain low-skilled groups of workers and causing fears among other groups – is being experienced at the same time.

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<sup>51</sup> This is not the place to elaborate these proposals. I merely list some: a single face of the euro area (might also help the single market); a single presidency of the EU (i.e. Council and Commission); greater proportionality of seats in the EP (i.e. less imbalanced for larger member states); greater role of national parliaments; more frequent debates in national parliaments with European Commissioners responsible for aspects of the single market.

<sup>52</sup> The official route of intra-EU migration is based on host-country control, that is, on respecting local (minimum) wages and other labour entitlements. The problem is that this route is massively avoided or circumvented and the alternatives have not been properly addressed by the EU single market regime. It took many years before the posted workers Directive has been accompanied by an enforcement Directive and even that is full of compromises. Thus, for instance, highly artificial legal constructions are now practiced in road haulage and in construction (and its value-chain), leading to massive displacement of Western workers and/or drastic wage cuts, if not exploitation of Eastern EU workers. There is some lingering illegal migration and work, too, which calls for more firm enforcement by member states.

In sectors such as horticulture, construction, road haulage and possibly in tourism, this adverse shift might be a consequence (in part) of a recent single market with high-wage and low-wage countries, free labour mobility and a selective failure of applying host-country control. Of course, what seems a threat for a worker used to high wages is an opportunity for a mobile worker from a low-wage EU country. Therefore, a decent compromise is to allow significant opportunities for workers from low-wage EU countries whilst being far more ruthless [both at EU level and nationally] on circumventive constructions and fraud, if only to demonstrate firmly to low-skilled workers from high-wage EU countries that the law that should protect their rights is not an inconsequential piece of paper. In the longer run, now that the crisis is over, the gradual convergence of per capita incomes engendered by market integration should reduce these problems.

The strategy to build a genuine single market as described above is ambitious and will be sensitive in some respects. It risks being framed in simplistic and sloganesque terms by some parties and movements. Such framing will not resonate with most voters if, but only if, the project is seen as legitimate. Legitimacy is of the essence for any single market strategy worthy of the name.

## 11. Conclusions

There is a cleavage between the appreciable prospective economic gains of a genuine single market and the incapacity, shown so far by the EU, to “do all it takes” to realise the genuine single market. Any serious single-market strategy must convincingly address the question of how to overcome this cleavage. It is misleading and self-defeating to refer to the more recent economic studies showing much higher possible gains than hitherto understood, whilst advancing mere incremental single-market packages that do far too little to come anywhere near these possible gains. The single-market strategy proposed in the present paper outlines a package of ten types of actions, policy initiatives and modified attitudes that will enable the realisation of the genuine single market. The strategy proposed is *not* an action agenda with lists of well-defined initiatives (although I do discuss many policy aspects in passing). Rather, an action agenda for the present Commission and European Parliament period should be a next step, *after first* considering the terms of the strategy proposed here. No action agenda will yield much when the ten elements of the strategy to realise a genuine single market are not first thought through, debated and adopted in one way or another based on ownership. Many of these elements are demanding for both the EU level and for member states. This should not be surprising: the genuine single market is an ambitious aim; hence, “what it takes” (and what, so far, has turned out to be difficult) cannot be anything but demanding!

The proposed strategy is first of all based on a clear and unambiguous design of the genuine single market, that is, its establishment and its proper functioning. Only once both are pursued in earnest and not merely on the basis of political convenience or feasibility, will the greatest economic gains, emerging from recent literature, be approximated. If both are not pursued in earnest but the single market continues to suffer from many deficits and distortions, it is misleading to hold out the prospect of large economic gains before the European voters.

“What it takes” to arrive at the genuine single market consists of three groups of actions or aspects. First, five types of demanding and at times intrusive actions at the EU level. The five include i) policy proposals addressing policy linkages or clusters (e.g. energy union; digital single market); ii) cross-cutting economic activities (e.g. logistics and [r]etail); iii) horizontal approaches (e.g. public procurement and its problematic national enforcement systems; consumer protection); iv) better EU regulation (based on ‘benefits first’, solid and detached

impact assessment, appropriate disciplines of the application of the Precautionary Principle - where less a-priori and a more analytical approach are required - risking otherwise to reduce the gains from market integration, without enjoying additional benefits), and v) finally alternative designs of submarkets of the EU single markets (e.g. the capital markets union and the Unitary Patent, with significant long-run consequences).

Second, a number of important improvements are needed on the EU-member state interface. Before listing the four types of actions or modified attitudes proposed, a more fundamental question ought to be posed, if one takes the genuine single market seriously. It is related to the division of powers between the EU and the member-state level. That division is sensitive and it should be. It is central to a well-accepted Union embracing diversity. However, once market and even macroeconomic integration is 'deep' and based on a wide scope of EU economic freedoms and regulatory powers, it occasionally happens that the line between the effects of EU and member state measures can be blurred. The EU level has to make sure that member states' competences, or, more broadly, their policy autonomy - as indicated in and protected by the Treaty - remain intact. But shouldn't that be true for member states as well? In other words, do member states exercise their powers in such a way as to minimise or avoid negative effects on the single market? It is suggested that (the proper functioning of) the single market, as the hard core of 'economic union', should not be 'jeopardised (Art. 121/4, TFEU) by national economic policies. This is best verified systematically in sound and detached national impact assessment on the basis of a single-market test, which should be performed by all member states. The single market is not only dependent on Brussels, also from what member states do and fail to do.

The four types of actions at member states level include firstly instances in which member states' actions hinder the functioning of the single market for economic operators or consumers (e.g. via major *distortions* such as the enormous subsidies of renewables, the highly disparate rail access charges for European freight rail or wasteful rivalry in national exceptions to the corporate tax base, unlike in the US ; or, innocuously, via cumulation of regulation at three or four levels of government, and/or due to regulatory heterogeneity - between member states - which turns out to be very costly for firms operating with EU-wide strategies and acting as a barrier for SMEs eager to Europeanise). Secondly, on this interface there are frictions about the appropriate degree of centralisation for the purpose of a better functioning of the single market. This is found in four network markets with large sunk costs (rail freight, electricity, gas, telecoms/digital) and in financial markets. It should be noted that precisely these are amongst the blockbuster gains of a genuine single market. Thirdly, are member states good custodians of the single market functioning inside their own country? Also, here a single market test in national impact assessment and ex-post evaluation is a solution, with ample consultation options for business in Europe. Fourthly, implementation, credible enforcement and market surveillance are critical duties of member states.

Finally, legitimacy and acceptance of the genuine single market is discussed at some length. In recent years, the fact of having an internal market with both high- and low-wage countries have generated adverse effects for low-skilled workers in a few sectors, whilst offering opportunities (but not always in legally correct ways) for low-skilled workers from low-wage EU countries. This sharp contrast concentrated in three or four sectors is hard to justify and, in any event, is bound to undermine the legitimacy of the single market, which is of the essence for any single-market strategy worthy of the name. These adverse developments - and certainly some dubious practices as well as circumvention of the posted workers Directive, and the notion of an 'independent' - must be urgently and convincingly addressed.

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