The Future of the EU Single Market Report – a Critical Review

Brief Study

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Research assistance: Ursula Glauninger, Cornelia Schobert

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The Letta Report on the future of the single market is a rich combination of policy proposals and ideas, revolving around the main idea that the EU Single Market needs a renewal. This brief study analyses briefly some of the main proposals of the paper through their economic, political and electoral feasibility and relevance. As correctly identified by the report, a stronger EU Single Market indeed requires better regulatory frameworks and reducing fragmentation, especially in strategic areas such as infrastructure, energy, transport and defence. This requires additional coordination at the EU level, as well as mobilising significant funding, both private and public. Consolidations in the specific economic sectors proposed in the report – telecoms, energy and finance, can raise difficult trade-offs. The fifth freedom to enhance education, research and innovation in the EU is a welcome one, but resembles more a public good and will be politically difficult to explain and obtain.

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1. Introduction

The global economy has undergone unprecedented changes in recent years. Geopolitical risks, trade wars, and energy supply shortages have become core challenges for the economic model of the EU. The Single Market has been at the heart of the European economic model since its inception, and many have deemed it the crown jewel of EU integration. Felbermayr et. al (2022) evaluate different EU integration steps and estimate that the Single Market has made the biggest contribution to increasing welfare in the EU compared to all other integration steps.

The Single Market however was born in a different environment, in a world that was in many ways smaller and less integrated. And since its creation, the Single Market has not been able to keep up economically with the US, although the two started with a comparable size (Figure 1). Furthermore, the Single Market is still incomplete in some important dimensions. The Single Market therefore needs to be renewed and adapted to these changing circumstances. The European Council commissioned in 2023 Enrico Letta, former Prime Minister of Italy, to write a Report on the Future of the Single Market. The Letta Report (2024) was presented to EU leaders in April 2024 and consists of a detailed list of policy proposals to strengthen the Single Market.

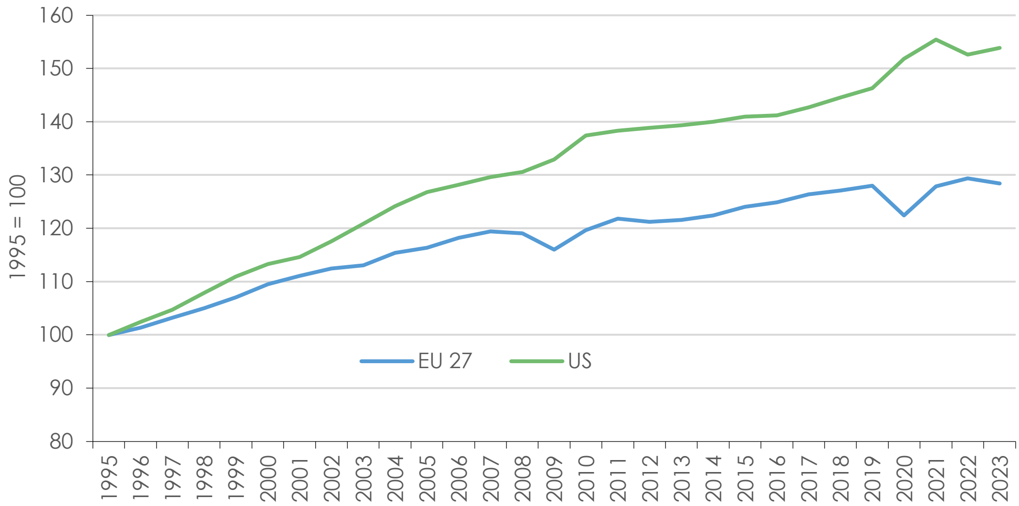
Note: "*the EU Single Market is lagging behind the US market. In 1993 the economic areas had a comparable size. However, while GDP per capita in the US increased by almost 60% from 93 to 2022, in Europe the increase was less than 30%*".

The Letta Report is a rich combination of policy ideas, revolving around the idea that the Single Market was created under different circumstances and needs a renewal. To continue providing benefits in the 21st century the Single Market will need speed, scale and sufficient financial resources. Many obstacles caused by borders, national regulation and fragmentation of EU rules still exist. On top of that, the Single Market is facing new challenges in the energy, transport and defence sectors. This Brief Study critically evaluates a number of the proposals set by the Report and how relevant and feasible they are to be addressed in coming years[1].

[1] Throughout this Brief Study, a direct quote, in Italic, without a reference, is a direct quote from the Letta Report.

Figure 1: GDP in the US and in the EU since 1995

Per Person employed at constant prices



Source: European Commission - AMECO.

2. A Single Market to Play Big

A central theme of the Letta Report is the need for the European Single Market to use its size and act on a bigger scale. The EU economy is large and yet not all the opportunities for growth are used fully. This can be argued both for the private sector given by the size of leading European companies, as well as for the EU budget. EU companies lag behind their global counterparts and this might drag down innovation, productivity and job creation. The report rightly points out that the need for a bigger size is not the case for all sectors, as it is crucial to sustain the EU growth model based on large and small enterprises co-habiting together.

The Letta Report argues that to reach scale, more EU integration, consolidation of firms in specific sectors and more EU-wide policies in some sectors are needed. The report puts an emphasis for consolidation in sectors deemed to be strategic – finance, electronic communications (telecoms) and energy. At the inception of the Single Market, the competences over these sectors were purposefully left to Member States to decide at the national level to retain domestic control over them. Yet, today that means that even the biggest national EU companies in these sectors are too small to compete with the size of the relevant US and Chinese competitors. Global developments have made it necessary to have companies at scale to achieve efficiency gains. Consolidation and mergers in these sectors are therefore recommended, with the Report arguing this could achieve higher efficiency and cost minimisation for consumers, while enabling better services, innovation outcomes and coordination.

Size matters in the global economy, not only for economic reasons, but also for strategic ones. Recent years have shown that the performance of single, world-leading companies can drive policy actions out of considerations for autonomy and national security. In the sectors of electric vehicles (EVs), microchips and mobile phones, global competition has influenced policy developments and trade policy retaliation between the US and China. European companies, with the exception of the Dutch company ASML, were not a main source of consideration in these discussions. Size comes therefore with additional strategic benefits which are hard to quantify. It is furthermore politically feasible to explain to European citizens why it is important to have world-leading European companies in these sectors. Such an approach could be seen therefore as a welcomed political priority in a world dominated by geopolitical divisions and power relations. „*The markets in question must evolve towards a European dimension, surpassing the national confines that currently hinder any substantial competition with American, Chinese or Indian conglomerates*“. This approach should however not completely take the competence for setting the rules away from national governments – it should instead create a second layer, where EU coordination is enabled– "*a two layers approach with a EU centralised authority responsible to guarantee the coherence of rules having a Single Market dimension, while issues, which for size or relevance remain national, should be dealt by independent national authorities with a common framework*". In the area of financial markets this approach is already in place with the existence of the Single Supervisory Mechanism as part of the ECB to oversee big banks, in combination with national financial supervision monitoring national developments.

Even so, consolidations and mergers in the three mentioned sectors are not necessarily a clear-cut case in terms of economic benefits. The case for consolidating is the easiest to make for finance. Consolidations may strengthen the EU banking sector and enable addressing the problem of costly cross-country banking transfers, which continues to be a burden for EU bank customers. It may also enable better cross-country investment opportunities and ameliorate the doom-loop and home bias problems, where domestic banks invest over proportionally in domestic government bonds, with amplification risks during banking crises. In theory, the regulatory framework for solving these problems had already been enacted and financial integration should have happened already driven by the common regulatory framework and common supervision. In practice however, challenges remain. While consolidation might help overcome them, it can also lead to "too-big-to-fail" entities and related moral hazard.

The case for consolidating becomes more difficult when looking at the energy and telecom sectors. Energy is an area where a higher level of coordination becomes necessary with the increased geopolitical and supply shocks. By coordination of responses, the EU managed to overcome the gas supply shock in 2022 successfully. Changes in the global energy mix themselves necessitate integration and more investments. They are the critical parts of the energy transition. With the growing role of renewables for example, "*continental-scale integrated markets ensure the deployment of new clean energy generation in the fasted and most cost-efficient manner possible*". A good interconnectivity will be necessary to optimise costs given the introduction of renewables, but also to enable enough storage and flexibility of the grid network. Interconnectivity would thus be "*the foundation of a Single Electricity Market*".

The critical element to achieve the transformation of the energy system is however energy infrastructure. In the coming years, the EU will need to renew its energy infrastructure to ensure connectivity between the different segments of the energy markets for electricity, hydrogen, and storage sectors. This will require better synchronised planning and delivery, which could be done via a new European Infrastructure Agency as proposed by Felbermayr (2024). Such new infrastructure would require significant new investments. "*The investment required for reinforcing both transportation and distribution electricity grids alone is substantial, with projections by the European Commission estimating the need for up to €584 billion by 2030*". While a part of this extra funding will need to be private, a significant part of it would need to be public funding, either at the national or preferably the EU level. The current EU funding for cross-border infrastructure in the form of the Connecting Europe Facility (CEF) for Energy is far from sufficient. The national Recovery and Resilience Plans as part of NextGenerationEU were supposed to have cross-border investments as a priority, but most countries opted for the easier option of investments bounded in national territories. RePowerEU embedded more seriously this approach by requiring that a certain share of RePowerEU funding goes to cross-border projects, yet the definition of cross-border projects used is very broad and has been used to misidentify specific projects as such.

It is however unclear whether these previous considerations directly necessitate mergers and consolidations on the side of big EU energy companies. There is a reason why this has not yet happened – energy policy has been left at the competence of Member States, because the energy mix across the EU is very heterogenous. This is based not only on geographical location and characteristics, but is also driven by different traditions and electoral choices. The discussions around nuclear energy have once again shown that. The large differences in fundamentals and in public opinion are not susceptible to change in the short to medium run, which can present a challenge for the further energy integration and coordination at the EU level.

Concrete proposals here include:

- Expanding the Connecting Europe Facility (CEF) funding for Energy, combined with a simplification of the procedures to apply for EU funding for energy related projects and additional technical support
- Enhance and deepen regional collaboration in the energy sector and give high level regional groups a more political steer

Similarly, the case for European telecom mergers the Report makes might come under scrutiny. The average US and Chinese telecoms have respectively 107 million and 467 million customers, while the average EU one – only around 5 million customers according to the Letta Report. Bigger size of companies might theoretically lead to cost reductions and higher R&D investments, but it is not clear whether the overall outcome will be beneficial for consumers. Looking into detail in the telecom industry in the US, Philippon (2019) argues that competition for broadband and wireless services in the US has decreased over the past 20 years and that this has led to American consumers paying more than consumers in other industrialized countries. The Letta Report on the contrary argues that the fragmentation of the Single Market in electronic communications and regulation with a focus only on ensuring new entries might be detrimental as it hinders firms to reach a size that would enable them to make massive investments needed to deliver advanced networks. This can result in consumer welfare losses. The necessary investments relate mainly to edge-cloud computing, 5G and fibre investments and programmable networks.

Concrete proposals here include:

- A two-layer approach to telecom regulations involving existing national regulators and a new Single Regulatory Authority for telecoms to ensure rules of net neutrality, roaming and cross-border services

3. Turning the Capital Markets Union into a Saving and Investments Union

To face the new challenges and achieve the green and digital transition, the EU will need to mobilise new funds and *"leverage the Single Markets potential in mobilising both private and public resources more effectively"*. Even only focusing on achieving the green and digital transition will require significant funding. European Commission estimates "*additional investments of over EUR 620 bn annually will be needed to meet the objectives of the Green Deal and RePowerEU*" (European Commission, 2023). On top of that come the increased spending needs for defence and security.

The first best option to do that is to mobilise private resources so that they are used efficiently to fund important investments. Ample private savings in the EU currently sit in the form of deposits and cash in the EU. The Letta Report argues they amount to € 33 trillion in savings. Furthermore, € 300 billion of EU savings each year are being redirected to savings vehicles outside of the EU, predominantly into the US economy (presumably as investments in US Treasury Bills). The paper argues that completing the Capital Markets Union will enable these savings to be invested in the EU. The necessary steps for the completion of the Capital Markets Union have been part of EU high-level discussions in the last 10 years, yet there has been no significant progress on many of them. The reason for that is twofold – differences between Member States continue to be large e.g., for harmonisation of insolvency laws or for the introduction of a European Deposit Insurance Scheme, while the topic is still not electorally popular so that citizens demand a solution is found.

The Letta Report identifies these reasons and proposes changing the narrative from completing the unpopular Capital Markets Union into the creation of a Savings and Investments Union. This has the potential of transforming a topic that is currently identified mostly as being in the benefit of the financial sector into a narrative about keeping European private savings within the EU and using them for the benefit of the EU economy. This can be a new and promising avenue since as Véron (2024) recently marked if the disappointing lack of progress on CMU continues „*it may be time to discard the CMU slogan altogether*".

Concrete proposals here include:

- Creation of an auto-enrolment EU Long-Term Savings Product to stimulate retail investments
- Launching a European Green Guarantee (EGG) to support bank lending to green investment projects
- Expansion of public private partnerships (PPP) and enhancing EU public procurement (re-thinking the lowest price award criterion)

- Facilitate the creation of an EU Deep Tech Stock Exchange with a sufficient sizes „*to raise the capital deep tech companies need at speed and in a cost-effective way compared with the USA*"
- Strengthening the ESMA by enhancing its direct supervisory powers
- Harmonising insolvency regimes
- Combining the emissions of EU debt of the different EU institutions and making them fully homogenous by marketing them under a single name, creating a safe asset with the same branding as US government bonds

Mobilising private savings at the EU level is an important goal, but it is likely to be achieved only to a limited extent. Therefore, the EU would need a larger budget in the longer term. A larger EU budget would allow for the financing of crucial infrastructure projects, further advancement of cohesion policy, and support for new priorities such as security and green transformation. This, in turn, would enable the single market to continue growing. Additionally, top-tier research can thus be more strongly and centrally funded. Compared to the US, the EU needs to play a larger role here, as the EU still lacks world-leading technology companies that would otherwise make these investments in cutting-edge research. Such considerations on a larger EU budget are scarce however in the Letta Report.

4. A stronger Single Market through coordination, regulatory improvement and simplification

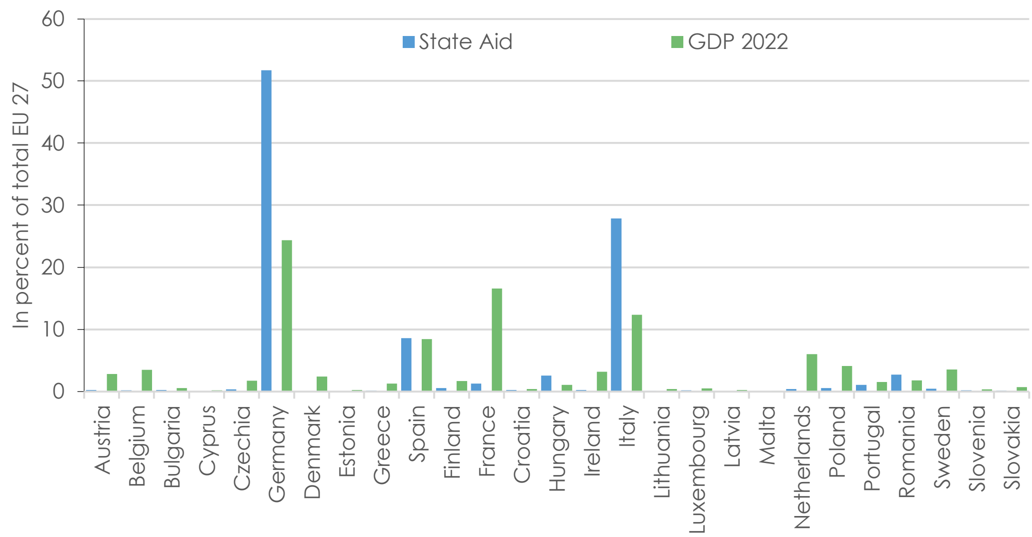
The recent crisis years have clearly demonstrated that joint solutions by EU member states are more promising than national solo efforts. During the COVID-19 pandemic, joint vaccine procurement ensured adequate supplies at good prices. With NextGenerationEU, the EU has finally established a common economic fund to finance economic recovery and the green transition. This measure was also well-received by financial markets – starting in 2021, EU bonds worth around € 100 billion are being issued annually to finance this fund, receiving the highest possible ratings. NextGenerationEU finances important EU projects under favourable conditions – for example, the construction of the Koralm Tunnel in Austria.

Transport and infrastructure are some of the areas where the report identifies that there is not sufficient coordination at the European level. Due to various barriers, transport routes are not yet integrated in a way that minimises competition barriers and technical obstacles for providers to ensure the smoothest possible traffic flow. The creation of a high-speed rail network between EU capitals is one of the clear goals that the report sets for the future of EU transport. Modern high-speed rail networks are currently in place only in some individual countries. This outcome is suboptimal, as high-speed rail networks can have economic benefits, but also significant benefits in terms of greening the economy.

The Letta Report also identifies further problems of miscoordination with the "*progressive relaxation of State Aid rules in response of the recent crises*", which can endanger the level playing field of the Single Market. On the one hand, this relaxation has helped Member States to mobilise public resources faster to support the economy given energy price shocks and supply chain relocations, on the other hand, it is leading to a fragmentation of the Single Market. Even though the Report recognises the increased use of public funding for industrial policy by USA and China, it also rightly points out that given the differences in the fiscal space of Member States, the erosion of State Aid rules has the potential to distort the level playing field that the Single Market should guarantee. Figure 2 compares the GDP shares of EU member states with their share of state aid to total state aid between 2022 and mid-2023. It demonstrates a few countries have dominated the usage of state aid in the EU since the relaxation of the rules. The report therefore proposes a stricter enforcement of State Aid rules at national level combined with the expansion of EU level funding support. A new EU funding instrument for industrial policy can enable a more equal distribution of subsidies. It might be economically the first-best option, but it is the opposite of the current arrangement where Member States implement subsidies by expanding their national budgets. As first steps to reach such an outcome, the European Commission should consider making RRF funding flexible enough to be used for industrial policy goals. The expansion of the IPCEI model should also be considered, as the Report points out.

The IPCEI model is seen as a successful example of cross-country cooperation, as it revolves around private sector firms and governments joining in voluntary cross-country consortia in the currently recognised IPCEI sectors to make joint investments and research and innovation. The report proposes that this approach could be extended beyond world-class innovation and first industrial development and become more commonly used.

Figure 2: Significance of state aid for companies between March 2022 and June 2023 in the EU 27



Source: European Commission, Eurostat.

The last chapter of the Report is devoted to the necessity to make the Single Market more flexible and less bureaucratic to boost economic growth. While other chapters devote significant attention to the need for increased government spending and therefore a bigger state, this chapter revolves around the necessity to improve the ease of doing business and minimise unnecessary regulation in the EU. It might seem these two priorities are in conflict, but they need not be. In some areas, such as defence and large-scale infrastructure, the role of government in both financing and regulation is undeniable. In many other sectors of the economy, unnecessary regulation has become a burden. It should be a priority therefore to make the Single Market more flexible by decreasing bureaucracy and avoiding gold plating and ring-fencing – the usual ways in which EU wide regulations receive further national level complications, leading to the fragmentation of the EU Single Market. Furthermore, the report also points out the need for better institutional decision making to improve EU regulatory frameworks faster and the need to use Regulations in the formulation of Single Market binding rules whenever possible.

Concrete proposals here include:

- The establishment of a comprehensive, pan-European high-speed rail (HSR) network to link EU major centres
- Ensuring a level-playing field by returning to strict State Aid rules, combined with a new EU wide instrument to fund industrial policy
- Decreasing bureaucracy by avoiding gold-plating and ring-fencing and optimise EU level decision making processes for a faster adoption of regulatory frameworks

5. Defence and Security

Given the geopolitical tensions, defence and security topics have gained prominence as important priorities for the coming years. This has already been embedded in EU decisions with the Versailles and the Granada Declarations and with the European Economic Security Strategy and the European Defence Industry Strategy. An important focus therefore in the coming years will be the inevitable increase in domestic defence production. The Letta Report judges that „*continuity with past policies and expenditures is not even imaginable.*“. A case in point for the insufficient defence capability can be made with the inability of the EU to provide the promised munitions to Ukraine. „*The gap between EU institutions' commitments and allocations remains very large, €144 billion committed versus €77 billion allocated.*“ The domestic industrial capacity in the field of security and defence must be seriously enhanced, as during the 2022-2024 the EU has spent substantial amounts for defence and security but 80% of these funds were spent on non-European materials. "*Supporting jobs and industries in Europe, rather than financing our partners or rivals' industrial development must be a primary objective when spending public money.*"

The European Defence Industrial Strategy (EDIS) recently proposed by the European Commission goes in a similar direction, arguing that better coordination and common decision-making will be crucial in enhancing the defence capabilities of the EU. This is even more so given the fact that "*even Member States with the largest defence budgets are increasingly facing difficulties to invest individually at the required levels, exposing the EU to increasingly extensive capacity and industrial gaps and growing strategic dependencies*". All of this points to the necessity to pursue Europeanisation of the European defence sector. The pursuit of an integrated EU market involves harmonisation of defence activity regulations, strategic planning and increased incentives for corporate cooperation.

The increased focus on defence and security will require increased spending. Innovative funding mechanisms will need to be pursued, including the discussion on Euro bonds for defence spending and the possibility for the ESM to extend lines of credit for national defence spending. Furthermore, and already in implementation, the EIB will need to extend its mandate and start supporting defence-related activities beyond the current scope of dual-use projects.

Concrete proposals here include:

- Align EU and NATO capacity building efforts to avoid duplications
- Harmonisation of defence activity regulations, strategic planning and incentives for corporate cooperation – using the Airbus and MDBA model as best practices
- Enhance European equipment procurement through a focus on domestic suppliers
- Consider different funding instruments such as Eurobonds and an ESM credit-line for defence spending

6. Fifth freedom – enhancing research, innovation and education

The Letta Report argues about the introduction of a fifth freedom of the Single Market[2] – to enhance and integrate research, innovation and education in the Single Market. This is an important avenue, making the case for embedding a positive freedom in the EU toolkit, in addition to the four freedoms based on the lack of barriers (to trade, labour and capital). In a sense, it is closer to a public good rather than a freedom. Recent proposals by the Commission have also iterated the need for EU wide coordination for education and EU wide diplomas (European Commission, 2024).

The fifth freedom to enhance research, innovation and education seeks to ensure that the EU uses and expands its potential in the field of innovation and knowledge-based economy at the frontier of research. This should be done by the further development of leading industrial ecosystems, retaining talents and the further development of a competitive and dynamic European Research Area. This requires addressing the investment gap in research and innovation.

Concrete proposals here include:

- The expansion of programme such as Marie Sklodowska-Curie Actions to increase the mobility of researchers and innovators, as well as by dismantling administrative and legal barriers for researchers
- Creation of an European degree – a certificate for a joint educational programme by a group of higher education institutions in different EU countries, as recently proposed by the European Commission (2024)
- Expanding the funding to the 60 European Universities alliance to € 10 million a year
- Erasmus for all/Erasmus High School initiative – extend mobility opportunity to every student, making it an integral and mandatory component of secondary education

[2] In addition to the four freedoms of the Single Market, which guarantee that goods, services, people and capital can move freely throughout the territory of the EU.

for all Europeans to ensure a level playing field and that mobility is not a privilege for a select few

Another idea was previously discussed by Letta as a proposal for a fifth freedom – „the freedom to stay". The idea behind the freedom to stay is that the EU Single Market should fulfil the promises of shared prosperity and should ensure EU citizens have the opportunity to develop themselves and have a prosperous life at their place of origin. *"The Single Market should empower citizens rather than create circumstances where they feel compelled to relocate in order to thrive. High quality jobs must be available for individuals who wish to contribute to the development of their local communities. Free movement is a valuable asset, but it should be a choice, not a necessity.*". One could see this goal also as the goal of achieving convergence of opportunities in all EU regions. This is all the more crucial for the long-term political cohesion of the EU.

The numbers cited to provide the point show that in many regions of the EU, economic divergence rather than convergence has taken place in recent decades. According to the report, around 135 million people, nearly one third of the EU population, live in places, which in the last two decades, have slowly fallen behind. *"Residents of regions in decline often feel having no opportunities, but to relocate due to the lack of jobs, access to quality education and adequate services."*

The recent report on „The geography of EU discontent and the regional development trap" makes the point that some EU regions are stuck in "development traps". They have undergone long periods of low or negative economic growth, driven by weak productivity developments and job losses. *"The lack of economic opportunities in these regions is often aggravated by a lack of access to services of general interest, such as healthcare and education services or basic infrastructures. While the EU cannot guarantee absolute equal standards of living and economic opportunities across the Union, more should be done to help all territories and citizens reap the benefits of market integration."* The report recommends the improved provision of general services – such as healthcare, education and transport, which are crucial for the fundamental functioning of any economic region. The report does not discuss how cohesion policy can be improved to increase its effect on such regions, stuck in development traps. Furthermore, cohesion policy funding might even be endangered in the next MFF, as new priorities such as defence might take a more major part of the EU budget.

Concrete proposals here include:

- Accessible, affordable, and adaptable Services of General Interest (SGI) across all EU regions as crucial factors for ensuring the freedom to stay

Overall, the Letta Report lists a rich list of priorities and detailed policy proposals. In Table 1 I group and evaluate them across two dimensions – their relevance and their feasibility. The relevance factor determines how salient the given priority is as part of the EU policy-making debates. Topics such as the Capital Markets Union or common defence, which have been for years or have become recently actively discussed, are graded as very highly relevant, while others that the Report is the first to discuss are evaluated as less relevant in the current debate.

Feasibility aims to evaluate how feasible it is that political consensus would soon be reached to make concrete steps and implement policy proposals.

Table 1: Main priorities, concrete policy changes and an evaluation of their relevance and feasibility

Priority or policy proposal	**Relevance**	**Feasibility**
Completion of the Capital Markets Union	Very High	Low
Expanding the Single Market and achieving consolidation in the areas of finance, telecoms and energy	Medium to Low	Low
Increased defence integration and spending	Very High	High
Deepening coordination in the energy, transport and infrastructure sectors	Very High	High
The fifth freedom to enhance research, innovation and education – a true European Research Area and innovation ecosystem	Medium	High
Protecting and expanding cohesion policy to ensure "the freedom to stay"	Medium	Medium
Creating a Savings and Investment Union	Low	High
Protecting a level playing field by strict State Aid rules combined with EU fund for industrial policy	Medium	Low

7. Conclusions

The Report on the Future of the Single Market by Enrico Letta, as well as the forthcoming report by Mario Draghi, show, that the EU Single market needs fundamental changes to accommodate to changing circumstances. As correctly identified, a stronger EU Single Market indeed requires better regulatory frameworks and reducing fragmentation, especially in strategic areas such as infrastructure, energy, transport and defence. This requires additional coordination at the EU level, as well as mobilising significant funding, both private and public. Consolidations in the sectors proposed in the Report – telecoms, energy and finance, can raise difficult trade-offs. The fifth freedom to enhance education, research and innovation in the EU is a welcome one, but resembles more a public good and will be politically difficult to explain and obtain.

Overall, in the coming years, Europe will face increasing financing needs and the necessity for greater integration. This integration would not undermine the sovereignty of individual EU countries but rather strengthen it, making the Union more independent and capable of addressing major challenges. This is a decisive feature of sovereignty and also the most crucial means to ensure that the EU delivers security and prosperity for its citizens.

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