

# ***Rethinking the European single market: Moving towards new frontiers for a highly competitive, socio-ecologically sustainable and resilient Europe***

**A report authored by: Mehtap Akgüç, Nicola Countouris, Bob  
Hancké, Philippe Pochet**

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## **Disclaimer**

On 18 January 2022, the FPS Economy awarded the public service contract n°2021/73968/T/Internal market prospective study, launched within the framework of a negotiated procedure without prior publication, to the European Trade Union Institute (ETUI).

The purpose of this contract is to carry out a prospective and preparatory study for the Belgian Presidency of the Council of the European Union, seeking to develop an assessment and a vision for a mature and resilient Internal Market. The ETUI report focuses on the strategic importance and opportunities of the Internal Market in a changing geopolitical, technological, socioeconomic, and environmental context; it provides a strategic analysis of the potential and opportunities of the Internal Market in response to social, environmental, and economic challenges within the framework of the development of an open strategic autonomy and the double transition.

A monitoring committee met seven times to accompany the successful bidder in the preparation of its report. This accompaniment was only intended to frame the methodology used by the bidder and, in no way, to validate its conclusions. Therefore, this report only reflects the opinion of the author and not the position of the FPS Economy, which cannot be held responsible for the remarks made in this prospective study.

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# Executive Summary

1. This report was commissioned by the Belgian Federal Ministry of the Economy (FPS Economy) from the European Trade Union Institute (ETUI) in 2022, following a competitive tendering procedure. Its main purpose is to support the Belgian authorities in their preparations for the upcoming Belgian Presidency of the Council of the European Union (EU) in the first half of 2024 by providing a comprehensive study on the importance and strategic opportunities of the European single market in the changing geopolitical, technological, socio-economic and environmental context. To this end, the report seeks to provide a strategic analysis of the European single market, taking stock of its past achievements, assessing its current challenges as well as threats, and considering its potentials and opportunities in the context of current and future societal and economic challenges, the twin transitions and open strategic autonomy.
2. At the heart of this report lies the belief that the major challenges associated with the European Green Deal and, in the interim, the ambitious targets included in the ‘Fit for 55’ package will require a rebalancing of the functioning of the single market in a way that can both facilitate reaching these goals and, at the same time, ensure the political stability and viability of the European integration project. In simpler terms, the report explores ways in which it would be possible to recalibrate some aspects of the single market’s functioning in order to make it fit for the next – challenging – decade whilst facilitating the strategic objective of meeting the pressing demands of the green transition, the technological and digital transition, the EU’s aspirations to greater strategic autonomy, and its social sustainability dimension.
3. The report begins by acknowledging that the single market sits at the centre of the European economic integration project and plays a key role in the process of political and social integration. Its centrality is recognised by the EU treaties, with Article 3(3) of the Treaty on European Union stipulating that ‘The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.’
4. This treaty provision is a powerful reminder of the strong nexus existing between the establishment and functioning of the single/internal market and several key policy objectives linked to Europe’s highly competitive social market economy and its sustainable growth model based on improving environmental standards. It presents a vision of Europe where market integration, economic progress, and social and environmental sustainability are inextricably linked.
5. Following a SWOT methodology, the report acknowledges the key strength of the single market project. By removing barriers to trade in goods and services and facilitating the free movement of capital and people within the EU, the European single market has served to promote intra-European trade, increase competition, boost labour markets by creating jobs, and attract foreign direct investment. According to a recent study by the European Commission, the economic benefits of the single market

translate into an approximately 8-9% increase in gross domestic product (GDP) for the EU compared to a counterfactual scenario in which the EU countries trade only under existing World Trade Organization (WTO) rules. It also accounts for 56 million jobs in Europe and generates around a quarter of the EU's GDP through trade in goods.

6. The single market has been a significant success on its own terms, and both the legal framework (the regulation of the 'four freedoms', but also of a number of contiguous policy areas such as consumer, environmental and social policy) and the institutionalisation of the structures that govern it (with detailed rules regulating and enforcing, for example, state aid and competition standards) are now deeply entrenched. This has led not only to robust internal standards and governance arrangements but also to an extraterritorial extension and adoption of EU standards and practices – the so-called 'Brussels effect' – which has greatly benefited EU market actors and the EU economy at large, as well as advancing people's welfare, both in the EU and, arguably, beyond.
7. However, it is also widely accepted that the integration has not been even across all domains and member states. Indeed, there is a longstanding and ongoing discussion and emerging literature hinting at the asymmetric nature of European integration, in which a deeper market integration appears to contrast with a shallower social integration. The 1987 Padoa-Schioppa Report on Efficiency, Stability and Equity already recognised that market integration could be a win-win process only when complemented by action at EU level to correct structural imbalances at subnational level. The 2010 Monti Report on the Single Market was equally earnest in acknowledging that 'the EU system has accumulated internal asymmetries between market integration at supranational level and social protection at national level, which generate frictions and are a source of disenchantment and hostility towards market opening'.
8. The report also notes that, more recently, it has become apparent that the single market entails a hitherto underexplored sustainability conundrum that must be addressed. Like any regional agreement creating a free market, the single market is essentially premised on the idea of harnessing the competitive gains deriving from comparative advantage and regional specialisation as well as free movement. But this often leads to long and stretched supply chains that, while economically efficient and beneficial in a narrow sense, have a substantial number of negative externalities, especially in terms of their environmental or social impact. This impact is further magnified by the fact that the single market has also been a key factor in the process of trade liberalisation, with several countries and regions of the world being keen to gain access to it. Some European institutions have increasingly acknowledged this conundrum. For instance, the European Parliament, in its 2020 resolution 'Towards a more sustainable single market for business and consumers', noted 'the role that green and social procurement could play in shortening supply chains' and, as stressed in the accompanying Committee Opinion, 'the importance of shortening supply chains' globally, also in the context of the challenges evidenced during the pandemic. But this is arguably a broader issue that the following pages seek to explore in greater depth.

9. The report thus moves on to assess a central opportunity for the single market project, especially its potential to become a central tool in Europe's quest for a more ecologically and socially sustainable and prosperous future, and the steps needed to achieve this. It begins by assessing the current state of the single market project, in particular its challenges and strengths and the main opportunities for its future development.
10. Following a more detailed exploration of this SWOT analysis in Chapter 1, Chapter 2 introduces the main analytical – but in some respects also normative – argument developed in the report, namely the idea that the EU could harness the undeniable strengths of the single market to achieve its sustainability and resilience goals, and that it could do so by engaging in innovative ways with the dual (green and technological) transition, with the strategic transition linked to the concept of 'open strategic autonomy', and crucially with what the report refers to as a social sustainability transition, a transition that is often neglected by other studies focusing on the green, technological and even industrial transition debates. The chapter suggests that unless these three transitions are approached in an integrated and mutually reinforcing way (as three fully integrated 'axes'), with the single market project (broadly understood) putting its substantial weight behind this effort, none of them is likely to be fully achieved. Conversely, the chapter suggests that if the single market project is able to reform precisely in order to facilitate the fulfilment of these transitions, it can both successfully 'reinvent' itself and contribute substantially to the resilience and sustainability goals of the European project.
11. The three axes having been outlined in Chapter 2, the next three chapters go on to assess each one in a more systematic way. Chapter 3 analyses, through a mix of literature review and qualitative and quantitative methodologies, the 'dual transition' linked to a combination of both the technological (and in particular digital) and green transitions. It goes on to explore how different areas of regulation of the single market, for example state aid, public procurement, and competition law, could be reformed in order to generate additional momentum to accelerate this dual transition. The chapter concludes by outlining three scenarios hypothesising how the dual transition in the EU could eventually play out: Scenario 1: Social minimalism redux; Scenario 2: The reactive social market economy; and Scenario 3: Proactive, inclusive transitions. These three scenarios are, in effect, the result of a combination of increasingly ambitious and active responses to the challenges raised by the dual transition, leading to incrementally accelerated transformation processes.
12. Chapter 4 offers a structured analysis of what the report refers to as the 'social sustainability axis'. In essence, it begins by outlining how the single market project has always had some, perhaps rather unfulfilled, social aspirations. But just as these started morphing into increasingly ambitious social policy goals linked to the development of 'Social Europe', a number of countervailing macroeconomic imperatives and employment creation strategies, and the deregulatory effects arising from them, generated an oppositional tension between an increasingly marked free-market profile of the SEM (Single European Market) project and decaying national

social, welfare and labour market institutions. One of the most visible and corrosive consequences of this progressive crumbling of the European social project is the rising levels of inequality in Europe, across a number of different parameters. The chapter argues that this trend needs reversing (a process that in some respects has already started), in order to ensure the social sustainability of the European project but also to support and accelerate the other two transitions discussed in Chapters 3 and 5. It concludes by exploring three incrementally ambitious scenarios that could contribute to this goal: a first scenario linked to labour market regulation and capabilities enhancement; a second aimed at harnessing the pre-distributive potential of the ‘social market economy’; and a third fully embracing the idea of an ‘integrated social market economy’ by correcting the redistributive failures of the single market.

13. Chapter 5 assesses the third axis explored in the report: open strategic autonomy (OSA). Using a similar methodology to Chapters 3 and 4, it begins by exploring the concept of OSA, and moves on to establish the key concepts that define the basic cost-benefit calculus on strategic autonomy, including reshoring, to analyse the nexus with the emerging EU industrial policy, and to assess some of the key fragilities and the hitherto underexplored environmental and social sustainability dimensions of OSA. It concludes by setting out three possible scenarios for the future development of the OSA debate: one premised on a minimalistic supply chain diversification; a second focusing on reshoring and verging on the establishment of a semi-autarkical regime; and a third concentrating on a combination of selective reshoring, strategic partnerships and a strategic use of trade policy.
14. At this point it may be worth stressing the value and purpose of these scenarios in the overall structure of the report. Chapters 3, 4 and 5 address the question of the future pace and trajectory of the respective axes they cover by discussing a small number of possible scenarios that are to varying degrees compatible with existing actors and arrangements in Europe. These scenarios are not ‘prescriptive’. They are a scholarly way of organising coherently alternative visions of possible futures by reference to a range of different policy actions and directions. Which scenario will prevail is ultimately a matter of politics – of collective choices made in the deliberative institutions that define European democracies – and of policies, the tools to pursue collectively defined targets, within a historical, institutional and political context. The task of this report is to outline them in a way that is both internally consistent and, when combined with each other in Chapter 6, conceptually and institutionally coherent. A more detailed methodological explanation can be found in the opening paragraphs of Chapter 6 and in the appendix to the report.
15. Chapter 6 combines the three sets of axis scenarios, as developed in the previous three chapters, into ‘macro-scenarios’, each encompassing a dual transition, a social sustainability and an OSA dimension. A quick calculation suggests that, on paper at least, the various combinations of micro-scenarios would result in a total of 27 macro-scenarios. The methodological appendix shows what these 27 scenarios would look like, but it is important to clarify from the outset that the report does not seek to explore all of them, and that its authors, in coordination with a number of other experts



consulted during the drafting process, chose to explore in greater detail only the five most likely, internally consistent and institutionally coherent macro-scenarios. These range from a minimalistic 'Market-conform adjustment' scenario to a more ambitious 'Good jobs in a strong and green economy' scenario. The analysis is complex, and readers are referred to Chapter 6 for a more detailed assessment of each scenario.

16. Chapter 7 concludes the report by summing up the main features of the two macro-scenarios from Chapter 6 that scored the highest according to the two criteria on which our scenario-building methodology was based (consistency and viability) while also offering two starkly different visions for the future of the single market project. These visions represent a very visible departure from the status quo: one is premised on policies aimed at fostering the rapid emergence of industrial ecosystems (Scenario 6.4) while the other is most likely to deliver good-quality jobs in a strong and green economy (Scenario 6.5). For each of the two scenarios, we also outline some key policy areas underpinning the particular vision on which they rest, accompanied by a (non-exhaustive and in some respects broad-brush) series of examples of possible policy reforms.

# 1. Resilience and tensions in the Single Market

## Introduction and structure of the report

The single market sits at the centre of the European economic integration project and plays a key role in the process of political and social integration. Its centrality is recognised by the EU Treaties, with Article 3(3) of the Treaty on EU (TEU) stipulating that “*The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.*”

This Treaty provision is also a powerful reminder of the strong nexus existing between the establishment and functioning of the single/internal market and several key policy objectives linked to Europe’s highly competitive social market economy and sustainable growth model based on improving environmental standards. It presents a vision of Europe where market integration, economic progress, and social and environmental sustainability are inextricably linked.

By removing barriers to trade in goods and services and facilitating the free movement of capital and people within the European Union, the European single market has allowed to promote intra-European trade, increase competition, boost labour markets by creating jobs and attract foreign direct investment (Hafner 2017). According to a ‘recent study by the European Commission estimates that, compared to a scenario in which EU countries trade under WTO rules, the economic benefits of the single market amount to an 8-9% increase in GDP for the EU’.<sup>1</sup> It also accounts for 56 million jobs in Europe and generates around one fourth of EU’s GDP from trading goods.<sup>2</sup>

The single market has been a significant success on its own terms, and both the legal framework (the regulation of the ‘four freedoms’, but also of a number of contiguous policy areas such as consumer, environmental, and social policy) and the institutionalisation of the structures that govern it (with detailed rules regulating and enforcing, for example, state aid and competition standards) are now deeply entrenched. This has led not only to robust internal standards and governance arrangements but also to an extraterritorial extension and adoption of EU standards and practices - the so-called ‘Brussels effect’ - which has greatly benefited EU market actors, the EU economy at large, but has also been beneficial in terms of advancing people’s welfare, both in the EU and, arguably, abroad (Bradford 2020).

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<sup>1</sup> in ‘t Veld, J. (2019) ‘Quantifying the Economic Effects of the Single Market in a Structural Macromodel’, Discussion Paper 94/2019 available at [https://ec.europa.eu/info/sites/default/files/economy-finance/dp094\\_en.pdf](https://ec.europa.eu/info/sites/default/files/economy-finance/dp094_en.pdf) and referred to at <https://www.consilium.europa.eu/en/policies/deeper-single-market/>

<sup>2</sup> Ibid.

However, it is also widely accepted that the integration has not been even across all domains and member states. In fact, there is a longstanding and ongoing discussion and emerging literature hinting at the asymmetric nature of European integration, in which there appears to be a deeper market integration as opposed to a shallower social integration. The 1987 Padoa-Schioppa Report on Efficiency, Stability and Equity (Padoa-Schioppa 1987) already recognised that market integration could be a win-win process only when complemented by action at EU level to correct structural imbalances at subnational level. The 2010 Monti Report on the Single Market was equally earnest in acknowledging that ‘the EU system has accumulated internal asymmetries between market integration at supranational level and social protection at national level, which generate frictions and are a source of disenchantment and hostility towards market opening’ (Monti 2010).

More recently it has also become apparent that the single market entails a hitherto underexplored sustainability conundrum that must be addressed. Like any regional agreement creating a free market, the single market is essentially premised on the idea of harnessing the competitive gains deriving from comparative advantage and regional specialisation as well as free movement. But this often leads to long and stretched supply chains that, while economically efficient and beneficial in a narrow sense, have a substantial number of negative externalities especially in terms of their environmental or social impact. This impact is further magnified by the fact that the single market has also been a key factor in the process of trade liberalisation, with several countries and regions of the world being keen on gaining access to it. Some European institutions have increasingly acknowledged this conundrum. For instance, the European Parliament, in its resolution ‘Towards a more sustainable single market for business and consumers’ (European Parliament 2020b) noted ‘the role that green and social procurement could play in shortening supply chains’ and, as stressed by the accompanying Opinion, ‘the importance of shortening supply chains’ globally,<sup>3</sup> also in the context of the challenges evidenced during the pandemic. But this is arguably a broader issue that the following pages seek to explore in greater depth.

The present report seeks to assess the potential, and necessary steps, for the single market project to become a central tool in Europe’s quest for a more ecologically and socially sustainable and prosperous future. It begins by assessing the current state of the single market project, a task that is performed by the following paragraphs of the present chapter, essentially through an assessment of its challenges, strengths, and of the main opportunities for its future development. The chapter concludes with a table that seeks to organise and visualise this SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis in a more systematic manner. The authors of the present report have also sought to rely on aspects of the SWOT methodology throughout the report as a whole, a central argument of the paper being that the green, technological, social, and strategic transitions the EU is currently confronted with are, at the same time, key challenges while also presenting important opportunities for a more prosperous and sustainable Europe.

Chapter 2 performs the task of introducing the main analytical, but in some respects also normative, argument developed in the present report. More specifically the idea that the EU

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<sup>3</sup> OPINION OF THE COMMITTEE ON THE ENVIRONMENT, PUBLIC HEALTH AND FOOD SAFETY (17.7.2020) for the Committee on the Internal Market and Consumer Protection on towards a sustainable single market for business and consumers.

could harness the undeniable strengths of the single market to achieve its sustainability and resilience goals, and that it could do so by engaging in innovative ways with the dual (green and technological) transition, with the strategic transition linked to the concept of ‘open strategic autonomy’, and crucially with what the report refers to as a social sustainability transition, a transition that is often neglected by other studies focusing on the green, technological, and even industrial transition debates. The chapter suggests that unless these three transitions are approached in an integrated and mutually reinforcing way (as three fully integrated ‘axes’), with the single market project (broadly understood) pulling its substantial weight behind this effort, none of them is likely to be fully achieved. Conversely, the chapter suggests that if the single market project is able to reform precisely in order to facilitate the fulfilment of these transitions, it can both successfully ‘reinvent’ itself and contribute substantially to the resilience and sustainability goals of the European project.

Having outlined the three axes in Chapter 2, the next three chapters go on to assess each one of them in a more systematic way. Chapter 3 analyses, through a mix of literature review, qualitative, and quantitative methodologies, the ‘dual transition’ linked to a combination of both the technological (and in particular digital) and green transitions. It goes on to explore how different areas of regulation of the single market, for example state aid, public procurement, and competition law, could be reformed in order to harness additional momentum to accelerate this dual transition. The chapter concludes by outlining three scenarios hypothesising how the dual transition in the EU could eventually play out: a first Social minimalism redux scenario; a second Reactive social market economy scenario; and a third Proactive, inclusive transitions scenario. These three scenarios are, in effect, the result of a combination of increasingly ambitious and active responses to the challenges raised by the dual transition, leading to incrementally accelerated transformation processes.

Chapter 4 offers a structured analysis of what the report refers to as ‘the social sustainability axis’. In essence it begins by outlining that the single market project always had some, perhaps rather unfulfilled, social aspirations. But that just as these started morphing into increasingly ambitious social policy goals linked to the development of ‘Social Europe’, a number of countervailing macroeconomic imperatives, job creation strategies, and the deregulatory effects descending from them generated an oppositional tension between an increasingly marked free market profile of the SEM project and decaying national social, welfare, and labour market institutions. One of the most visible and corrosive consequences of this progressive crumbling of the European social project is the rising levels of inequality, across a number of different parameters, in Europe. The chapter argues that this trend needs reversing (and in some respect has already started to do so), in order to ensure both the social sustainability of the European project, but also to support and accelerate the other two transitions discussed in chapters 3 and 5. It concludes by exploring three incrementally ambitious scenarios that could contribute to this particular purpose. A first scenario linked to labour market regulation and capabilities enhancement. A second aimed at harnessing the pre-distributive potential of the ‘social market economy’. And a third one fully embracing the idea of an ‘integrated social market economy’ by correcting the re-distributive failures of the single market.

Chapter 5 is dedicated to the assessment of the third axis explored in this report: ‘Open strategic autonomy’. Using a similar methodology to the one deployed in Chapters 3 and 4, it begins by exploring the concept of OSA, and moves on to establishing the key concepts that define the basic cost-benefit calculus on strategic autonomy, including re-shoring, analysing

the nexus with the emerging EU industrial policy, and assessing some of the key fragilities and the hitherto underexplored environmental and social sustainability dimensions of OSA. It concludes by setting out three possible scenarios for the future development of the OSA debate, one premised on a minimalistic supply chain diversification, a second one focusing on reshoring and verging on the establishment of a semi-autarkical regime; and a third one focusing on a combination of selective reshoring, strategic partnerships, and a strategic use of trade policy.

At this point it may be worth stressing the value and purpose of these scenarios in the overall structure of this report. Chapter 3, 4, and 5, address the question of the future pace and trajectory of the respective axes they cover by discussing a small number of possible scenarios that are to varying degrees compatible with existing actors and arrangements in Europe. These scenarios are not ‘prescriptive’. They are a scholarly way of organising coherently alternative visions of possible futures by reference to a range of different policy actions and directions. Which scenario will prevail is ultimately a matter of politics – of collective choices made in the deliberative institutions that define European democracies – and of policies, the tools to pursue collectively defined targets, within a historical, institutional and political context. The task of this report is to outline them in a way that is both internally coherent and, when combined with each other in chapter 6, ensure they are conceptually and institutionally consistent. A more detailed methodological explanation can be found in the opening paragraphs of Chapter 6, and in the appendix annexed to this report.

Chapter 6 takes upon itself the task of combining each of the three individual axis scenarios’, as developed in the previous three chapters, into ‘macro scenarios’, encompassing both a dual transition, social sustainability, and OSA dimension. A rapid mathematical calculus immediately suggests that, on paper at least, the combination of each of the micro-scenarios would lead to an overall figure of 27 macro-scenarios. The methodological annex attached to this report shows how these 27 scenarios would look like, but it is important to clarify from the outset that the report does not seek to explore all of them, and that its authors, in coordination with a number of other experts consulted through the drafting process, have only chosen to explore in greater detail the five most likely, internally consistent, and institutionally coherent macro-scenarios. These range from a minimalistic ‘Market Conform Adjustment’ scenario to a more ambitious ‘Good jobs in a strong and green economy’ scenario, and given the complexity of the analysis we refer our readership to chapter 6 for the further detailed assessment of each scenario.

Chapter 7 concludes the report by summing up the main features of the two macro scenarios that, in chapter 6, scored the highest in terms of the two criteria that our scenario building methodology relied upon (consistency and viability), and that – at the same time – offer two starkly different visions for the future of the single market project that depart, more visibly, from the status quo: the scenario that is premised on a new era of industrial policy (scenario 6.4) and the scenario that is most likely to deliver good quality jobs in a strong and green economy (scenario 6.5, in the previous section). For each of the two scenarios we also outline some key policy areas underpinning the particular vision on which they rest, accompanied by a (non-exhaustive and in some respects broad brush) series of examples of possible policy reforms.

## 1.1. Challenges of the single market: past but ongoing

Despite its large benefits and noteworthy performance, a number of barriers continue to affect the functioning of the single market and there is the realization that the single market has not reached its full potential yet. In his seminal report commissioned by the Barroso Commission with the ambition to propose a new vision and strategy to revive the single market and make it work both for Europe's economy and society, Monti (2010) makes the following analogy: "... the single market is an engine that works at around 95% of its potential." While one could acknowledge that 95% is already a big achievement for such a large-scale project, Monti (2010) mentions that the single market (already back then, i.e. slightly more than a decade ago) is at a critical juncture and highlights the three key challenges it faces, which one could argue continue to persist today, but magnified by the additional challenges, threats and opportunities of our current times.

The first challenge that Monti highlights relates to the possible erosion of the political and social support for further market integration in Europe. He identifies two mutually reinforcing forces: an 'integration fatigue', that might erode the appetite for more Europe and single market; and a 'market fatigue', that might reduce confidence in the role of the market more broadly. The second challenge relates to the uneven (and even ad hoc) policy attention dedicated to developing different components of the single market in order to make the latter more comprehensive, effective and sustainable. The last, but not the least, challenge relates to the 'sense of complacency' in which "the single market was felt to be yesterday's business" (Monti 2010). The latter challenge has nominally been addressed through the entry into force of the Lisbon Treaty 2009 bringing together various building blocks of European integration, and there is no doubt that 'Brexit' has significantly reduced any remaining 'single market laxism, but remains an issue, both in terms of developing a new vision for the project and celebrating its success and further potential.

When looking at particular barriers as identified by member states, businesses and citizens, the most commonly observed obstacles include restrictive national legislations, complex administrative procedures, uneven (and insufficient) administrative capacity across member states, challenges in public procurement processes, language and cultural barriers, challenges faced by citizens about movement between member states related to social security and health benefits, transferability and recognition of skills and competences, difficulty in getting information in cross-border transactions and challenging business environment in some member states with red tape, to name a few.

Among other initiatives and actions to boost market integration, the 2020 European industrial strategy<sup>4</sup> has led to the formation of the Single Market Enforcement Taskforce (SMET) under the Action plan for better implementation and enforcement of the single market rules.<sup>5</sup> SMET is a high-level forum composed of the European Commission and Member States, which work together to ensure a coherent approach for the smooth functioning of the single market, by

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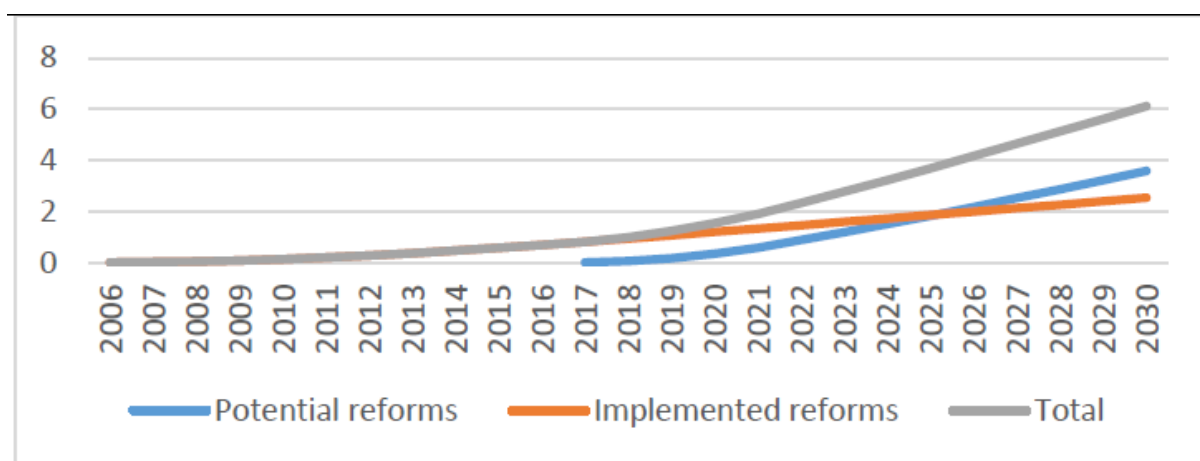
<sup>4</sup> European Commission (2020a) A New Industrial Strategy for Europe, COM(2020) 102 final available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0102&from=EN>

<sup>5</sup> European Commission (2020b) Long term action plan for better implementation and enforcement of single market rules, COM/2020/94 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2020%3A94%3AFIN>

identifying obstacles and threats, and jointly devising and proposing solutions to be implemented. The recent report by SMET draws attention to (among others) cross-border restrictions for professionals for temporary and occasional service provisions, measures with potential protectionist effects in agri-food sector as well as heavy administrative burdens during the process of posting of workers.<sup>6</sup>

To give an idea of the situation, the following figure shows the impact of removal of barriers in the services sector on the overall EU gross domestic product (GDP) during the period 2006-2030 based on the recent Annual Single Market report by the European Commission (2022a). The estimated figures draw on the findings after the adoption of the Services Directive in 2006 and point to further gains in the overall EU GDP if potential reforms could also be fully implemented, conditional on them being duly transposed across all Member States, which has not been straightforward over the past decades.

**Figure 1 Impact of removal of barriers in the services sector on the EU GDP (%)**



Notes: The values displayed are based on cumulative net present value of GDP impact of already implemented reforms as well as of those of more ambitious nature, all of which are reported as a percentage of the base year GDP (2006).

Source: European Commission (2022a: 20).

While many of these (and more) initiatives aim at improving the existing single market performance from a number of important but partial angles, the single market project is also in need of a more holistic vision in order to reach its full strength. A vision that, in full compliance with the grand design anticipated by the drafters of the Lisbon Treaty, offers a realistic path to reform, renew, and relaunch its functioning. As put by Jacques Delors, ‘you cannot fall in love with the Single Market’. The single market must both deliver, and be seen to deliver, on the aspirations and hopes of European citizens, especially in the aftermath of the traumatic passage of the Covid-19 pandemic and the existential challenges of climate transition and digital transformations.

However, one of the problems of the single market has been that supply chains have become more fragmented. Before 1995, many production systems had a strong regional characteristic:

<sup>6</sup> <https://ec.europa.eu/docsroom/documents/47154>

just-in-time supply chains and production systems in many assembly industries required geographic proximity; the Italian districts and their southern German, Danish and Flemish counterparts produced resilient local clusters of companies in one or a small number of related industries; and agglomeration effects produced a series of very wealthy local economies in which economic processes are concentrated and superimposed (known as the ‘blue banana’, stretching from London over the southern Netherlands and Flanders, the Ruhr area and southern Germany, Switzerland and Eastern France, over the Po Valley in northern Italy to Catalonia).

The rapidly increasing economic integration of the European economies has shaped the construction of value chains that exploit comparative institutional advantages: many activities lower down the value chain have moved to jurisdictions where they could be produced more effectively. If costs were important for a particular value segment, they went to lower wage and lower tax jurisdictions; and if skills, innovation, or proximity for collaboration are important, they are more likely to stay in the centre. Hence the paradox of the single market: its resilience and strength, expressed in close trade ties, especially in intra-industry trade, has produced the conditions for fragility in supply chains when disruptive processes occur, as we saw with the Covid-19 and implied supply chain crisis.

## **1.2. Global trends, tensions and resilience in the single market**

With a futuristic approach, the previous Strategic Foresight Report (European Commission 2021a) – to which the ETUI had contributed – identified four key structural global trends that will impact the EU’s capacity and freedom to act:

- (1) Climate change and other environmental challenges,
- (2) Digital hyperconnectivity and technological transformation,
- (3) Pressure on democracy and values,
- (4) Shifts in the global order and demography.

While this important document is primarily forward looking and engages with these trends and challenges from a global perspective, it is also acutely aware of the impact that these challenges will have on the single market project.

Before sketching out a possible trajectory for relaunching the single market project, it is important to recognise the resilience of the single market project itself in the face of major global trends and tensions. For nearly two decades, the single market has been witnessing a number of challenges and crises, some of which are intertwined, while also largely surviving them relatively unscathed. These include the political crisis following the ‘Constitutional Treaty’ referenda in 2005; the ‘fault lines’ between market and social integration emerging with the CJEU decisions in *Viking* and *Laval* (Monti 2010); the economic and social challenges in the aftermath of the financial crisis of 2008-2009; the refugee crisis of 2015; the terrorist attacks around 2015-2016; the increased frequency of environmental and climate-related disasters (floods, wildfires, land erosion, earthquakes, volcanic eruptions); swings in the geopolitical scene, such as the rivalry between the US and China, the polarisation and rise of extreme politics threatening democracies and European values, the Covid-19 pandemic and



the consequent public health crisis since 2020 and more recently the war in Ukraine following the invasion of Russia as well as the human disaster and massive refugee flows towards the EU since early 2022. Along these lines, ‘Brexit’ – which is often explained as a fracture partly linked to pressures on democracy and values – has in many ways both shaken the foundations of the single market and, somewhat paradoxically, reminded Europe and the world of its inherent resilience.

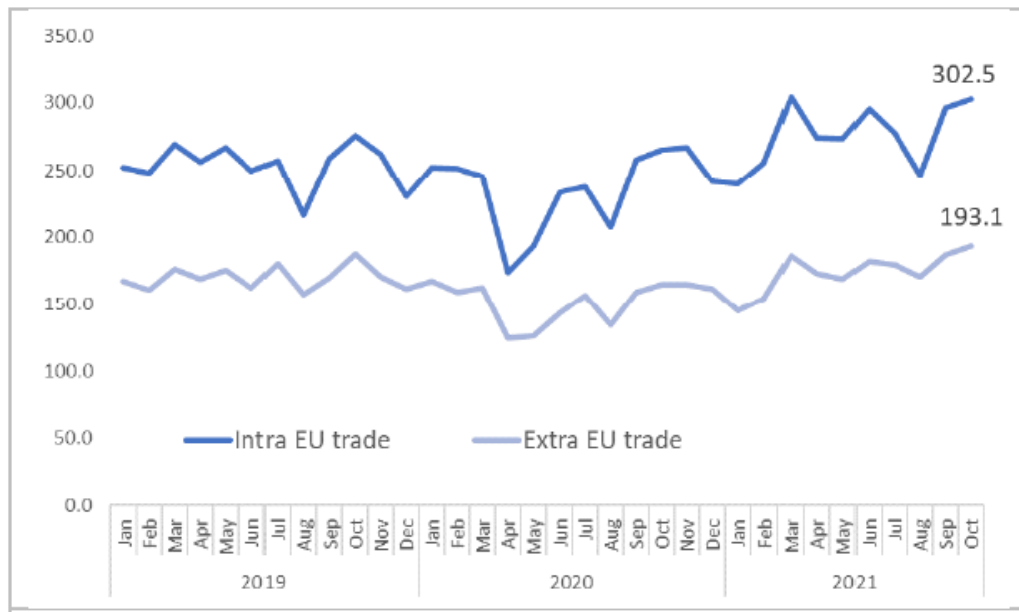
It is certainly appropriate to focus on the disruptive effects of the recent Covid-19 pandemic as well. The pandemic has exposed, and in some cases even deepened, some of the external dependencies of the EU on critical raw materials, and thus has led to vulnerabilities in various domains and disruptions in supply chains. It has also led to new ways of thinking and actions to increase socioeconomic resilience and boost the recovery at the EU level. For example, the Next Generation EU and the accompanying Recovery and Resilience Facility have been put forward as the key financial scheme supporting the recovery from the pandemic by funding investment and reforms of Member States as part of national Recovery and Resilience Plans and help them successfully manage the green and digital transitions to improve socioeconomic resilience. In particular, the facility requires at least 37% and 20% of the spending to be allocated to investments in environmental and digital projects, respectively. When implemented, the Recovery and Resilience Plans might serve as catalysts for boosting the economy and labour markets, and thus may improve social and economic resilience in the EU.

But each of these crises has also had a significant impact on the integration and smooth functioning of the single market, dented its performance, and at times shaken some of its foundations. A visible, recent, example of these disruptions can be seen in the overstretched value and supply chains in strategic raw materials and the production of essential goods, fragmentation of the markets, obstacles to the free movement of people, chiefly because of the recent pandemic. The notion of open strategic autonomy and rethinking about the critical dependencies in global supply chains have also gained eminence following the pandemic. This notion has only increased its importance in the political discourse with the onset of war in Ukraine given the existing energy and raw material dependence on Russia and might lead to speeding up green transition, or diversification of dependencies away from Russia at the very least. Similarly, ‘Brexit’ may have disproportionately harmed the UK economy, but it is also understood of having disruptive effects for the economy of the EU27, as well as having the potential to create job in some Member States (Vandenbussche 2019; Mathieu 2020). The recent (and currently ongoing) and massive refugee flow from Ukraine has demonstrated the unprecedented solidarity of the Europeans. All in all, crises seem to come along with their opportunities.

### **1.3. Single market integration despite challenges**

One of the key indicators of the single market integration process is the trend in intra-EU trade. Despite severe disruptions due to the Covid-19 pandemic in the first two quarters of 2020, the intra-EU trade, which is way above the extra EU trade, has picked up significantly in the following quarters as shown in the following figure. The following recovery has been relatively steep and trade figures (both intra and extra EU) have gone up beyond 2020 levels already in 2021.

**Figure 2 Intra EU trade (EUR bn)**

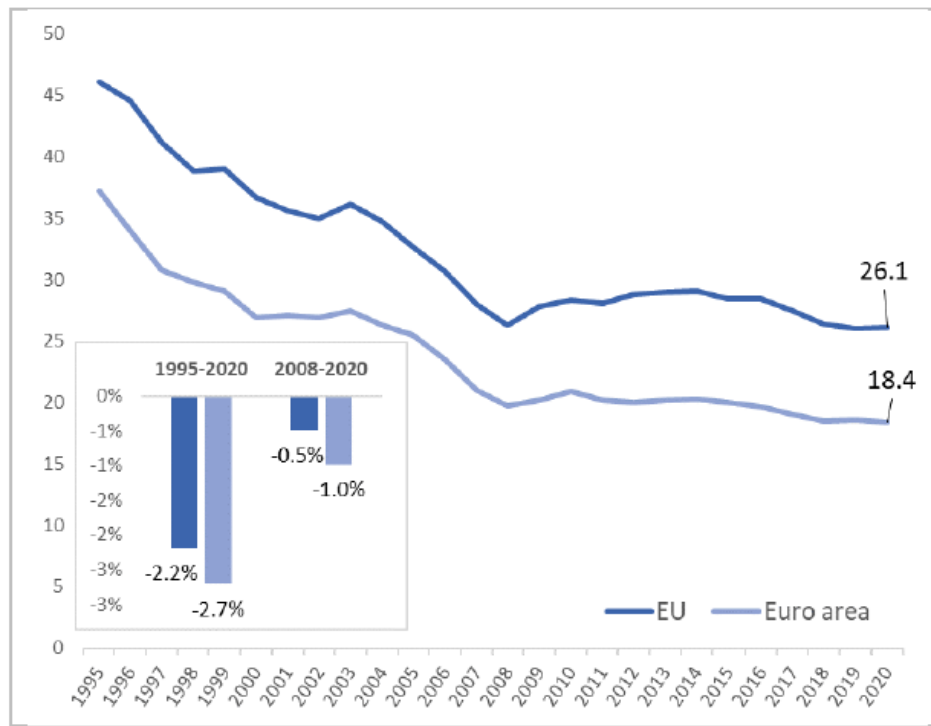


Note: Intra and extra EU trade in billions of EUR (nominal values). Trade is defined as the average between imports and exports.

Source: European Commission (2022a: 53).

Another useful indicator for the integration of the European economy is the price differences across Member States. The following figure illustrates that there has been a significant reduction in price dispersion between 1995-2008 in the EU, followed by an increase due to the financial crisis. Between 2014-2019, there has been a slow price convergence, but it stalled in 2020. In either case, the prices have converged more in the Euro area.

**Figure 3 Price convergence across member states**



Notes: Coefficient of variation of price level indices (PPP for GDP) and their average growth rates (in small box).

Source: European Commission (2022a: 54).

## 1.4. The green transition and the European Green Deal

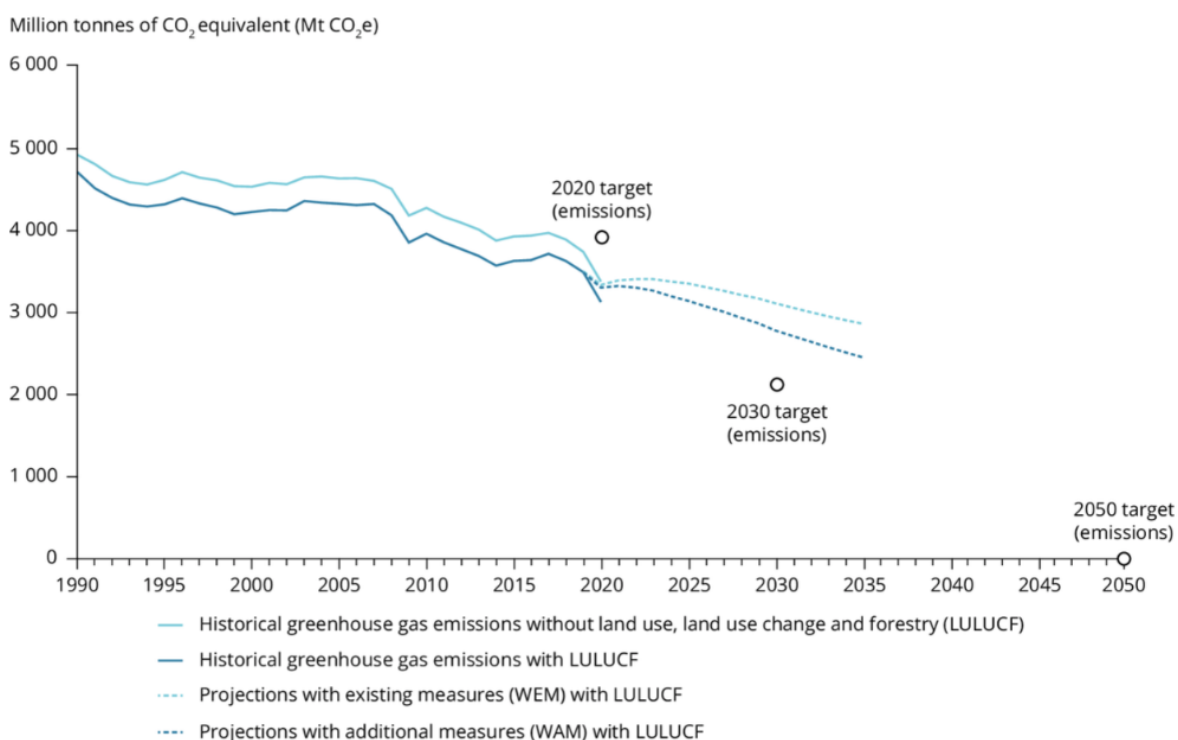
Developments of a systemic nature such as climate change and environmental degradation pose challenges that shape various policy areas. To give a few examples, climate change will threaten agricultural yields<sup>7</sup>, increase risks of food shortages, and lay bare food supply dependencies on other countries, which might also be negatively impacted by climate change due to its systemic nature. Moreover, increasing temperatures are causing rising sea levels that will threaten coastal infrastructures, pose risks for smooth running of economies in maritime and coastal regions, while droughts and heat waves will lead to disruptions in food supplies, water resources, and economic activity and create risks for human and animal health and survival. Climate change may also lead to spread of infectious diseases.<sup>8</sup> Moreover, climate change is able to trigger developments that would modify and affect the global availability of materials and resources, and the sustainability of production chains by changing the set of critical assets or dependencies, thus further affecting the capability in energy sustainability and provision of goods and services.

<sup>7</sup> EEA ‘Projected impact of climate change on agricultural yields’, available at <https://www.eea.europa.eu/data-and-maps/figures/projected-impact-of-climate-change>

<sup>8</sup> EASAC (2010) Climate change and infectious diseases in Europe, available at <https://easac.eu/publications/details/climate-change-and-infectious-diseases-in-europe/>

Limiting the negative effects of climate change requires a sharp reduction in greenhouse gas emissions (mitigation) and measures aimed at increasing resilience to the impacts that will inevitably occur (adaptation).<sup>9</sup> To address mitigation measures against climate change and achieve a sustainable Europe, the European Green Deal has been proposed by the European Commission with the aim of pursuing ambitious greenhouse gas emissions cuts – amounting to 55% less of current emissions compared to 1990 levels – by 2030 and carbon neutrality by 2050.<sup>10</sup> The proposed deal is also very comprehensive, going beyond environmental and climate plans, and it will actually have profound effects on the economic and political relationships, industries and lifestyles. The ‘deal’ is also incorporated in a legal instrument, Regulation (EU) 2021/1119 (the so called ‘European Climate Law’) enshrining legally binding overall and intermediate targets for both EU institutions and Member States alike. The following Figure 4 shows the historical trends and future projections of greenhouse gas emissions by the EU. While there is a significant decrease in emissions over the last two decades, the remaining decades foresee even more significant cuts to reach net-zero.

**Figure 4 Historical trends and future projections of greenhouse gas emissions by the EU**



Source: European Environmental Agency (2021).<sup>11</sup>

Green transitions will have also unequal and severe distributional effects in various sectors of the economy. While they can generate new jobs in renewable and sustainable energy production sectors, the transformations associated with it will also translate into job destruction in sectors such as mining and other industries heavily dependent on fossil fuels.

<sup>9</sup> <http://www.oecd.org/env/cc/adaptation.htm>

<sup>10</sup> [https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en)

<sup>11</sup> <https://www.eea.europa.eu/ims/total-greenhouse-gas-emission-trends>

The EU can reduce some of the unequal and distributional effects of green transition processes by identifying and investing in strategic sectors and by offsetting job losses with new employment creation in ‘clean’ sectors. This might involve directing offshored industries towards the internal market, which would imply not only decreasing its external dependence on other countries and regions of the world, but also creating positive employment effects internally. In parallel, appropriate correction measures (e.g. not only timely channelling funds from Just Transition and Social Climate Funds, but also putting efforts to increase the sizes of these funds) would need to be taken both to curb the inequalities arising from these transitions and to manage any societal backlash in connection with rising carbon prices, an inevitability of any green transition strategy.

The EU can and should balance any disparities arising in societies due to green transitions related transformation, and this is where the social dimension of the European Green Deal would have to play a pivotal role. To ensure fair and just transitions towards a carbon-neutral economy, sufficient funds need to be earmarked to support the most affected sectors dependent heavily on fossil fuel or carbon-intensive processes. Further investments in clean and renewable energy sectors are expected to generate jobs, but transitioning will also require engaging citizens on these issues, investing in them and reskilling workers. Besides upskilling, quality of employment, ensuring decent living wages and supporting transformative communities are indispensable elements for fair transitions. A socially cohesive, confident, and suitably skilled and prepared population is far more likely to accept, and even embrace, the challenges arising from the rapid transformations linked to the decarbonisations of our economies. Conversely, a divided, insecure and precarious, let alone ill-equipped and dispossessed working population, is unlikely to be willing to accept any further risks and would inevitably resist change.

Facilitating this process thus requires ambitious reforms and investment in people, infrastructure and industries for the EU to aim for sovereignty over critical sectors such as energy, and the ability to remain fully committed to its sustainability and climate-neutrality objectives over the next decades. At the same time, Europe has an important role to play in the global scene in pushing for its exemplary Green Deal, with ambitious emissions targets, by respecting the ‘do no harm’ principle and paying close attention to the social dimension of the green transition by successfully implementing measures ranging from accompanying workers in sectors facing major restructuring during the coal phase-out to reorient them to other sectors by reskilling to supporting lower-income households facing energy price inflation during the transition (for more details, see chapters 3 and 4). Doing so will not only mitigate negative climate effects on future economic activities and reduce environmental footprint, but it will also win the citizens along the transitions and minimise social discontent.

## **1.5. Digital transformation and a new technological era**

Technological advancements and digitalisation have already been happening over the last decades with an increasing pace, influencing almost all aspects of our lives and economies. Digitalisation trends will surely continue in the future, but their impacts on societies and the planet as a whole should be monitored closely.

On the one hand digitalisation helps reduce some resource exigency dimensions, increase productivity gains and efficiency, upgrade education and training systems, facilitate provision of public and private services (e.g., e-governance, e-health), transform the world of work and

underpin green transitions towards achieving ambitious climate and environmental targets. On the other hand, the digital developments will put pressure on resources and raw materials (e.g., battery, chips), for which Europe is mostly dependent on other countries (for the time being). Moreover, when digitalisation does not benefit certain demographic groups because of pre-existing inequalities or lack of infrastructure in some regions, there is a risk of growing digital divides. This could be partly addressed by investing in digital skills and mainstreaming training of such skills in education and training systems to achieve digital inclusion at a wider scale, as well as targeting specific regions with ad hoc resources. Finally, concerns of personal data protection in clouds, which are often managed by non-EU tech giants, will continue to exist, and so will other cybersecurity risks and apprehensions (monitoring, proctoring, surveillance), all demanding determined action at a European level, given the visible transnational dimension of technological services and technology.

Similarly, technological change is believed to have the potential to transform global commerce.<sup>12</sup> But the strategic foresight exercise of the Commission also recognises the potential benefits arising, in this domain, from the so called ‘Brussels effect’, ‘whereby multinational corporations comply with EU-level regulation’ as a by-product of the stringency of that regulation and the size of the single market. Last but not least, the report acknowledges the direct link between protecting European people against the social consequences and the risks arising from these transformations, the role of the single market, and the protection of Europe’s democratic values (European Commission 2021a). It notes that

*‘Europe’s social market economy is also key to its democratic model, protecting people against social risks and their consequences. The single market gives a strong basis for a recovery and the resilience of the EU industry, and to facilitate the green and digital transitions. To be accepted, these transitions must be fair and accompanied by stronger economic and social convergence. The COVID-19 crisis has highlighted the importance of an open, competitive and fully functioning single market to enable businesses to grow to the scale needed to compete globally.’*

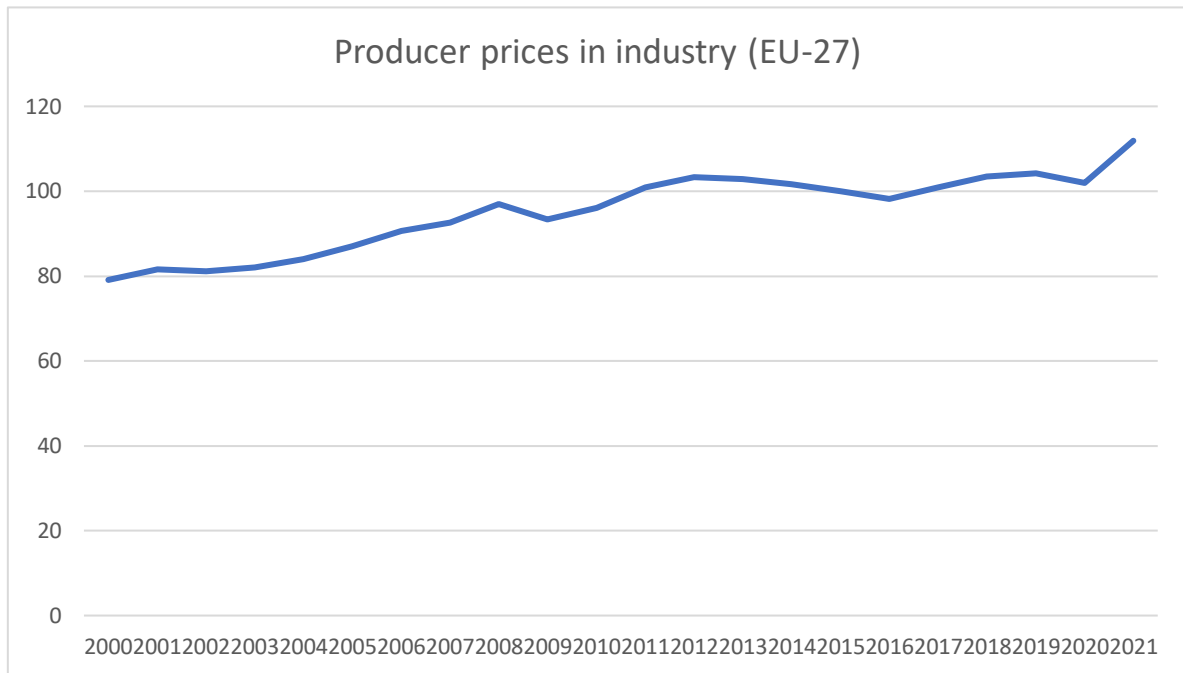
## **1.6. Industrial strategy**

In the aftermath of the previous financial crisis, EU industrial production witnessed a steady growth that lasted until the pandemic in 2020. Correspondingly, the evolution of the value of sold industrial production followed a similar trend (see the figure below).

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<sup>12</sup> WTO (2018).

**Figure 5 Evolution of value of industrial production (EU-27)**



Source: Eurostat (2021), (variable: *sts\_inpp\_a*). Authors' elaboration.

In March 2020, the European Commission adopted a new Industrial Strategy “to help Europe’s industry lead the green and digital transformations and to drive Europe’s global competitiveness and open strategic autonomy (European Commission 2021b),” which was later adapted in May 2021 following the experience of the Covid-19 pandemic highlighting the need to promote an inclusive recovery in the face of green transition and digital transformation to improve resilience of the EU industrial ecosystem as well as to stay fit for future challenges. This also implies identifying and co-designing a transition pathway by giving priority to industrial ecosystems – such as energy-intensive industries<sup>13</sup> – that have experienced (or will experience) significant challenges during various emerging global trends and crises. The transition pathway is, however, a bumpy road with challenges along the way, which is why a broader sectoral approach might be necessary towards a carbon-neutral future, while securing and strengthening the resilience of the EU value chains.

In the areas of innovation policy, chips act, strategic alliances and sustainable competitiveness, the EU can capitalise on three unique advantages: (i) its industrial capacities, which are concentrated in relatively high-end export market niches; (ii) the diversity of innovation models within its borders; and (iii) its close allies in the rest of the advanced industrialised world – the US and Japan. Firstly, the EU exports are known the world over for their high quality and customisation. That has allowed it to reap the benefits of (relative) non-cost competitiveness, with high skills and high wages as cornerstones. Secondly, the EU also

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<sup>13</sup> For more information on ETUI’s work on energy intensive industries, see <https://www.etui.org/decarbonizing-energy-intensive-industries-what-are-risks-and-opportunities-jobs>

For more information on ETUI’s work on automobile sector, see <https://www.etui.org/future-automotive-sector-o>

resembles a tightly integrated innovation system, with many different yet complementary production and innovation regimes. Some Member States have excellent capacities in new technologies close to the scientific frontier, while others have developed specialisations in developing and commercialising these cutting-edge technologies. Far from an innovation-deficit (as, for example, measured in the number of unicorn start-ups), the EU harbours a vibrant innovation ecology, in which highly qualified scientists and engineers handle different stages and aspects of the innovation process. Thirdly, and finally, in international economic relations, the EU is not alone, but has strong, cooperative relations with the US and Japan, which are likely to strengthen with the rise of China as a new power in the international political economy. Improving the EU's competitiveness in innovative sectors and industries will need to take these three realities into account and evaluate where possibilities exist for positive-sum initiatives that build on these strengths, while also protecting the single market from external, market distortive, unfair trade practices, including unlawful subsidies especially in strategically important and emerging markets.

Among action points, one of the objectives of the single market should be to facilitate the EU to become the leader in the industrial policy. In a world confronted with climate change, decreasing availability of rare earth materials, deepening rivalry and growing tensions among trade partners, the EU will need to find its niches to be a global champion. This also implies ensuring that the rules of the single market foster partnerships and cooperation not only among Member States, but also with like-minded partners outside of the EU. The single market should also serve as a catalyst towards a sustainable economy and ensure that divergences among Member States are reduced, despite the aforementioned challenges and risks that it has been facing.

## **1.7. Rethinking the single market: opportunities for the future**

As the backbone of the European economy, small and medium-sized enterprises (SMEs) employ around 100 million people and represent nearly 99 per cent of all businesses in the EU.<sup>14</sup> SMEs also play a key role during twin transitions in addressing the challenges related to climate change, resource efficiency, digitalisation and social cohesion with their creative solutions. Therefore, SMEs have the potential to contribute to improving competitiveness, economic and technological sovereignty, prosperity and resilience of the EU. Given their essential role in the EU economy, SMEs should be better supported to thrive by accelerating their digitalisation and greening process. SMEs will also benefit from an undistorted market where more established corporate players are not permitted to abuse of their more dominant market position and the emergence of oligopolistic or oligopsonistic markets.

Another area where the EU has advanced and needs to develop further is setting (harmonised) standards through which the EU could ensure that goods and services in the market reflect the highest ethical standards (e.g. fully respecting human and labour rights during the production process and opting for sustainable production methods within and outside of the EU) and working conditions (e.g. fully respecting and enforcing labour standards along the lines of ILO) that are in line with the objectives of the sustainable development goals and the European Green Deal. Not only is the single market a key institutional instrument for such standards within the EU, but its size as the largest market in the world allows the EU to use its 'soft'

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<sup>14</sup> [https://ec.europa.eu/growth/smes\\_en](https://ec.europa.eu/growth/smes_en)



economic power to impose them onto third parties through trade agreements. Whereas today actors in the EU sometimes pursue different and even divergent agendas, an integrated approach, bringing together national governments, Commission, Council and Parliament, will strengthen the EU's internal resolve and project the same values outwards.

The single market remains inextricably linked to the four freedoms, both in terms of its functioning and in terms of its ability to deliver prosperity and peace for the European continent. However, the centrality of the four freedoms should not generate a tunnel vision whereby furthering the functioning of the single market necessarily, let alone exclusively, depends on dismantling all obstacles restricting the free movement of goods, services, capital and persons. This is so, arguably, for three key reasons.

Firstly, the four freedoms have been integrated and liberalized for a number of decades now, thanks to a relentless effort on the part of both the EU law making institutions and the European Court of Justice. While these advances must be maintained, and while there is consensus that certain freedoms (e.g. free movement of capital, or free movement of services) and within those freedoms certain particular dimensions or sectors (e.g. cross border lending, or digital services) could be integrated further, it is fair to suggest that few 'low hanging fruits' remain and that further integration would require a substantial political effort, as well as a certain degree of creativity, on the part of the EU and national institutions.

Secondly, while there are some margins for further integration in respect of some freedoms, these margins often impinge on a variety of national political and even cultural sensitivities. From protected designation of origin schemes to 'country of origin' principles, to accessing certain forms of welfare allowances or financial benefits without being economically active or deeply connected to the host country, there is no shortage of examples of such sensitivities.

Thirdly, as also noted by a recent policy brief by the Delors Institute,<sup>15</sup> the full implementation of the four freedoms 'would require a large number of national reforms and compromises at EU level', with many fearing that 'opening up the economy could exacerbate growing inequality'. There is a concern that a further liberalization of certain dimensions of the four freedoms in a context of growing national and regional, as well as social and economic, inequalities, could be politically risky and even counterproductive.

On balance, while it would appear that further market integration, and further single market deliverables, could be achieved by integrating more deeply the four freedoms, this would be a politically demanding and even risky task, without many obvious low hanging fruits, and with increasingly clear 'diminishing returns' considering current advances and the effort required to push some agendas further. It is therefore arguable that while the freedoms on which the single market is premised need to be preserved, a much more ambitious strategy for the renewal and the rethinking of the single market project can be better articulated in connection with reforms that would release the environmental and social sustainability potential of the European economic integration project while at the same time ensuring its resilience as a strategic objective. The following chapters provide a deeper analytical framework along these crucial dimensions before coming up with more targeted proposals and areas of action to rethink and recalibrate the single market. To help rationalize the overall analysis and structure

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<sup>15</sup> <https://institutdelors.eu/wp-content/uploads/2018/01/171024jdigrundfreiheitenenwebeinzelseiten4.pdf>

of the report, the elements of the following SWOT framework are integrated and addressed throughout the report.

**Table 1 Underlying SWOT framework for rethinking the European Single Market**

<b>Strengths</b>	<b>Weaknesses</b>	<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>➤ Highly skilled workforce</li> <li>➤ Exemplary EU social acquis</li> <li>➤ Standard setting capacity</li> <li>➤ Industrial capacity and enabling ecosystems</li> <li>➤ Resilience</li> </ul>	<ul style="list-style-type: none"> <li>➤ Policy fragmentation and coordination across different competences</li> <li>➤ Strategic dependencies</li> <li>➤ Ageing and declining populations and workforce</li> <li>➤ Digital competitiveness</li> </ul>	<ul style="list-style-type: none"> <li>➤ Green transition</li> <li>➤ Digital transformation</li> <li>➤ Energy transition and expansion of renewable energy</li> <li>➤ Open strategic autonomy</li> <li>➤ Social/Green market stabilisation</li> </ul>	<ul style="list-style-type: none"> <li>➤ Climate change</li> <li>➤ Biodiversity loss</li> <li>➤ Political polarisation</li> <li>➤ Rising geopolitical rivalry</li> <li>➤ Rising inequalities</li> <li>➤ Market/integration fatigue</li> </ul>

## 2. Rethinking the Single Market

### Introduction

Against the background described in the previous chapter, the rest of the report focuses further on the importance and strategic opportunities of the European single market in a changing geopolitical, technological, socioeconomic and environmental context. While doing this, the report aims to provide a strategic analysis of the European single market, after taking stock of its previous achievements, assessing its current challenges as well as threats, considering its potentials and opportunities in the context of current and future societal, economic and geopolitical challenges, the green transition and the digital transformation. Along these lines, the concept of open strategic autonomy has also gained further importance first following the recent Covid-19 pandemic and more recently in conjunction with the war in Ukraine, at the doorstep of the EU.

This chapter introduces very briefly the following three chapters by building a narrative about how the strengths of single market could be enhanced and harnessed in order for the EU to succeed in delivering on what is arguably its number one challenge: a just green transition. We argue that a just transition can only be successfully achieved if it is jointly green (as part of the *dual transition axis* including both green objectives such as emissions reductions targets by the committed deadlines, preserving biodiversity, avoiding the degradation of the environment, but also objectives to lead the digital transformation in the economy, technology, innovation etc.) and just (as part of the *social sustainability axis* ensuring that nobody is left behind and that vulnerabilities and inequalities faced during transitions are properly addressed) and at the same time fully reconcilable with the socioeconomic and geopolitical resilience of the European project (the *open strategic autonomy axis*). All of these complex axes require a recalibration of the single market, and this recalibration would also be fully in line – in fact it would finally give full expression – to the dicta of TEU on the highly competitive social market economy that also respects environmental sustainability.

At the heart of this report rests the belief that the important challenges connected to the European Green Deal and, in the interim, the ambitious targets included in the ‘Fit for 55’ package, will require a rebalancing of the functioning of the single market in a way that can both facilitate reaching these goals and, at the same time, ensure the political stability and viability of the European integration project. In simpler terms the report would explore ways in which it would be possible to recalibrate some aspects of the single market’s functioning in order to make it fit for the next, challenging, decade.

### 2.1. Harnessing the strengths of the single market to achieve the EU’s sustainability and resilience goals

The constantly evolving economic, technological, environmental and geopolitical contexts generate the need to adapt the internal and external policies that make up the single market project (and beyond). The existing gaps coupled with the changing needs of the market imply that the whole single market project needs a recalibration of its key levers and parameters. That does not necessarily mean to abandon it and start anew, but rather adapting the existing system to the needs of the current and future challenges. As put in the words by Micossi (2016), “the completion of the SEM (single European market) has become a moving target, requiring continuing adaptation.... The changing economic environment, including globalisation, the

development of new technologies and the increased prominence of environmental issues in public policy, also greatly contributed to the legislative agenda, with new demands from the public and member states (‘widening’), and a continuing need to review and adapt existing legislation (‘deepening’).”

In what follows, we pursue the following methodology. We begin by briefly outlining the analytical elements underpinning the three key axes that will need addressing in the process leading to the recalibration of the single market. After laying the ground for a more normative analysis for each axis, these axes will then be explored in greater detail in the following three chapters. Following that, the three axes will be integrated through a scenario-building exercise, in which the report will propose and develop scenarios for each axis individually and then sketch how interactions could evolve in a separate chapter. While describing the combined scenarios, the report will also elaborate which key levers and parameters would be necessary to achieve these scenarios (some of which might be more ambitious than others) in the rethinking of the European single market.

### ***2.1.1 The dual transitions axis: green transition and digital transformation***

The ever-increasing resource exigency and degrading biodiversity as a result of industrialisation and various other human activities have led to unprecedented levels of greenhouse gas emissions in the atmosphere leading to global warming and climate change with long-lasting impacts on the whole ecosystem. As a way to address this systemic challenge and ensure a green transition to avoid irreparable and uncontrolled environmental repercussions in the decades to come, ambitious policy and industrial objectives have been put forward by policymakers around the world. In December 2019, the EU came up with its ambitious European Green Deal that encompasses various dimensions ranging from energy production and consumption to agricultural sector reforms and circular economy actions in order to reduce emissions by 55% by 2030 compared to 1990 levels and achieve carbon neutrality by 2050.

While, as humans, we have the right to clean air, water and access to nature for survival, our current consumption and production patterns are putting a lot of pressure on what are ultimately scarce and finite resources, causing environmental degradation and risking the sustainability of ecosystems. Moreover, the green transition will have a major impact on global value chains in various aspects, for example, by putting pressures to shorten value chains as a way to decrease the carbon footprint and alleviate social costs (Hancké and Mathei 2022). Along these lines, Raworth (2017) proposes a new way of thinking about the economy, in which there is “a social foundation of well-being that no one should fall below, and an ecological ceiling of planetary pressure that we should not go beyond. Between the two lies a safe and just space for all.” (p. 11). The shape of a doughnut summarises the safe zone where the two limits – social deprivations and environmental boundaries – should be reconciled.

Resource efficiency is a key component of the European Green Deal towards achieving a sustainable and carbon-neutral economic system. To this aim, the Circular Economy Action Plan is being put in place to scale up circularity in the system that keeps resource consumption within planetary boundaries and reduces import dependence on raw materials or other resources, by recycling used resources, reducing resource exigency, waste and pollution and

ensuring a well-functioning internal market for high quality secondary raw materials.<sup>16</sup> This is a key building block of a sustainable product policy framework, in which consumers are also empowered with cost-saving opportunities through repair or product maintenance services and trustworthy information on the environmental footprint of products they want to purchase. All these and more circular economy actions are essential to reduce the negative impacts on the environment and for the preservation of biodiversity and natural capital and thus contribute to reducing import dependence, resource demand and ecological footprint.

But these, and other related, strategies will also have an impact on the single market as they ‘may distort supply, demand and trade in the major producing regions, including the EU, inducing price variability and spikes that could have serious socio-economic impacts’ (European Commission 2021a). To avoid or reduce unequal distributional effects, green transitions should be accompanied by fair transitions, where people and industries are supported fairly and adequately during green transformation processes. This can facilitate the acceptance of transitions by society at a large scale and reduce likely tensions. Therefore, EU policies and strategies need to tackle in a fair manner these tensions and conflicts that come as a by-product of green transitions.

On the digital front, technological progress and digitalisation have been transforming almost all aspects of our economies and labour markets. While digital tools have been increasing productivity and efficiency, automation has been disrupting workplaces and can create job losses in some sectors. Life-long learning, upskilling, and reskilling will need to accompany workers to be digitally fit in performing transformed tasks. Remote work and other types of digital platform work will continue to expand, transforming conventional work arrangements offering flexibility over working hours and workplaces, but these developments need to be carefully monitored to minimise precariousness, ensure fair wages and social protection for workers as well as work-life balance.

Digital technologies are also intimately connected to the climate challenge, to the point that Commission officials often profess that ‘There is no Green Deal without a Digital transition’ (Maes 2021). Verdolini (ETUI 2022 forthcoming) rightly posits that these technologies have enabled and are enabling the diffusion of novel low-carbon solutions in all sectors; that they contribute to energy and material efficiency through real-time sensing, connectivity and prediction, the reorganization of production, and additive manufacturing (Watanabe et al. 2000; Sarc et al. 2019; Sun et al. 2021). But she also notes that while digital technologies promote increased production and consumption, they put pressure on earth rare materials, generate waste, and consume energy to operate. So once more their functioning and spread of use needs to be assessed and monitored carefully in order fully to evaluate their overall impact on the green transition processes promoted by the EU.

Last but not least digital technologies are linked to the single market project by virtue of being either goods or services in free circulation. The EU has developed a dedicated ‘Digital Agenda’ with instruments and strategies for the fostering of digital services, digital products, and promoting and regulating advanced digital technologies, including those based on artificial intelligence systems.

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<sup>16</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>

### **2.1.2. The social sustainability axis**

The current state of the EU social market economy is the outcome of a long and gradual development of the social mandate of EU along with its other key policy areas. From the outset, the EU has always had some social legislation, including within its treaties, especially in the domain of equal pay and equality legislation (as epitomised by what used to be Article 119 of the original Treaty of Rome, now Article 157 TFEU). Currently, Article 3(3) of the Treaty on European Union stipulates that, among others, the EU’s aim is to “promote peace, its values and the well-being of its people, offering its citizens an area of freedom, security and justice without internal frontiers” and “combat social exclusion and discrimination, promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child.”<sup>17</sup> In this vein, the EU social acquis and social aspirations have progressively evolved in order to complete the single European market, also with the view of establishing a floor of rights in domains such health and safety at work, working conditions, and some areas of free movement and even corporate law more intimately connected with workers rights (European Commission 2016). Following the Lisbon Treaty in 2009, the EU has included for the first time in its own treaties the concept of a highly competitive social market economy that aims at full employment and social progress.

The importance of fairness has been specifically underlined in a range of more recent policy initiatives, most visibly since the adoption and proclamation, in 2017, of the European Pillar of Social Rights. As a matter of fact, social fairness constitutes one of the six priorities of the Commission for 2019-2024.<sup>18</sup> More broadly, building and maintaining a fair and well-functioning Europe and strengthening its social dimension are key political priorities of the EU. As a major geopolitical actor, the EU needs to ensure social fairness internally to set the example, but also the standard, in the social domain on the global scene, which might also leverage its positions at international level, for example, by showing its commitment to Sustainable Development Goals. The present report highlights the structural role that ambitious social and green policies would have in stabilising the single market, while at the same time offering the skills necessary to meet the challenges arising from these important transitions.

As mentioned above, another relevant milestone marking one of the key achievements of EU policymaking in the social domain is the proclamation of the European Pillar of Social Rights in 2017, a remarkable hybrid document, part-white paper, part-charter of rights. Building on existing legislation and provisions, the Pillar has acted as a catalyst to launch a new wave of regulatory instruments in the social and labour law domains. The pillar includes 20 principles structured around three people-centred and social dimensions including: (i) equal opportunities and access to the labour market (e.g. education, training and life-long learning, gender equality), (ii) fair working conditions (e.g. right to fair wages, healthy, safe and well-adapted work environment) and (iii) social protection and inclusion (e.g. right to access to health care and essential services such as water, sanitation, energy and transport, inclusion of people with disabilities). These principles are in line with the Charter of Fundamental Rights

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<sup>17</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008M003>

<sup>18</sup> [https://ec.europa.eu/info/strategy/priorities-2019-2024\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024_en)

of the EU as well as the Sustainable Development Goals and should act as a compass when designing any policy within the single market as well as in international agreements.

Following a lull during the ‘Austerity decade’ of 2007-2017, the EU can be once more credited as being a frontrunner in terms of human development and social rights and appears once more committed to delivering on the social aspirations enshrined in the Lisbon Treaty. The ‘social market economy’ combines the fundamental principles of an open market economy with targeted social policies and, comparatively speaking, generous welfare state while ensuring a fair competition and level playing field in the single market (Marktanner 2010; Wrobel 2010; Countouris 2020).

However, considering the potential disruptions that the green transition and digital transformations could produce within existing labour markets, as well as current and future challenges and shocks (e.g. the recent pandemics, geopolitical circumstances beyond the EU borders), the EU must continue to strive in its reconciliation attempts – sometimes in ways which might generate novel and interdependent disruptions to the status quo – between the (geo)political, economic, technological, industrial and environmental objectives and the social ones, ensuring an ongoing alignment between its integration processes and the principles of the European Pillar of Social Rights as well as Sustainable Development Goals. As the past experiences linked to the Services Directive and Posting of Workers Directive have shown, not integrating social dimensions into policy frameworks since the beginning can often lead to fragilities, controversies and even missed opportunities in terms of economic integration. Instead of trying to retrofit social concerns, a lesson to be learnt from these experiences could be that of, for instance, mainstreaming the relevant principles contained in the Pillar in a range of EU policies, from those aimed at strengthening the Union’s industrial production and capacity in key areas (e.g. supporting industrial alliances across Member States such as through the Important Projects of Common European Interest (IPCEI)), to those seeking to create positive employment effects in critical sectors through green transitions and reshoring processes, while protecting citizens against economic or other systemic shocks linked to these transitions and other, currently unforeseeable crises.

### **2.1.3. The open strategic autonomy axis**

Faced with the Covid-19 pandemic crisis, the concept of open strategic autonomy has quickly emerged as one of the key elements in the EU discourse and roadmap for a prompt recovery, and beyond. While the concept of strategic autonomy has been primarily used in defence, foreign and security policy domains, the Next Generation EU Communication<sup>19</sup> introduced a broader concept of open strategic autonomy defined as “shaping the new system of global economic governance and developing mutually beneficial bilateral relations, while protecting ourselves from unfair and abusive practices.” In a recent study by the European Parliament, strategic autonomy is defined as “the ability to act autonomously, to rely on one’s own resources in key strategic areas and to cooperate with partners whenever needed (European Parliament 2020a).” In line with these, the 2020 Strategic Foresight Report of the European Commission (European Commission 2020a) defined strategic autonomy as “the capacity to pursue, promote and defend ones’ strategic interests” and states that “the EU is an advocate of openness, as it is committed to multilateralism to realise global public goods.”

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<sup>19</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:456:FIN>

With the aim of expanding its concept to other domains, open strategic autonomy is also increasingly being considered across the whole spectrum of economic activities overseen by the EU, ranging from trade, industry, energy, infrastructure, or critical raw materials policies to technology including, for example, digital or communication. Some of the more recent EU policy initiatives as well as the experience from the recent pandemic suggest that an enlarged notion of open strategic autonomy is essential to attain the EU's six priorities which includes (i) EU Green Deal, (ii) an economy that works for all, (iii) securing the EU way of life, (iv) EU fit for the digital age, (v) a stronger EU in the world and (vi) EU democracy. Moreover, the ongoing war in Ukraine and the degrading geopolitical and economic relations with Russia will have unprecedented ramifications for the rethinking of the open strategic autonomy and energy independence of the EU which has been relying significantly on Russia (among others) for energy production and consumption. As explored further in Chapter 5 below, the recent war has again altered the political discourse surrounding the EU concept of open strategic autonomy, emphasising once more its security and defence oriented traits.

While the broadened concept of open strategic autonomy predominantly touches upon economic and technological dimensions beyond conventional foreign policy, security and defence aspects, this report argues that social and environmental aspects are also equally important and should be strengthened and highlighted further. From the social perspective, including this particular dimension in the concept is paradigmatic of the opportunities linked to expanding the idea of OSA (for example to allow the concept to act as a vehicle for reshoring certain jobs to Europe in the context of shortened supply chains) but also of the risks linked to inaction (for instance if OSA were sucked into a defence-oriented 'tunnel vision' that would strain public budgets at the expenses of welfare and other social expenditure). Such an approach would decrease the likelihood of a disconnect between policies and people and, it could thus facilitate wider social engagement in and acceptance of a political and economic agenda that remains to be explained to the wider European population – working for and with citizens – and minimise discontent. Extending the open strategic autonomy concept to cover environmental dimensions will take into account ecological footprints as drivers of climate change and leading to reduction in capacity to access to key resources (e.g. raw materials, water, energy, food), which can aggravate human health, security, economy, well-being and, even, survival. This also requires a careful consideration of the coordination of distinct policy competences at the EU and national levels as well as interlinkages and feedback loops across different policy dimensions.

Moreover, reconciling the objectives of open strategic autonomy with the functioning of the single market will require combining competition policies, state aid and procurement policies, industrial policies and trade policies in a way that increases the ability of the EU to steer industrial, environmental and social development without undermining the benefits of the single market (for more details, see chapter 3 and 5). It will also allow the EU to reduce its technological dependence on external sources for certain key products by diversifying its sources of supply in the face of shortages of raw materials or other disruptions in supply chains.

Importantly, this process of integration between different policy goals, areas and, inevitably, of policy instruments will require a careful balancing act. Paradoxically, some of the challenges that the EU is currently confronted with are in part the by-product of the single market's undeniable success. Three areas of tension stand out in this respect. Firstly, tighter economic integration and increased competition have led to 'thinner', often less resilient value chains,



in which parts suppliers and other subcontractors reflect local comparative advantages in different jurisdictions within and outside the EU. Secondly, the emphasis on level playing fields in the single market doctrine has often curtailed possibilities for active industrial policies. Finally, the high-value added, knowledge intensive specialisation of much of European industry makes a return to lower-value added activities (such as the production of mature semiconductor for cars and personal computers) harder to accomplish.

## **2.2. Institutional levers and regulatory constraints**

Last but not least it is important to elaborate on, and factor in, the key role and untapped potential of some of the central regulatory institutions pertaining to the functioning of the single market project, in particular rules on state aid, competition law, public procurement legislation, as tools for harnessing the strengths of the Single Market in order to achieve Europe policy goals such as the ones outlined in the previous sections.

A recent example of the potential of these rules emerges from an instrument in the domain of State Aid controls adopted in the early days of the Covid-19 pandemic in order to permit national governments to introduce strong countercyclical business subsidies: the Temporary Framework for State Aid<sup>20</sup> (“TF”) established on 19 March 2020 and extended until the 30<sup>th</sup> of June 2022. The TF allowed Member States to counteract the economic losses and keep businesses afloat during multiple lockdowns. The TF has been welcomed by Member States as they could efficiently and swiftly support their national economies. According to the Commission, until September 2021 more than 650 decisions on aid were implemented, amounting to around 3 trillion EUR in authorised aid to undertakings in difficulty.<sup>21</sup> According to Biondi (2022) the aim of the TF is twofold: first, to apply State aid control in a ‘targeted and proportionate manner’, so as to ensure that national measures help the undertakings which suffered the most the consequences of the Covid-19 outbreak; secondly, to ‘frame’ the national support measures into the State aid control system so as to guarantee that the EU Internal Market level playing field stays intact. The Framework, therefore, while emphasising that this is not the time for harmful subsidy races, departs from the orthodox state aid rules, and also allows a coordinated and proportionate application of State aid rules that could be vital in preserving at least some level of European solidarity. A key question arises as to whether adjustments similar to the orthodox rules on state aid, similar to the ones contained in the TF, could be replicated in the future in order to pursue other policy priorities pertaining to a sustainable and strategically sovereign European economic integration model.

A further example, this time of the constraints arising from the current regulatory framework sustaining competition rules, is provided by the litigation surrounding the attempted merger between Alstom and Siemens. Rubini (2022) notes that the Commission objected to the said merger because of the distortions it would have caused in the EU internal market. The parties complained that the Commission had not considered that the market was not limited to the EU but rather truly global, and that a major competitor of both Siemens and Alstom was *China Railway Rolling Stock Corporation* (CRRC), a Chinese state-owned enterprise heavily

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<sup>20</sup> Communication from the Commission, Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak, C (2021) 8442, 18.11.2021.

<sup>21</sup> See at [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_21\\_4948](https://ec.europa.eu/commission/presscorner/detail/en/ip_21_4948). See Biondi A. (2021:363-376); Agnolucci I. (2022)

subsidised,<sup>22</sup> and not subject to any form of control comparable to EU State aid rules. Whether similar concerns should be taken into consideration in the context of proposed mergers between firms in sectors that are strategically important for the achievement of sustainability and strategic autonomy goals remains an open discussion, explored in the following sections of this paper. Two things are clear, however. In the aftermath of the Commission's objection to the Alstom and Siemens merger, the French and German governments issued a joint 'A Franco-German Manifesto for a European industrial policy fit for the 21st Century',<sup>23</sup> that for all purposes advocates 'changes to existing European competition rules' in order to 'take greater account of competition at the global level, [and] give the European Commission more flexibility when assessing relevant markets'. Some of the proposals contained in that Manifesto, for instance the suggestion to 'consider a right of appeal of the Council which could ultimately override Commission decisions ... subject to strict conditions' would involve a paradigm shift in current EU competition law rules, in effect allowing political choices in favour of greater concentration in certain sectors to override technocratic decisions of competition authorities in favour of competitive markets. We note that while these ideas have encountered some support in some quarters of the European political sphere,<sup>24</sup> several member states objected to these proposals,<sup>25</sup> although the debate is arguably ongoing.<sup>26</sup> It is also clear that the emergence or promotion of 'European champions' would raise a number of questions as to the social sustainability of these companies that would, by definition, establish themselves as oligopolistic players in particular sectors and labour markets, requiring some necessary adjustments and guarantees in the social and labour domain as well. While the analysis contained in this report is firmly located within a constitutional vision of a 'competitive social market economy, in the following pages we do elaborate on some mitigating strategies should the EU decide to loosen its current merger control framework (a political decision well beyond the remit of this work and that the current report is therefore neutral about).

Elaborating on the constraints to these levers (and their compatibility and relationship with World Trade Organisation (WTO) rules, EU Free Trade Agreements (FTAs), Specific Grant Agreement (SGA), fragmentation of the system of production, supply chains etc.) and how to push the current boundaries (including by using the purchasing power of the single market as a bargaining chip in future FTA etc.), are issues that will be further explored in the following sections.

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<sup>22</sup> According to *Global Trade Alert*, CRRC would have received annual subsidies equal to USD 2485 million in 2016, USD 1653 million in 2017 and USD 2063 million in 2018: [www.globaltradealert.org](http://www.globaltradealert.org) ("Intervention 77444", "Intervention 77445").

<sup>23</sup> Bundesministerium für Wirtschaft und Energie und ministère de l'Économie et des Finances (2019) 'A Franco-German Manifesto for a European industrial policy fit for the 21st Century' available at <https://www.bmwk.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf%3Fblob%3DpublicationFile%26v%3D2>

<sup>24</sup> Guy Verhofstadt (2019), 'Europe's Missing Champions' Project Syndicate, available at <https://www.project-syndicate.org/onpoint/europe-s-missing-champions-by-guy-verhofstadt-2019-03>

<sup>25</sup> "The governments of Sweden, Belgium, Finland, Denmark and Portugal all spoke out publicly against the

Manifesto', cf. Amory, B, et al, (2019), 'Beyond Alstom-Siemens: Is there a need to revise competition law goals?' available at <https://www.jonesday.com/-/media/files/publications/2020/09/beyond-alstomsiemens--is-there-a-need-to-revise-competition-law-goals.pdf>

<sup>26</sup> <https://euobserver.com/world/153557>



### **3. The 'dual transition' axis**

#### **Introduction**

Like many other advanced economies, Europe is facing two transitions simultaneously. The first one, often characterised as the fourth technological or digital revolution, is based on advanced automation, the developing internet (of things), artificial intelligence and the primacy of software over hardware. These technological shifts will have significant but not yet fully known effects on growth patterns, sources of tax revenue, skills and other aspects of human capital formation, organisational forms, various economic models and broader societal and economic relations, including labour relations.

The second transitions (that could also be characterised as a shock) – the climate crisis – is forcing the (advanced capitalist) world (and beyond) into rethinking many economic processes from the ground up to with the view of reducing their carbon intensity and ecological footprint in general: from carbon-neutral transport and energy systems, the reduction of wasteful products and generally 'cheap' consumption, to low-carbon organisational innovations. However, the green transition is a bumpy road with various challenges ranging from the availability of, and dependence on, critical raw materials, some sector-specific challenges in energy-intensive industries and rising socioeconomic inequalities, to barriers to the rapid deployment of renewable energy sources, the transformation of existing economic and production models towards cleaner and circular ways of production and consumption, just to name a few.

In short, the economic processes at the basis of the single market are slowly being reconfigured under the pressures of digitalisation and decarbonisation. This is likely to lead to significant disruption in all aspects of our economies as well as social dislocation. While Europe's social market economy has been relatively inclusive so far (and has retained some space for national policies aimed at confronting social exclusion) especially compared to other economic blocs, more fragmentation is likely to occur, not least because these revolutions are likely to have significant pre- and re-distributive effects. This also necessitates rethinking how to counterbalance differential regional effects of the transitions to prevent new fault lines emerging.

In this chapter, we first highlight the main characteristics and issues of each of the transitions and then consider them jointly within the context of the single market. The chapter then elaborates on various types of reforms, instruments and institutions pertaining to the functioning of the single market that would enable the latter to become a net contributor to the delivery of the EU's objectives in the dual transition. In some cases, a fully-fledged reform (e.g. further revising of public procurement, rethinking state aid rules or other competition regulations) and legislative change might be necessary to ensure a proper alignment with the key elements of the digital transformations while being on track towards a net-zero carbon economy, while in other areas, a clarification of existing frameworks and regulations or their readjustments as well as soft law approaches (e.g. guidelines) may be needed to reconcile the sometimes competing effects of digitalisation, the green transition, competitiveness and social resilience.

### 3.1. Accelerated technological revolution

The last two decades have witnessed a sharp increase in processes associated with innovation, digitisation, and automation. In principle, the digital transition offers plenty of benefits. It increases productivity and aggregate economic performance. It also holds the promise of eliminating dangerous and onerous jobs, while supporting workers with high skills by reducing their time spent on simple tasks. At its most general level, automation frees up time for other economic or social activities, much as Keynes suggested in his 1930 essay on the *Economic Possibilities for our Grandchildren*. And the pace and type of automation today embodies the prospect of new solutions to (perhaps currently unknown) problems. In sum, and on balance, automation is ripe with opportunities. However, it also embodies potentially dark social futures and stark political choices. Understanding these is key to making the digital transition not only an economic but also a social success, contributing to political stability.

There is discussion about the distant causes of the current technological acceleration: is technology a driver or a reflection of economic conditions and social and political choices? A consensus has emerged, however, about the short-term relation with the economy. In that perspective, automation poses the highest risks for jobs that consist of many routine tasks and are relatively easy to codify. Separate analyses (with different methodologies) have estimated the share of such jobs at around 45% of those currently existing (Frey and Osborne 2017; Josten and Lordan 2019). Taking into consideration that manufacturing accounts for less than 25% of employment in most EU economies, this number implies that automation will not be limited to production of goods but also affect about a third of service jobs. The increased application of ‘machine learning’ techniques (commonly referred to as ‘artificial intelligence’) is, in addition, likely to raise this share. While the prospect of new jobs potentially emerging in new (though yet unidentified) markets means that net job losses will be (probably considerably) lower than the share implied earlier, it is certain that the digital transition will lead to significant short-term social disruption.

Importantly, in a fundamental sense innovation thrives on inequality. Consequently, accelerating innovation produces high rewards for the few, in stock options and other ‘rents’, while leaving out those whose direct contribution to innovation has been minimal. Nowhere has this been clearer, perhaps, than in the recent development of Covid-19 vaccines.

Innovation also leads to starker regional inequalities through clustering effects: computers and software in Silicon Valley, and biotech in the two Cambridges, MA and UK. Among the many reasons for their success is the closeness of universities and other scientific organisations that produce a local high-skill, high-wage labour market for scientists. In sum, without measures to accompany its impact, innovation is likely to lead to many new or increased social inequalities – in income, working conditions, life chances more generally, and even political influence over important decisions that affect those.

Skills face a very different situation but with similar consequences. The crucial fear that has driven most of the debates on automation over the last decade has been that robots will replace human labour. In a world without institutions, rules and social conventions, that may indeed be the secular impact; but in the real world of European political economies, automation effects are filtered through institutional settings. Formalised workers’ participation is one of

the defining characteristics of labour markets of the EU's socio-economic model. They influence how technology finds its way into the workplace and mitigate negative employment effects. The labour-exclusive effects of automation therefore very strongly depend on the ability of social actors to influence its deployment ex ante and accompany negative effects to contain them. Germany's Industry 4.0 project is a well-known example of this: companies, works councils, trade unions and public actors cooperate to maximise the joint positive economic and social effects. Workers' participation models are therefore powerful tools to make innovation more labour inclusive; but since not all industrial relations systems start from the same place, they need to be contextualised.

Automation also works best when it supports human work instead of competing with it. In fact, there is some, perhaps slightly counterintuitive, evidence that automation is not a zero-sum game in which machines displace jobs, but that skills, institutionalised workers' participation and automation can interact in a virtuous cycle. Countries with strong co-determination institutions have a higher robot density than those with weaker or no workers' participation schemes (Van Overbeke 2021). And some of the leading analysts of automation suggest that the benefits for firms of automation are larger when they complement rather than compete with human skills (Brynjolfsson and McAfee 2014).

If skills have such a crucial role in bringing out more of the benefits of automation, then they become a crucial strategic asset, which has to be managed carefully and collectively across the economy. Governments play an (obvious) critical role in this process, in two ways: first as providers of basic education and in many places also the framework for higher education; second as regulators, through direct intervention or by offering a framework for others to negotiate. Employers and business associations, the ultimate 'consumers' of skills, also have an obvious place at the table. And organised labour, as the collective representative of new skilled workers, plays the dual role of 'quality control' (making sure skills reflect workers' needs as well as those of companies) and of setting framework conditions through collective bargaining to make skill acquisition a sensible investment for workers and employers.

The emergence of a knowledge economy is the wider shift heralded by automation and new jobs. Automation will affect many workers and households in the middle of the income distribution. The increasing economic role of information, creativity, science, and handling of symbols instead of producing goods or providing tangible services, in turn, is likely to lead to a sharp increase in income inequality between the top 5-10% of earners and the rest. Many of the predicted changes in the production of goods and services are characterised by an increase in conceptual tasks for a small (top) group in the labour market, a sharp loss of autonomy and skills in the middle segment, and an increase in hard-to-automate but relatively simple tasks at the bottom of the labour market.<sup>27</sup> The top stratum will do extremely well in such a scenario, while the middle is hollowed out, losing jobs and forced to accept lower wages because of de-skilling. The asymmetric distribution of rewards goes well beyond science-based knowledge work. The remuneration structure in organisations has become such that highly-paid conceptual work has been concentrated in executive positions, which other members of organisations – from middle management to workers – are expected to execute. This

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<sup>27</sup> As a rule of thumb, employment shares can be thought of as 10-15% at the top, 60-70% in the middle, and 20-25% at the bottom, with some local variation.

hierarchical organisational structure reflects the equally hierarchical reward structure, in which a few wins massively while many lose out in relative terms.

This ‘knowledge economy’ that we see developing today is an elitist project (Unger 2019); therefore, with the bulk of its financial and emotional rewards accruing to a small number of employees, while jobs for the majority remain mired in old hierarchical ways. This not only sets back the life chances of individual workers more than it should, but it is also problematic for the economy since we underutilise the creative and productive potential and unique sources of prosperity in Europe – innovation and skills.

The digital transition thus throws up a series of challenges for any economic project that aims to further efficiency, social cohesion and political stability, and which are difficult to address with traditional institutional means. How well is Europe prepared to engage this process? In many ways, the EU (and wider Europe) starts from a very strong position. But there are gaps – not least because of the radically uncertain future.

In recent years, EU-level R&D funds have not been expanded (and some even cut. But this relative EU-level deficit should not hide that the research and educational systems in the member states, often supported by (albeit somewhat diminished) EU funding and programmes, remain world class. The continent scores high on patenting, R&D and other measures of innovation, and even though it harbours relatively few ‘unicorns’, it compensates that with a vast stratum of highly competitive SMEs, and globally leading engineering firms. In addition, many young people in today finish post-secondary studies, and many of those who do not end up in high-level apprenticeship systems that secures them a decent job, and companies a high skill level. (That said, a small but significant minority of young people never finish their studies with portable skills and thus find themselves excluded from the labour market.)

Very often among policymakers, innovation is associated with ‘blockbuster’ results – radical shifts into new technologies and product markets, and on that measure, Europe is relatively weak. However, such a pessimistic assessment ignores that innovation in Europe typically takes a very different, less dramatic but perhaps more sustainable form, building on deep technological competencies by employees, including engineers, small companies in supply chains, and close operational links between companies in implicit or formal joint ventures. Combined, the research and education systems confer a high capacity for such an incremental innovation, especially in sectors where high specific skills, deep knowledge of technology, and vertical exchange of tacit knowledge between engineers and workers is crucial. In contrast, sectors where innovation relies on rapid shifts in competencies to reflect product market shifts fare less well in this broad social innovation system; trade with economies in which such ‘radical’ innovation models prevail is therefore necessary, as it ensures mutual benefits.

Decision-making structures in the economy in most of the EU also prepares the continent quite well for the coming shifts. At many levels of the economy, it involves crucial stakeholders: political representatives of business and labour in parliaments, information exchange and consultation in macro-economic policymaking, wage negotiations and other labour market governance mechanisms in sectors, and institutionalised workers’ participation in companies.

While varying in organisation and strength across the EU, such intricate multi-level decision-making patterns not only allow many alternative adjustment strategies to find a place on agendas, but they also guarantee that negative distributive effects of important changes remain under control. Usually, these arrangements are underpinned by hard legal and institutional constraints, for example on company restructuring processes, that avoid unnecessary social costs, and compensate those who stand to lose from the adjustment. Decision-making processes may be slower than in systems with unilateral, top-down structures, but they are also more inclusive – with the added benefit of more rapid, and often more successful, implementation.

In sum, these two key supply-side characteristics of the social market economy in the EU suggest that the digital transition could be an economic success, with manageable social costs. The necessary elements for that combination exist, and governments and social partners in many member states are able to address the problem. The availability of structures, however, is a necessary but far from a sufficient condition. Making the digital transition in Europe a success requires building political instruments, both in the sense of power resources and policies, to ensure that economic and social progress continue to proceed in lockstep during the current technological shocks.

### **3.2. Belated but urgent green transition**

The world has been experiencing rising temperatures with extreme weather conditions over the last decades. Seventeen of the 18 warmest years on earth have occurred over the last two decades (European Commission 2018b) and this pattern is only being confirmed as time goes on. The accumulation of carbon dioxide – the main cause of rising temperatures – in the atmosphere has steadily increased, reaching its highest level in May 2020 (despite the Covid lockdown measures<sup>28</sup>). Global warming will therefore continue in the future, even if measures to tackle it are taken and scrupulously implemented. The unprecedented levels of greenhouse gas emissions in the atmosphere, as a combined result of various developments such as ever-increasing resource exigency, rapid industrialisation and other human activities, are posing a significant burden on keeping global warming under control, preventing the loss of biodiversity and wildlife. These developments imply everlasting impacts on the whole planetary ecosystem and will threaten the livelihood of all inhabitants of the planet.

Climate change will trigger environmental developments that modify the availability of materials and resources and endanger the sustainability of production chains, by changing the set of critical assets or dependencies. Climate change also threatens various aspects of everyday life including agricultural yields due to droughts, floods or wildfires, hence increasing the risks of food shortages and laying bare food supply dependencies on other countries.

While climate change has been documented as a problem for over twenty years, the political debate only gathered pace after the Stern (2006) Review and the IPCC report (2007). As a result, we are now implementing a delayed green transition, planned over the next decade

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<sup>28</sup> <https://www.nationalgeographic.com/science/2020/05/plunge-in-carbon-emissions-lockdowns-will-not-slow-climate-change/>



rather than over one or two generations. This delay is now acting as a pressure cooker, imposing steeper trade-offs than an earlier, more measured transition would have imposed.

The recent Intergovernmental Panel on Climate Change (IPCC) released its Special Report on 1.5°C, which suggests that there are important differences in scenarios depending on whether the target of stabilisation of temperatures is put at 1.5°C or 2.0°C, with the risk of reaching dangerous tipping points in the latter case.<sup>29</sup> Based on these scenarios, the High-level Panel of the European Decarbonisation Initiative highlights that a “very ambitious R&I programme, capable of delivering the zero-carbon solutions (is) needed, while also promoting industrial competitiveness in the EU economy, is one of the necessary means – even if not sufficient – to achieve the goal” (European Commission 2018a). In particular, a comprehensive set of measures to reduce greenhouse gas emissions (mitigation) and to increase resilience against the impacts of climate change (adaptation) will be necessary to limit the negative effects of the climate emergency in the medium to long run. According to the OECD (2015), adaptation planning needs to be flexible and integrated to policy making, with a risk-assessment-based approach.

Despite many – often unforeseeable - challenges and a range of unpredictably risk scenarios, rising temperatures could be kept under control through green transitions, which involve proactive and ambitious initiatives such as carbon-neutrality over the next three decades and other strategies that aim at reducing environmental degradation. To address this systemic challenge and ensure a green transition to avoid catastrophic situations in the decades to come, a series of policy and industrial objectives have indeed been put forward by policymakers around the world, including the ambitious European Green Deal. Proposed in December 2019. The initiatives in the European Green Deal cover areas from energy production and consumption, agricultural production and the food sector, and circular economy actions to control resource exigency, with the overall objective to curb greenhouse gas emissions by 55% by 2030 and achieve net-zero carbon neutrality by 2050 for the EU.

The EU economies – like many others – depend on natural resources including air, water, soil, minerals, biomass, wind, geothermal, tidal, and solar energy, which are crucial for the functioning of economies as well as the quality of life as put forward in the roadmap to a resource efficient Europe.<sup>30</sup> However, currently existing consumption and production patterns put a lot of pressure on the scarce resources leading to environmental degradation and risking the sustainability of ecosystems. This is where the framework about planetary boundaries as proposed by Raworth (2017: 11) becomes relevant in rethinking economic models based on the doughnut vision. This should ideally include “a social foundation of well-being that no one should fall below, and an ecological ceiling of planetary pressure that we should not go beyond. Between the two lies a safe and just space for all”, which takes the shape of a doughnut – hence the term doughnut economics – where the two limits, social deprivations and planetary boundaries, can be reconciled. These two limits alert us to two key issues in the green transition: on the one hand, environmental boundaries that require careful management of resources and increase their efficiency, while minimizing the ecological footprint; on the other hand, the social cost that should be avoided by ensuring a just and fair transition that leaves no one behind towards a net-zero carbon future. There is a growing

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<sup>29</sup> <https://www.ipcc.ch/sr15/chapter/spm/>

<sup>30</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011DC0571&from=EN>

interest to implement such a doughnut vision that would require a shift in how the economies would be used to work, ranging from modified production and consumption patterns (e.g. more in line with circular economy practices) to how to use scarce resources in a way that does not deplete these resources (e.g. adopting strong regulatory oversight on environmental matters) while boosting prosperity (e.g. ensuring a floor in line with the Sustainable Development Goals).

Decreasing resource exigency and boosting the efficiency of resource use is one of the key priorities of the European Green Deal. The Circular Economy Action Plan addresses this issue in several ways: by reducing resource exigency; by promoting and scaling up the circularity of (raw) materials in the system; by recycling resources; by reducing waste and pollution; and ensuring a well-functioning internal market for high quality secondary raw materials.<sup>31</sup> This circular economy action package constitutes one of the key building blocks of a sustainable product policy framework, which also includes consumers through cost-saving opportunities in repair or product maintenance services and trustworthy information on the environmental footprint of products. As a by-product, increasing circularity in the EU not only eases the strain on natural resources in general but also reduces import dependence on raw materials from abroad.

Similar to high social standards in a market economy, the EU has high environmental standards and ambitious carbon-neutrality objectives, which underpin sustainable agriculture practices that are threatened by climate change. At the same time, extreme weather conditions (such as heavy rainfall, sudden snowmelt causing flooding, and droughts) threaten agricultural production, while human impact threatens marine ecosystems.<sup>32</sup> In this vein, the Farm2Fork Strategy<sup>33</sup> and Biodiversity Strategy<sup>34</sup> are supporting complementary elements of the overarching European Green Deal. They address the challenges of sustainable food systems, proposing climate change adaptation measures to improve resilience, reducing vulnerabilities, preserving nature, and reversing of the degradation of ecosystems, and acknowledging the vital link between healthy people, healthy societies and a healthy planet. However, the success of these strategies will depend on various factors including the pace of climate change and environmental degradation and successful implementation of policies with public and private buy-in.

While agricultural production and food security are essential needs of the citizens in the EU, the importance of a robust and resilient food system has been further emphasised during the Covid-19 pandemic. The recent crises, from the pandemic to the war in Ukraine, have also revealed the strong interdependencies between health, ecosystems, food supply chains, consumption patterns and planetary boundaries. The EU is committed to maintain a healthy and nutritious food supply chain that works for consumers and producers by respecting the environment and reducing its ecological footprint. Moreover, sustainable European food systems could also help raise food standards globally and pave the way towards sustainable ecosystems across the globe. All these elements underpin the leadership of the EU in healthy

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<sup>31</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>

<sup>32</sup> <https://science.sciencemag.org/content/319/5865/948>

<sup>33</sup> [https://ec.europa.eu/food/farm2fork\\_en](https://ec.europa.eu/food/farm2fork_en)

<sup>34</sup> [https://ec.europa.eu/environment/strategy/biodiversity-strategy-2030\\_en](https://ec.europa.eu/environment/strategy/biodiversity-strategy-2030_en)

food and good farming practices in international relations and agreements, which more and more touch upon environmental dimensions and sustainable production in many policy fields.

However, the green transition will – like the digital transition – have disruptive effects on societies and established economic systems. Especially, green transitions will have unequal impacts on citizens who are employed in sectors directly dependent on fossil fuels as well as those in the secondary sectors serving the primary sectors (e.g., ground services in airports, conglomerate business activities serving towns with coal mines) causing negative economic and labour market effects. These unequal distributional effects will create tensions, which can increase divisions in the society. Moreover, energy transitions are expected to translate into increases in energy-related expenses at least until 2030, causing negative budget effects on households (European Commission 2018b). For example, the *gilets jaunes* (yellow vest) movement was a backlash against the measures of carbon taxation in France, because lower- and middle-income households paid relatively more of that tax on top of the existing deeper socioeconomic and environment-related challenges (e.g. rising transport sector emissions). Beyond 2030, the estimated energy expenses show upward or downward variance depending on the scenario considered (European Commission 2018b). These forecasts and energy price volatilities are further exacerbated by the ongoing war in Ukraine and swinging geopolitical relations between the EU and Russia on matters of energy dependence and will likely lead to deepening inequalities.

On the positive outlook, whilst coal mines and other sectors heavily dependent on fossil fuels will lose jobs, new jobs will be created in sustainable and clean energy sectors during transitions. According to the ILO (2018), the low-carbon transitions could increase EU jobs by 2 million compared to a business-as-usual case by 2030. Similarly, using simulations based on ambitious climate policies, employment gains of ecological transitions is estimated at around 1.5 to 2 million jobs in Europe in 2050 (European Commission 2019a). While these numbers are small, amounting to a small fraction of total EU jobs, employment in environmental goods and services is likely to increase over the next few decades, and could make up as much as ten per cent by the middle of the century. Circular economy action plans, when implemented fully, will generate jobs in repair and maintenance of electronic goods, for example, while reducing transport costs (and CO<sub>2</sub> emissions associated with global imports). Through renovation and refurbishment of old buildings, the construction sector will generate jobs, increase energy efficiency and climate-proof critical infrastructures, decreasing energy consumption.

Interestingly, most of the employment effects in the green transition are likely to manifest themselves in other ways. An approach that looks at tasks within jobs, instead of jobs within sectors, yields a much more dynamic picture (Bowen and Kuralvayeva 2015). First of all, sectors with a high proportion of ‘brown’ tasks, such as energy and manufacturing, are declining across the EU, while (very) low carbon sectors in services are on the rise. All other things equal, secular shifts in the economy over the last five decades have dramatically reduced CO<sub>2</sub> emissions by themselves. Second, sectors have core skill profiles, which determine the greening strategy. Where jobs are based primarily on deep, specific skills which cannot easily be deployed outside the sector where they are required, ‘greening’ will primarily take place within existing jobs through the addition of new tasks and retraining. This will include many of the EU’s sophisticated manufacturing sectors. Where skills are ‘general’ – more portable across companies and industries – green adjustment in the labour market will primarily follow a pattern of removing ‘brown’ and hiring ‘green’ workers (Hancké and Mathei 2022).

To avoid or reduce unequal distributional effects, green transitions should be accompanied by fair transitions, where people and industries are supported fairly and adequately during green transformations. Therefore, the EU policies and strategies need to tackle in a fair manner these tensions and conflicts that come as a by-product of green transitions. Ensuring fair and just transitions in the face of climate change is essential in contributing to the resilience of the single market by supporting workers previously employed in polluting sectors, equipping them with necessary skills and orienting them towards cleaner and strategic sectors reducing energy dependencies of the EU, and by facilitating public acceptance of climate actions. At the same time, shaping the clean energy sector within the single market may create an opportunity to ease tensions (e.g. energy poverty linked to high energy prices or energy inefficiencies), whereby the EU can obtain social buy-in by balancing increasing clean energy production, energy security and support to new firms and business models that will allow for declining costs of clean energy.

### **3.3. A combined technological and green transition**

Two transitions take place at the same time; in some areas they reinforce each other, while in others they raise very different problems and exacerbate pre-existing challenges. On the one hand, digital technologies allow measuring more precisely the exact greenhouse gas emissions or capture the damage of global warming on the ecosystems through regular satellite images, thus contributing to the knowledge about climate emergency. Similarly, as we will detail below, digital transformations could also offer opportunities to cut down ecological footprint. On the other hand, and as suggested earlier, both of these transitions are disruptive in their own ways and can also make things worse if not managed carefully. For example, digital and technological advancements are creating different types of resource exigencies (e.g. for batteries for which raw materials are scarce and concentrated in a few regions in the world) and can also lead to further emissions if not kept under control. The key challenge for the EU single market would be to strike a balance that ensures these transitions to reinforce each other, while remaining socially and environmentally sustainable.

The recently updated EU Industrial Strategy aims for a globally competitive, green and digital EU where “Europe’s industry lead(s) the twin (*sic*) transitions towards climate neutrality and digital leadership.<sup>35</sup>” The importance of leading simultaneously on the dual transitions has been emphasised in several policy frameworks and strategies including the European Green Deal and the accompanying Fit for 55 package as well. From this perspective, it is indispensable to aim for a green transition with the aforementioned ambitious climate targets without a strong digital component that accompanies the ecological agenda.

As reported in the science for policy report by the Joint Research Centre of the European Commission (Cagnin et al. 2021), developing further the deep tech not only is instrumental for the overall economy and society more broadly, but it also has the potential to address some of the challenges, including the climate emergency. For instance, boosting investment in green tech and breakthrough innovation have the potential to speed up the decarbonisation process. Especially, digital transformations can unlock technologies to curb carbon emissions or improve carbon capture in certain sectors including construction, industry and agriculture.

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<sup>35</sup> [https://ec.europa.eu/commission/presscorner/detail/en/fs\\_20\\_425](https://ec.europa.eu/commission/presscorner/detail/en/fs_20_425)

Transport will be the pioneering sector. The electrification of mobility (e.g. automation of transport, developing software for smart and cleaner mobility options) showcases the situation whereby the two transitions can go hand in hand. While transport and mobility services are fundamental components safeguarding the economy and social life and they comprise a complex network of public and private companies contributing to the free movement of persons and goods within the single market (European Commission 2019b), this sector has also been singled out for its environmental footprint and its need to be clean, future-proof and affordable, necessitating further investments to achieve zero-emission mobility solutions.

In the construction sector, automation and technological advancements allow for smart equipment and buildings in which, for instance, lighting, heating and cooling or ventilation systems could be optimised and where various other issues (e.g. humidity, leakage) could be detected in real time, which would then decrease unnecessary energy use and hence improve energy efficiency of buildings overall. Similarly, granular digital measurement technologies could lead to less raw material use in various areas, including less steel use in buildings as far as the building structure remains safe.<sup>36</sup>

Another area where the two transitions could reinforce each other is circular economy and relatedly waste management. There is an emerging field in which advances in robotics, artificial intelligence and other technological improvements could boost the circular economy actions and better manage waste (particularly electronic or e-waste). E-waste usually consists of a complex mixture of materials and components that could be hazardous to the environment and human health, if not managed or recycled properly.<sup>37</sup> According to the recent Eurostat figures, a little less than half of the overall e-waste is recycled in the EU in 2019, compared to the target of 65%.<sup>38</sup> Moreover, various artificial intelligence techniques are being offered to improve waste-sorting of materials such as plastic<sup>39</sup> that are then issued to the Digital Product Passport providing further transparency in the recycling chain.

Against this background of large possibilities of digital technologies in supporting ecological objectives, the question arises on how to scale up the deployment of such tools to achieve economies with net-zero carbon emissions. SMEs are the backbone of the European economy and prosperity, and their involvement in leading digital and green transitions is therefore crucial in achieving climate targets. However, some transformations are disruptive for SMEs as well, and they need significant investments. Besides various funds and support measures, including the funding coming from the Recovery and Resilience Facility of the Next Generation EU, another relevant option would be to scale up the framework of the IPCEI to come up with strategic projects combining leading technologies with green objectives, such as green hydrogen or other strategic areas or green innovation, through which the EU can work further to decrease its ecological footprint as well as external dependencies.

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<sup>36</sup> <https://www.euractiv.com/section/energy-environment/news/no-green-deal-without-digital-eu-official-says/>

<sup>37</sup> [https://ec.europa.eu/environment/ecoap/about-action-plan/objectives-methodology\\_en#:~:text=Eco%2Dinnovation%20at%20the%20heart%20of%20EU%20policies&text=The%20EU's%20economic%20prosperity%20and,in%20the%20years%20to%20come.](https://ec.europa.eu/environment/ecoap/about-action-plan/objectives-methodology_en#:~:text=Eco%2Dinnovation%20at%20the%20heart%20of%20EU%20policies&text=The%20EU's%20economic%20prosperity%20and,in%20the%20years%20to%20come.)

<sup>38</sup> [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Waste\\_statistics\\_-\\_electrical\\_and\\_electronic\\_equipment&oldid=496674](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Waste_statistics_-_electrical_and_electronic_equipment&oldid=496674)

<sup>39</sup> <https://www.oecd.org/env/waste/recircle.htm>

From the perspective of the labour market, the dual transition has already transformed the world of work through its impact on sectors, workplaces and skills. Meanwhile, the Covid-19 pandemic has caused millions of job losses – some of which might be permanent – and appears to have accelerated the ongoing trends on digital transformation (e.g. automation, digital work, telework, remote work). However, since not all workers have the necessary skills and competences to move to new jobs or be reskilled to adapt to the changing work environment in the face of the dual transition, they risk being left behind. Forward-looking labour market analyses that involve identifying new skills and new jobs will, therefore, be needed to guide the education and training curricula to ensure that the skills supply match the labour market needs in relevant industries during the dual transitions. For example, the availability of big data providing real-time information on labour markets (e.g. job portals, online vacancies and resumes) is one way to closely follow the dynamics on the two sides of labour market needs (i.e. jobseekers and employers) for such matching. In this case, labour market policies will need to go hand in hand with big data analysis.

### **3.4. Harnessing the single market to support the dual transition**

Against the background in this chapter on dual transitions, there are a number of instruments and tools pertaining to the functioning of the single market that would enable the latter to become a net contributor to the delivery of the dual transition goals. These instruments and tools consist of already existing regulations, rules and practices, such as public procurement, state aid rules, merger controls and other more general competitiveness regulations which require recalibration and continuous rethinking so that the single market closely follows the economic, social, environmental and other strategic developments in the EU (and beyond) and ensure that social and environmental sustainability is respected and open strategic autonomy is advanced. In what follows, we briefly elaborate on these instruments highlighting their potential as a tool to harness the strengths of the single market facing current and future challenges.<sup>40</sup>

#### **3.4.1 Public procurement**

Public procurement mainly refers to a public contract between the contracting authority (i.e. the government) and the supplier, in which the government buys goods and services from the supplier by using public funds from the commercial market in order to address the needs to carry out its functions (Andhov 2022). There are a number of EU-level directives containing the rules of the public procurement operation with the overall objective “to open up the market of public contracts through efficient competition through a set of rules that ensures equal treatment of tenderers and transparency in the award of public contracts” (see Andhov 2022). One of the key principles of these processes is to follow the economic rationale (i.e. the best value determines the choice) and EU procurement rules (e.g. transparency, equality etc.).

While its main function is to match the need of a government through a contract with the supplier, the public procurement has been more and more used as a tool to achieve other goals ranging from environmental protection to promotion of innovation and other social considerations (see, among others, a thorough analysis of integrating social and

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<sup>40</sup> For further technical and legal details of these instruments, we refer to accompanying working papers within this project framework.

environmental dimensions in public procurement at all stages by Van den Abeele 2014). In particular, given the increasing relevance of climate emergency in many aspects of the EU economies, the importance of sustainability has also increased in the context of public procurement, as a result of which Green Public Procurement (GPP) and Sustainable Public Procurement (SPP) have emerged. GPP is defined as a process in which “public authorities seek to purchase goods, services and works with a reduced environmental impact throughout their life-cycle compared to goods, services and works with the same primary function which would otherwise be procured.<sup>41</sup>” In a similar vein, SPP is defined as “a process by which public authorities seek to achieve an appropriate balance between the three pillars of sustainable development – economic, social and environmental – when procuring goods, services and works at all stages of the project” (ibid).

As described in detail by Andhov (2022), public buyers can influence the behaviour of the tenderers, for example, by imposing green standards whereby production of goods and services rely on clean energy sources or energy-efficient methods. This process could incentivise the tenderers to further develop green technologies and products to win the public contract, and thus could harness the strength of the single market along the EU policy goals and objectives to lead the dual transitions. Andhov (2022) argues that there is still untapped potential of public procurement to contribute to green transition, by introducing EU-wide mandatory minimum green criteria. One such area is the implementation of the Circular Economy Action Plan and Sustainable Product Policy, which can offer leverage to the public buyer to transform what they buy from the market. Another relevant element here is the recent proposal for Corporate Sustainability Due Diligence Directive, which can “foster sustainable and responsible corporate behaviour throughout the global value chains” and offer further leverage to the contracting authorities to “monitor their supply chains for risks of breaches of environmental and social rules” (Andhov 2022). Of course, challenges remain in enforcement in general and there is certainly some leeway for Member States to steer (or not sufficiently) the implementation of public procurement along the social and green dimensions.

### **3.4.2 State aid**

As a key tool in market interventions by governments, state aid is mainly used “by national governments for directing public resources towards ‘public needs’, ... to attract private actors or to stimulate private investment, R&D activities, green supportive measures or instead to rescue or promote the growth of local industries; with the looming danger of those policies triggering anti-competitive behaviours and protectionism” (Biondi 2022). While the formal state aid rules have almost not changed since the Treaty of Rome in 1957, the scope and implementation of state aid control has been adjusted significantly over the last decades (ibid). In addition to the formal rules, a number of soft law practices and guidelines have also emerged over time with the objective to foster competitive behaviour and good business practices across the EU.

However, the economic developments such as the Great Financial Crisis of 2008, the recent Covid-19 pandemic or the 2022 war in Ukraine have imposed changes in and adaptations of state aid rules, which overall have provided a certain degree of flexibility to the Member States in managing their state aid facing various challenges.

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<sup>41</sup> [https://ec.europa.eu/environment/gpp/versus\\_en.htm](https://ec.europa.eu/environment/gpp/versus_en.htm)

In terms of the relevance of state aid rules to harness the strength of the single market to ensure social and environmental sustainability while leading on the dual transitions strategically, similar to the logic in public procurement, the objectives pertaining to the dual transitions could be incorporated and further developed into the state aid rules in the form of a conditionality, despite resistance to it sometimes. As Biondi (2022) describes it, “nation states could require beneficiaries to meet a certain share of energy consumption by renewable energies, or to invest in energy efficiency.” However, the increasing use of soft law practices and risks of abuses therein, implementation of such conditionalities should be closely monitored. The potential distortions or asymmetries in resources of Member States notwithstanding, state aid framework is “pivotal in providing an EU-wide legal framework backing Member States’ efforts to reach ... climate targets” (Biondi 2022) as well as digital transformation objectives. Moreover, the extent of measures that can be exempted from state aid control has been enlarged to include many measures ranging from those aiming at curbing greenhouse gas emissions to those improving energy efficiency of buildings or even support clean mobility or build alliances in certain digital areas such as chips and semiconductors (ibid).

### **3.4.3 Competitiveness and level-playing field**

The competitiveness of the European single markets is one of its key principles. To maintain and enable competitiveness in the single market, the European Commission supports “among others, reforms to strengthen the SME sector, reduce market barriers, facilitate foreign investment and trade, develop the digital economy, stimulate research and innovation, manage public–private partnerships and improve the governance of state-owned enterprises.<sup>42</sup>” Various EU competition law instruments as well as other international trade agreements to which the EU is a party (e.g. the WTO law) govern the issues of competitiveness in the single market. In that respect, as Rubini (2022) puts it, the dual transition is “dramatically changing the socioeconomic and regulatory landscape in many countries and, as such, it is inevitably affecting government action and competitive conditions in which companies operate.” However, the issues of green transition have not been sufficiently included in the competition laws until recently, late 2020 for that matter, when the Commission launched a consultation on how to rethink of competition policy to support the European Green Deal, looking for guidance to adapt antitrust and merger laws and practices to make them compatible with the climate objectives (ibid). For example, given the increasing role of environmental and sustainability considerations, suggestions were made to reflect consumer preferences for environmental friendliness or other sustainable product features when pursuing antitrust or merger investigations. Similarly, when considering mergers and acquisitions cases, the importance (and protection) of green innovation (particularly by smaller companies) was emphasised to be sure that incumbents do not lead to ‘killer acquisitions’ and that the latter are also following environmentally friendly business strategies overall (Rubini).

However, there are challenges in reconciling certain industrial policy considerations (particularly along the intersection of dual transition and open strategic autonomy axes, e.g. creating European champions in a limited number of sectors of strategic importance) with the existing competition rules of the single market. For example, despite their claimed strategic

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<sup>42</sup> [https://ec.europa.eu/reform-support/what-we-do/competitiveness\\_en](https://ec.europa.eu/reform-support/what-we-do/competitiveness_en)



importance – especially following the Covid-19 pandemic and the ongoing geopolitical swings – supporting or strengthening national champions would clash with competitiveness rules and merger controls. Similar concerns are raised about foreign subsidies which need to be monitored for their potential distortive impacts in the single market. The current existing regulation of foreign subsidies (from May 2021) gives the European Commission the power to investigate financial contributions originating from a non-EU country and which benefit companies operating in the European single market. If need be, the Commission has the right to redress the related distortion caused by foreign subsidies through a number of tools available (for more details see Rubini 2022).

Last but not least, the proposed Carbon Border Adjustment Mechanism (CBAM), together with the existing European Emissions Trading System (ETS), would allow the “EU importers to buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced under the EU’s carbon pricing rules. Conversely, if a non-EU producer can show that they have already paid a price for the carbon used in the production of the imported goods in a third country, the corresponding cost could be fully deducted for the EU importer” (Rubini 2022). Through CBAM, the fundamental objective is to prevent ‘carbon leakage’, which refers to the risk that companies could move carbon-intensive production to non-EU countries with more relaxed carbon pricing, if at all (Kiss-Dobroyni and Fazekas 2022). Despite its ambition and role in the fight against climate change, there are also contested issues – such as compatibility of WTO law requirements – concerning the implementation of the CBAM. There are also disparities in how carbon price is calculated abroad and how these differences could be reflected in applying the CBAM.

### **3.5. Discussion and outlook**

How will the dual transition in the EU play out? In this chapter and in the next two, we will address that question by discussing a small number of possible scenarios that are to varying degrees compatible with existing actors and arrangements in Europe. Which scenario will prevail is a matter of politics – of collective choices we make in the deliberative institutions that define European democracies – and of policies, the tools to pursue collectively defined targets, within a historical, institutional and political context. With regards to the dual transition, we see three groups of possible scenarios.

#### **Scenario 1: Social minimalism redux (S1)**

The first scenario offers the baseline: a fast dual transition constrained only by limited social shock absorbers. While unlikely, it is a stark reminder of how previous large-scale processes of industrial readjustment, in the steel industry and coal in the 1970s and 1980s, have played out in various (then) EU member states. When active change management was low, and social inclusivity was an afterthought rather than a guiding principle, the results were almost always socially, political, and often economically, inferior (Auer 1991). This minimalist scenario also has another benefit, in that it suggests the gains to be had from thicker institutional contexts and more active policies. In the limiting case, this scenario suggests the costs (and benefits, but we see few) of essentially leaving adjustment to the market. Anything that deviates from that will alter the cost-benefit analysis and thus allow for more informed political-economic choices.

The tools for this scenario are minimal. Industrial restructuring will entail mass bankruptcies throughout the different value chains involved in automation and decarbonisation. That, in turn, will lead to significant job losses and de-skilling of large shares of employees, with a deterioration of wages and working conditions as a result. Accompanying measures are limited to time-limited income support, a modicum of retraining efforts and relocation premia, and EU-level cohesion, restructuring, and recovery and resilience funds. In its organisation and content, the policy framework and orientation perhaps remind us most of the restructuring in the British mining industry in the 1980s, where entire communities were left to fend for themselves, labour markets disintegrated.

The outcomes of such a minimally interventionist scenario are therefore easy to identify. They can perhaps best be captured in a series of contradictions – rising aggregate competitiveness against regional destitution; increased polarisation in the labour market, with falling social cohesion and rising inequality as a result; increasing political instability as a result of, first, disenfranchisement and then alienation; and ultimately a society in which winners and losers of the dual transition are pitted against each other in a zero-sum conflict.

Ultimately, this is an unstable political-economic situation, which is likely to lead to a social backlash along the lines of the *gilets jaunes* in France – a revolt by the left behind in the ‘places that do not matter’. However, the two transitions are not symmetric in this regard. Since technology cannot easily be politically blocked without endangering companies, jobs and the economy at large, the existential anger will be directed mainly to the green transition. The chances of a conservative producer coalition, which tries to safeguard its specific assets (skills and capital) stalls or significantly slows down the green transition, will increase dramatically.

‘It could not happen here’ is the wrong reply. Much like a robot photo in a police station, this scenario combines discrete elements of past adjustment (‘policies’) in Europe in a single configuration. In past and current member states as diverse as France, the UK, Italy, Germany and some of the new member states some of these elements played out – fortunately not in its entirety – with recognisable consequences.<sup>43</sup> We have a good sense of how a socially polarising transition unfolded then. We have the means to avoid it now.

## **Scenario 2: The reactive social market economy (S2)**

In this second scenario, which is close to the world as we know it today, and therefore also (statically) the most likely in our view, the transitions themselves remain very similar to Scenario 1: a socially ‘passive’ introduction of digital transformation and green transition. However, an important difference is that it includes considerably more significant accompanying social measures to limit the negative impact of the dual transition on jobs, skills, and life chances more generally. At different levels in the economy – shop floor, company, sector, nationally and EU-wide – stakeholders are consulted about the transitions and their possible effects, and training, innovation, and redevelopment funds are made available to address the need for competitiveness and social adjustment.

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<sup>43</sup> In the US this has been the dominant adjustment strategy in old economic sectors. To wit: Detroit, the steel industry in the ‘Rust Belt’, and farming communities in the Midwest have all been left to themselves when world markets turned against their products. President Trump’s electoral reservoir was disproportionately concentrated in these regions, as the cliff hanger results in Ohio and Pennsylvania (once solidly blue-collar Democratic electorates) illustrate.

As this short sketch suggests, this scenario builds largely on existing institutions of economic governance in companies, regions and the national and European economies. All member states know some form of social dialogue, and in most of the EU employees have a voice in company decision-making – from information and consultation rights to a hard veto. While there are problems with these participation systems – the willingness of employers to share information and the expertise by unions to develop a sophisticated understanding of plans and possible alternatives – these arrangements offer a potentially strong starting point. And if the transitions announce themselves as complex and require recourse to the tacit skills of the workforce, as we suggested earlier, then including employees in these strategic areas may become a competitive necessity. We explore that possibility in scenario 3 below.

These elements of social adjustment are also reflected in the wider regional, national and European-level accompanying policies. Social plans, funded by industry in some member states or the public purse in others, have traditionally been the backstop for major industrial restructuring efforts. They usually operate in two stages: minimising direct negative employment effects, and compensation and retraining arrangements for employees who stand to lose their job. We suspect that many company-level social plans will have to be rolled into wider restructuring funds in the case of the dual transition, because of the high cost of restructuring against the background of steep write-offs in dedicated physical and human capital. Many regions that have become dependent on a relatively small number of industries and sectors will feel the shock in collapsing local economic activity and soaring unemployment and poverty.

Key elements of adjustment finance will therefore include a short-term transition funds geared towards green and digital restructuring efforts in companies and medium-term job adjustments. This would have to be linked to a ‘just transition’ fund that compensates or retrains employees that lose out in the dual transition – even though the latter raises the problems of how to define future skill requirements and of developing platforms to gather, process and discuss that information in a highly uncertain technological and economic environment (Hancké 2020a). Industrial policy options remain limited, primarily because of its necessary compatibility with the existing (restrictive) interpretation of the single market.

In sum, the dual transition in Europe will be flanked by the social market economy in Europe. The transitions run their course, possibly aided by policies that stimulate innovation and economic restructuring, while governments and social partners search for ways to alleviate the social cost. This is a tried and tested recipe, as the textile, steel and coal crises since the 1970s suggest. But it also risks becoming a very expensive solution. Instead of a single sector, all of the continent’s economic activity, in private and public sectors, is implicated in the green transition, all manufacturing sectors in the digital transition, and many service jobs will be affected as well. While passive adjustment may be the most likely answer to the dual transition, its repercussions will remain with us for a long time.

### **Scenario 3: Proactive, inclusive transitions (S3)**

That raises the question of a more active (instead of passive) response to the challenges raised by the dual transition. Not only is active governance of change likely to reduce the up-front costs of adjustment by pursuing alternatives to expensive passive adjustment processes. It will also ensure that less tangible social costs, such as skill depreciation and long-term regional decline are eased or avoided altogether.

Below a short sketch of such an adjustment scenario. In essence, it consists of three mutually reinforcing elements. The first is the institution of a proactive social impact assessment of the dual transition's effects to avoid expensive post-hoc compensation policies. Knowing what you're up against, in its many expressions, is a first step toward handling the problem. Such a social impact assessment can take many forms, from local forums over industry-wide discussions to economy-wide national or even EU-level deliberations. But all stakeholders should have a chance to voice their interpretation of the dawning problems, raise their main concerns, and are able to express the top solutions that they see. Beside increasing the possibility of compromise, such an inclusive strategy also allows different parties, with sometimes opposing interests, to understand the context for the others.

Building on this social impact assessment, and in part informed by it, the EU and the governments of the member states need to think about a more active industrial policy, especially one that furthers the development of employment-friendly technology, and which is articulated with good-jobs oriented organisational and economic change. Given that Europe's comparative advantages lie in innovation and skills (and virtually nowhere else), industrial policy needs to be organised so that it addresses both simultaneously: what good is sophisticated technology – linked to decarbonisation or not – without qualified operators staffing them? Addressing these policy needs will require a different approach to the single market, and especially to state aid programmes.

Beside shifts in existing policy frameworks, this strategy will also require considerably more sustained social dialogue, probably well beyond what exists in much of the EU today. This follows almost naturally from the economic quid pro quo: the mutually articulated implementation of industrial and innovation policies and labour market and skill policies need to be jointly managed to ensure effective, targeted and fair implementation.

While some of these arrangements may sound far-fetched, in many (north-)western European countries, embryonic arrangements for such social impact assessments and a negotiated future are already present and building on those seems easily possible. The danger, of course, is that such an outcome will lead to a multi-speed (and 'multi-road') Europe. Active institutional transfer programmes from the institutionally strong to the weaker, through one-on-one links between government and social partners from both member states could alleviate those concerns. And the EU institutions could play a significant role in incentivising member states to adopt a more inclusive approach to industrial and economic adjustment – along the lines of what the rule of law proceedings possible against current member states.

We believe that these three (families of) scenarios give a good sense of the broad possible lines of development in the EU. Individual elements may differ from these ideal-typical constructions, and the existing diversity within the EU may also shine through in their implementation. But none is purely dystopian or utopian in the conventional sense that they belong to a different political-economic realm than ours – embryonically, key elements of all three are present in the EU today, as we suggested above. But it should also be clear that all three do not have the same chances of becoming fact in the near future (and engaging on one track makes shifting tracks difficult).

We think that the order of likelihood is  $S_2 > S_3 > S_1$ .  $S_2$  has the strongest affinity with the institutions and governance mechanisms in the EU and its member states, and we think that this institutional continuity will trump the potentially massive costs of adjustment (a parallel

with the euro crisis a decade ago, where more optimal alternatives were trumped by institutional and political inertia, is instructive in that regard). We also think that S3 is more likely than S1: despite this being a departure from EU business as usual, it is a closer sibling to that than the relatively 'de-institutionalised' passive, almost Darwinian S1. That said, S1 cannot be excluded: without agreement among the EU27, and with rising costs, the EU could almost accidentally stumble into the social dystopia associated with S1. Raising that possibility in these scenarios may, we hope, be among the best ways to prevent that from happening.

## 4. The 'social sustainability' axis

### Introduction

The relationship between the single market project and social policy has been a rather complex one. Barnard argues that the lack of a European level social dimension in the Treaty of Rome was 'a victory for the classic neo-liberal market tradition: there was no need for a European level social dimension because high social standards were "rewards" for efficiency, not rigidities imposed on the market.' The report presented by Paul Henri Spaak in preparation for the Messina Conference of 1956 is oftentimes referred to as evidence of a certain social agnosticism underpinning the creation of the common market project. However, it is worth pointing out that, even there, its author clearly anticipated that for this economic project to succeed a certain level playing field in the social domain had to be established, including by means of minimum harmonization in areas such as equal pay between men and women, certain aspects of working time regulation, and the duration of paid holidays (Spaak 1956, page 66).

These, perhaps minimalistic but present, social preoccupations have developed over the decades, and successive treaty reforms, into an arguably patchy but not unambitious set of social and labour standards and rights, governance processes, and structural and ad hoc funding mechanisms (first and foremost the European Social Fund, already present in the Treaty of Rome of 1957 and now regulated under Article 162-165 TFEU) that shape what is often referred to as the European 'social *acquis*'. This *acquis*, we are reminded by the Commission working document accompanying the launch of the consultation on European Pillar of Social Rights in 2016 (SWD (2016) 50 final) 'initially evolved in order to complete the single European market', and while it would be unfair to deny that – in recent decades - it has also developed its own *raison d'être*, this nexus remains both deep and visible.

### 4.1. The nexus between the Single Market and European social policy

At its core, this nexus between single market and social policy currently revolves around three main sets of regulatory mechanisms and institutions. Firstly, a number of labour and social standards, mainly directives but sometimes regulations and recommendations, with a 'level playing field' function and a minimum harmonization, and at times coordination, *modus operandi* (more rarely a 'unification/maximum harmonisation' one). Over the years, the ambitions of this first pillar have moved beyond a minimalistic 'level playing field' rationale and have embraced a more ambitious 'social progress' rationale (see *Deutsche Post AG v Elisabeth Sievers* (C-270/97) and Article 3 TEU).

Secondly, this relationship is also shaped by a growing number of structural, investment, and ad hoc funds and instruments, with a 'solidaristic' and redistributive rationale. They include 'structural funds' such as the European Social Fund (ESF), the European agricultural guarantee fund (EAGF) and the European Regional Development Fund (ERDF), expressly referred to in Article 175 TFEU, and the Cohesion Fund, the European agricultural fund for rural development (EAFRD), and the European maritime and fisheries fund (EMFF), operating under the framework of Regulation 1303/2013. They also include a growing number

of 'special instruments' (such as the Globalisation Adjustment Fund, GAF, or the Just Transitions Fund, JTF) with their own specific regulatory framework. Specificities aside, the general objectives of the structural funds are captured by Article 174 TFEU, that refers to terms such as 'harmonious development', 'strengthening ... economic, social and territorial cohesion', 'reducing disparities between the levels of development of the various regions', in particular 'rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps'.

This redistributive and solidaristic vocation is however somewhat limited by three factors. Firstly, the resources committed to these funds vary considerably. The two funds servicing the Common Agricultural Policy, the EAGF and the EAFRD have a budget for 2021-27 amounting to €291.1 billion and €95.5 billion respectively (CAP still absorbs 1/3 of the EU budget), whereas the budget assigned to the GAF is a mere € 210 million mainly co-funding training and career advice initiatives. Secondly, the growing number of policy goals pursued by these funds has often raised concerns about 'policy overload' and 'policy dilution'<sup>44</sup>, a concern that remains relevant even after the rationalisation the regulatory framework of these funds (with the amalgamation of a number of funds into the ESF+, and essentially two regulations shaping the functioning of some 11 funds) and the reduction of the CF and ERDF goals from 11 'thematic objectives' to five 'policy objectives'. Finally, their objectives sometimes conflict with other policies of the EU, occasionally with the functioning of the single market itself, and end up correcting self-inflicted social and structural imbalances, for instance with the overall thrust of the EU's macroeconomic and structural adjustment policies during the previous, macroeconomic rigour, austerity driven, decade.<sup>45</sup>

And, thirdly, there is a more overt 'market regulation' pillar, essentially shaped by the key legal institutions encouraging the free, and undistorted, flow of the main factors of production (labour, capital) and of goods and services (within the internal market and between the internal market and a growing number of regions of the world, connected to the EU by means of Free Trade Agreements – see Cremona 2002 referring to the 'external dimension' of the single market). Historically, this third market regulation pillar has both contributed some social outcomes (e.g. by assisting unemployed workers in certain regions of Europe to find work, on an equal treatment basis, in other regions where job opportunities abounded) but also clashed with some national social policy institutions or practices, as most vividly and divisively exemplified by the seminal decisions of the Court of Justice, nearly two decades ago, in *Viking* and *Laval* (Freedland and Prassl 2014).

It is also important to recognise that in the social domain the EU does not have an exclusive competence, and that, in fact, the European social model still heavily relies on the regulatory and redistributive mechanisms of each individual member state (Giubboni 2006). This factor partly explains why, in spite of some convergence processes partly instigated by European integration itself, social outcomes vary considerable between the different countries and regions of the Union. Historically, it is fair to say that successive treaty revisions have sought to expand the supranational, EU, regulatory competence in the social field, but also that this process has rarely precluded member states from retaining or promoting higher national

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<sup>44</sup> <https://www.epc.eu/en/Publications/Can-the-EU-structural-funds-re~261024>

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[https://www.europarl.europa.eu/RegData/etudes/STUD/2017/601974/IPOL\\_STU%282017%29601974\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2017/601974/IPOL_STU%282017%29601974_EN.pdf)

social standards, their own welfare models, let alone excluded national regulatory competences as such. With some exceptions, the relationship between EU social regulation and national regulation is one where the EU sets minimum standards common to all Member States (e.g. the social policy areas falling under Article 153 TFEU) or coordinates national regulatory efforts in certain domains such as employment policy and job creation, education and vocational training (for instance under Articles 145-150, and 156 and 165-166 TFEU). More rarely the EU seeks to set standards, by means of Regulations (for instance in the area of social security and for certain aspects of free movement of workers) that supplant any pre-existing national standards, whether higher or lower, and simply 'unify the law' (for example Regulation 492/2011 on free movement of workers, or Regulation 883/2004 on the coordination of social security). On the basis of the 'principle of conferral' EU competencies in this, as in other fields, remain limited to what the treaty drafters have agreed to concede to the EU and, notably, excludes completely some policy areas from EU regulatory intervention (Article 153(5) TFEU).

To summarise, it could be said that – at its essence – European social policy pursues three main objectives essential to the functioning and the sustainability of the single market: the creation of a level playing field for fair market exchanges and competition between EU member states occasionally morphing into a more ambitious 'social progress' rationale, that also contributes to the political and social acceptance of the market integration project itself; a redistributive objective with a solidaristic rationale, best exemplified by the EU's structural and investment funds and its cohesion policy, however somewhat hampered by policy overload and policy misalignments and conflicts with other EU policies (macro and micro-economic ones); and a market functioning rationale where some of the free movement instruments prohibiting discriminatory treatment of workers, self-employed, and service providers, and coordinating social security rules or the mutual recognition of professional standards across the EU can be seen as producing some positive social outcomes, but that can also come into conflict with some fundamental national social standards.

## **4.2. The limits of the traditional understanding of the relationship between the single market and social policy: the price of inequality**

The first few decades of the common market project essentially revolved around removing discriminatory barriers to trade between countries with comparable levels of economic development (perhaps with the exception of the Italian South) and robust, if not wholly functionally equivalent, social and redistributive institutions, from labour legislation, to strong social actors operating in viable industrial relations systems, to welfare regimes that secured constitutionally protected fundamental social rights. Overall, these early years led to economic growth and convergence among participating countries.<sup>39</sup> However, already at that point, and in the early 1970s, it became clear that the market integration process generated some optimisation dynamics, for instance in terms of industrial restructuring, that were bound to create winners and losers and required some degree of regulatory harmonisation (for instance with the adoption of a directive on minimum standards in collective redundancy processes). It was only with the accession of the relatively poorer countries Ireland, Greece, Spain and Portugal in the 1970s and 1980s that the need for the EU's own cohesion policy grew considerably as divergencies and inequalities between and within EU Member States were now much more marked.<sup>40</sup>



Over the years, and in spite of the social policies outlined above, the agglomeration effect associated with continued integration of the European economies has produced deep regional inequalities between high-growth regions (usually graphically captured in the image of the so-called 'blue banana', stretching from London over Amsterdam and Brussels, to Hamburg and southern Germany, over Switzerland and Eastern France, northern Italy and north-east Spain). Deregulation in product and certain segments of the labour market, a corollary of the SEM process, has contributed to deepening inequalities within countries and across the EU in terms of (pre-tax) market income, often also with implications for the tax base that funds redistribution. While many of the new member states in the 2004 accession process have seen living standards rise, and in some countries even converge on those of old member states, the differences in many aspects of life chances – employment, pensions, income, etc. – remain stark, while demographic challenges, some triggered by internal market restructuring and internal migration processes, are a genuine concern in some parts of Europe's economic periphery.

The convergence at the start of the Single European Market project led to a vague image of a single 'representative' middle-class consumer as the key beneficiary of the process. For that group of consumers, many prices have indeed come down as a result of competition in sectors as diverse as travel, telecommunication and even imported food and wine. But for a large, growing group of lower-income consumers, with a very different basket of goods and services, this has not been the case. With the increase of income inequality, the distribution of the positive effects of the Single European Market has therefore also become more unequal.

The nexus between rising inequalities and economic underperformance has been scrutinised and assessed painstakingly in the last decade. A stalwart contributor to the early analysis of this nexus is economist Joseph Stiglitz. His seminal 2012 publication *The Price of Inequality*, best exemplifies that genre of work that, in contrast with some earlier literature (e.g. Forbes 2000<sup>46</sup>), stigmatised that 'widely unequal societies do not function efficiently, and their economies are neither stable nor sustainable in the long term' (Stiglitz 2012: 83). Subsequent work, including empirical work produced by the OECD, suggested 'that income inequality has a sizeable and statistically significant negative impact on growth, and that redistributive policies achieving greater equality in disposable income has no adverse growth consequences. Moreover, it suggests that it is inequality at the bottom of the distribution that hampers growth' (Cingano 2014).

In 2016 Stiglitz usefully identified three key channels through which inequality harms economic performance. 'First, inequality leads to weak aggregate demand. [...] Second, inequality of outcome is associated with inequality of opportunity ...[ and] the economy pays a price not only with weaker demand today, but also with lower growth in the future. [...] Third, societies with greater inequality are less likely to make public investments which enhance productivity such as in public transportation, infrastructure, technology and education' (Stiglitz, 2016). Hard data have progressively emerged that further corroborate these analyses. For instance, the 2015 OECD report 'In It Together: Why Less Inequality Benefits All', 'which draws on data for 31 OECD countries covering the period 1970-2010, finds that income inequality has a sizeable impact on growth. Between 1985 and 2005, for example, inequality rose by more than 2 Gini points on average across 19 OECD countries, an increase

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<sup>46</sup> For more details, see <https://www.aeaweb.org/articles?id=10.1257/aer.90.4.869>

estimated to have knocked 4.7 percentage points off cumulative growth between 1990 and 2010'.<sup>47</sup>

While similar nexuses also exist between, for instance, poverty and growth (Cerra et al 2021: Chapter 2), Tony Atkinson cautions us against a 'focus on poverty strategy', as the efforts to curb poverty are typically thwarted and their impact diminished when accompanied (as in the UK under New Labour governments) 'by a marked rise in top income shares' (Atkinson 2015: 24). Solely focusing on poverty reduction, without directly addressing the challenges posed by inequalities, may be politically more palatable but is unlikely to address the problem. In recent years, the World Bank has regularly suggested that tackling inequality is vital to reduce poverty, extreme poverty in particular.<sup>48</sup> At the very least poverty reduction out to be integrated with income and wealth redistribution policies aimed at reducing inequalities.

It is also increasingly evident that socio-economic inequalities have had dramatic political effects: Brexit and Trump in the US, the rise of populist parties in the EU, and the decline of the centre-Left parties and their centre-Right counterparts that were at the basis of the EU's social market economy. The inequalities have also significantly reduced territorial, national and even supra-national cohesion, expressed in re-emerging cleavages between rural and urban areas, and between wealthy economies in the core of the single market and less wealthy ones at the periphery.

It is no longer a contested position to say that the social sustainability of the European integration process is essential for that project to be politically sustainable. More than a decade ago, the report on the Single Market produced by Mario Monti clearly identified a number of challenges faced by the single market project. The first was what he defined as 'the erosion of the political and social support for market integration in Europe' shaped by two key trends, an 'integration fatigue' and a 'market fatigue'. Monti defined 'market fatigue' as closely connected to the perception of 'The market ... as unfair, having generated unacceptable inequalities; and inefficient, having attracted massive resources into financial activities whose contribution to the economy is questioned'. In his assessment of the main political attitudes towards the project, Monti identified the 'vast majority of Member States, political groups and stakeholders' (and one would add of European citizens) as those who 'regard ... the single market as an important ingredient for the economic advancement of Europe [but] consider the single market to be insufficiently mindful of other objectives (for example, social or environmental) and would support a relaunch only if accompanied by some reorientation' in these directions.

It is fair to say that little much has happened since that report was produced in 2010, to reassure European citizens that such as reorientation has indeed occurred. This is arguably due to three factors, all pointing to the emergence of inequality as a major obstacle in the path of Europe's economic and political integration, and also an impediment in Europe's plan to navigate effectively and successfully its twin transitions.

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<sup>47</sup> OECD (2015b), *In It Together: Why Less Inequality Benefits All*, OECD Publishing, available at <https://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm>

<sup>48</sup> For more details, see <https://www.worldbank.org/en/news/press-release/2016/10/02/tackling-inequality-vital-to-end-extreme-poverty-by-2030> and <https://openknowledge.worldbank.org/handle/10986/34507>.

Firstly, in a large number of Member States, from Ireland to Greece to a number of CEECs, austerity and the social conditionalities attached to the various 'bailout' agreements in the first half of that decade have simply undermined trust in the European project as a whole. They dismantled the mechanisms that reduce inequality and enable equitable growth causing lasting damage to a number of national redistributive mechanisms and institutions (from welfare systems to collective bargaining and industrial relations models). While the single market was not the main driver behind these policies, -austerity has done little to dispel either integration or market fatigue and reduce inequalities in Europe, as also acknowledged by high profile EU political figures.<sup>41</sup> A 2018 report by the European Central Bank on the topic on inequality, noted that 'Looking at the distribution of income Europe in the period 2005-2015, ...[the] lower deciles of the income distribution are the ones that have lost the largest share of total equivalised disposable income. Instead ... the 8th and 9th deciles are the ones witnessing the highest increase'.<sup>42</sup> Unsurprisingly, as noted by the Ballas, Dorling, and Hennig, 'nationalist populist trends seem to be more dominant in countries that were most badly hit by the 2008 financial crisis and austerity measures and especially where the political scapegoating of the EU has been most prevalent ... and where the social safety net protecting the most vulnerable is weakest'.<sup>43</sup>

Secondly, and this despite a policy reorientation in the second half of the decade, evidenced by the new instruments on Posted Workers and initiatives such as the European Pillar of Social Rights as well as the novel approach in responding to the challenges posed by the Covid-19 pandemic, inequalities (social, economic, territorial, labour market, and – in spite of decades of antidiscrimination legislation - even gender inequalities) in Europe have reached levels that one can only define critical and politically corrosive (see ETUI 2021). Not only have 'old' inequalities grown, but new inequalities (from teleworkability to health) have developed. Austerity, industrial change, globalisation and market integration, technological developments, have further accentuated territorial disparities and social divides. Again, while worsening inequalities are not always the direct consequence of single market integration, it is difficult not to see the nexus with some dysfunctions of the process and news headlines such as 'Amazon Europe Unit Paid No Taxes on \$55 Billion Sales in 2021' (following the previous year's 'Amazon had sales income of €44bn in Europe in 2020 but paid no corporation tax'), suggesting that – at the very least – the single market facilitates some tax optimisation strategies (that on some grounds could amount to illegal state aid) that undermine both the European and national tax base, and are an impediment to more robust redistributive policies.

Thirdly, it is now evident that Europe is confronted with some new and almost existential transitions linked to challenges that appear to be precipitating at an alarming pace, such as climate change, the rapid advance of digital technology and artificial intelligence, a worrying armed conflict that is reshaping Europe's identity from the original project of peace and prosperity to one where conflict and an accrued geopolitical and geostrategic role seem inevitable. But a large number of Europeans do not believe that the European project, as it currently stands, is able to navigate them through the treacherous waters that they see ahead of them, no doubt in great part due to the insecurity created by change in a context where the economic, social and political institutions that are tasked with allocating (fairly) risks and opportunities in society appear to have faltered and inequalities grow (in spite of unprecedented levels of public investment, as evidenced by initiatives such as Next Generation EU and the general response to the pandemic).

Unsurprisingly, the nexus between inequality, but also insecurity, and sustainability is becoming increasingly apparent and accepted across a broad spectrum of policy circles. The United Nations' own Sustainable Development Goals (SDGs), adopted in 2015 and part of the UN's 2030 Agenda for Sustainable Development, expressly refer to the concept of equality both in respect of gender equality (Goal 5) and in respect of inequality reduction within and between countries (Goal 10). No less importantly Goal 8 recognises the importance of 'Promoting full and productive employment, decent work for all and social protection', and establishes a clear link between sustainable growth and development, universalistic and robust social security and labour standards. The accompanying outcome document of the Rio +20 Conference, at paragraph 152, also stressing that 'workers should have access to education, skills, health care, social security, fundamental rights at work, social and legal protections, including occupational safety and health, and decent work opportunities'.<sup>49</sup> While the EU was initially criticised for 'the (absence of) political will to implement the UN Agenda, currently halted by internal discussions on the EU's future and ignorance of EU leaders',<sup>50</sup> in recent years SDGs have gone up the list of the Union's political priorities. This is also evidenced by the integration, since 2020, of the SDGs in the European Semester process<sup>51</sup> and the yearly SDG monitoring report becoming part of the Semester documents and each European Semester country report including a dedicated section discussing the country's status, compared to the EU average, and progress in each SDG area. This process will eventually lead into the one shaping country specific recommendations.

To conclude, the current rising levels of inequality in Europe are both hindering the full potential of the single market and generating political and social instabilities that are damaging for the sustainability of the economic integration project itself. A more equal Europe, where incomes and wealth are better distributed across its populations and where economic insecurity is mitigated by robust redistributive policies, would be a more prosperous Europe, more inclined to take risk and innovation in its stride, and more open to the restructuring processes that are necessary to meet the green transition challenges.

### **4.3. A novel approach - Harnessing the single market for social sustainability**

The previous paragraphs have identified a major obstacle in the path of Europe's economic and political integration, as well as for its efforts to manage successfully its twin transitions: inequality. Inequality is a complex and laden term. But for the purposes of this report we refer to it as a compound concept and problem that, according to the definition by Professor Pickett<sup>52</sup> (Pickett 2021), has both a 'horizontal dimension' ('inequalities between groups of people with different characteristics or who live in different places') and a 'vertical dimension'

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<sup>49</sup> United Nations (2012) The Future We Want, A/CONF.216/L.1\*

<https://wedocs.unep.org/bitstream/handle/20.500.11822/13662/N1238164.pdf?sequence=1&3BisAllowed=>

<sup>50</sup> Kamphof, R. (2018) EU and Member State Implementation of the UN Agenda 2030 and Sustainable Development Goals, Working Paper Series W-2018/1, available at <https://cris.unu.edu/sites/cris.unu.edu/files/W-2018-1.pdf>

<sup>51</sup> European Commission (2021c) Annual Sustainable Growth Survey 2022, COM(2021) 740 final, available at [https://ec.europa.eu/info/system/files/economy-finance/2022\\_european\\_semester\\_annual\\_sustainable\\_growth\\_survey.pdf](https://ec.europa.eu/info/system/files/economy-finance/2022_european_semester_annual_sustainable_growth_survey.pdf)

<sup>52</sup> [https://www.etui.org/sites/default/files/2021-12/01-ETU%20BM2021-Chapo-Guest%20editorial.%20Unequal%20Europe\\_o.pdf](https://www.etui.org/sites/default/files/2021-12/01-ETU%20BM2021-Chapo-Guest%20editorial.%20Unequal%20Europe_o.pdf)

(‘the inequalities of income and wealth, the disparities in access to power and resources’), with these two dimensions ‘intersecting and interacting’ to produce a vast palette of damaging, corrosive and socially corrosive economic and political outcomes. Beyond a certain point, inequalities make any political and economic project, socially unsustainable.

There is nothing particularly original about the suggestions that ‘EU policies and in particular further initiatives to deepen the single market can directly increase inequality’.<sup>53</sup> What is perhaps more interesting it to elaborate on the ways in which the SM project can be recalibrated as a tool to reduce inequalities, in particular by combining its proven resilience and ability to optimise the allocation of key resources and factors of production, with the type of distributive institutions that, as noted above, have existed for decades but still lack the ability to perform optimally. The three following scenarios elaborate three distinct, conceptually coherent, and incremental (in the sense of their key building blocks potentially combining with each other) sets of policy guidelines that could contribute, jointly and severally, to harnessing the social sustainability potential of a, reformed, SM.

#### **4.4. Discussion and outlook**

##### **Scenario 1: Labour market regulation and capabilities enhancement (S1)**

This first, rather minimalistic, scenario focuses around three key pillars, all by and large revolving around the concepts of ‘labour market regulation’, capabilities enhancement, and internal market efficiency.

The primary objective in this scenario is to ensure a well-functioning European labour market and rationality in decisions pertaining to labour demand and supply. By rationality we mean that business choices about human resources ought to be dictated primarily by strategic decisions about capital investment and comparative advantage, rather than, for example, by a short term and opportunistic exploitation of labour market failures, e.g. wage growth that does not reflect productivity or realistic living costs; social security and welfare contributions that are not aligned to the requirements of the country in which labour is provided; labour and health and safety standards that are inadequate or inadequately enforced; or decisions dictated by prejudice in respect of certain groups of workers and that do not lead to inclusive labour markets.

Ensuring (and enforcing) a ‘level playing field’ in social matters is central to this scenario, and it is important to acknowledge that this has been an established rationale for pre-existing waves of supranational, EU level, labour and social law measures. What this scenario is not concerned with is regulation aiming at ensuring, or securing, particular social outcomes. Certainly, some social outcomes, including in terms of higher wages, better working conditions, reduced inequalities, could well be a consequence of good, inclusive, and effective European labour market regulation, but they are not its primary objective.

So, in respect of the first pillar of this scenario, the ‘labour market regulation’ one, it is more a matter of a) expanding safety nets by identifying new areas of social policy (including social

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[https://www.strategie.gouv.fr/sites/strategie.gouv.fr/files/atoms/files/making\\_the\\_best\\_of\\_eus\\_single\\_market\\_-\\_cae-note038-en.pdf](https://www.strategie.gouv.fr/sites/strategie.gouv.fr/files/atoms/files/making_the_best_of_eus_single_market_-_cae-note038-en.pdf)

security contributions) that can be regulated at the EU level by means of minimum harmonisation with a view of avoiding or minimising ‘social dumping’ practices, and b) ensuring that these European standards are properly enforced, both at a national and supranational level.

In terms of expanding the social policy areas where the EU may want to intervene, some obvious examples would be the areas referred to in Article 153 TFEU but currently requiring unanimity vote, for example the ‘protection of workers where their employment contract is terminated’ and ‘conditions of employment for third-country nationals legally residing in Union territory’. As collective bargaining offers a very tested level playing field, obstacles that hinder its flourishing (including obstacles inherent in the regulation and functioning of the single market) should be removed. Decent minimum wages would need to be supported across the EU, and monitored regularly, while forms of work that fall outside the protective safety net of individual and collective labour law (e.g. those emerging as a consequence of technological development, or those emerging outside the traditional concept of subordinate employment) would need to be regulated and protected. Safety nets and level playing field would go hand in hand. Equal opportunities will need to be enhanced beyond the current framework, by expanding pay transparency to other protected characteristics, in particular race and ethnic background. It would be also important to ensure a level playing field by ensuring that all standards adopted are properly enforced. This could be done on a standard-by-standard basis (the model would be Directive 2014/67/EU enforcing the posted workers directive) or on a more comprehensive basis (see the proposal for an ‘Enforcement Directive’ contained in Rasnaca et al. 2022<sup>54</sup>) and by expanding the prerogatives and resources of the European Labour Authority (ELA).

As for the second pillar, the key activities falling under the concept of ‘capability’ enhancement would revolve around ensuring that Europe’s labour force has the skills and educational levels that are necessary to pursue successfully the dual transition. A labour market that cannot rely on a sufficiently and suitably skilled labour force, cannot operate efficiently. In this respect it would be important to reorientate the operation of structural and investment funds towards this primary goal and to better articulate a European skills strategy with national educational authorities and the social partners and with an employability strategy aimed at facilitating the encounter between demand and supply to facilitate the transitions. This would require introducing new EU regulatory competencies in this domain. Some recent reforms of the EU Funds already go in that direction, but more needs to be done. As noted by a recent report produced by the European Parliament, the ‘new multiannual financial framework (for the 2021-2027 period) address several of these concerns and make the first steps towards ‘socialising the budget’ in a better way and placing social investment (investment in human capital) at centre stage. However, there is still no balance between the principles of solidarity, cohesion, upward convergence and competitiveness’.<sup>55</sup>

State aid legislation could be strengthened and clarified to disincentivise fiscal regime shopping, ensuring that certain tax breaks benefiting and attracting multinationals can amount to illegal state aid. Public procurement directives and legislation that already contain references to social standards (e.g. Directive 2014/24/EU, Article 18) would benefit from

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<sup>54</sup> <https://www.bloomsbury.com/us/effective-enforcement-of-eu-labour-law-9781509944439>

<sup>55</sup> [https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/651909/EPRS\\_IDA\(2020\)651909\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/651909/EPRS_IDA(2020)651909_EN.pdf)

better enforcement for instance by giving effect to Article 18(2) and ensuring that breach must be made mandatory grounds for exclusion in line with Article 57(1) of Directive 2014/24/EU (and the other directives).

But overall under this scenario, measures would aim at maximising market functioning, reinforcing the level playing field, and ensuring that supply side measures facilitate the two transitions. Structural funds and employability activities would be tasked with fostering a certain degree of upward convergence and cohesion.

### **Scenario 2: Harnessing the pre-distributive potential of the ‘social market economy’ (S2)**

A second scenario would see the EU intervening in the social sphere beyond the minimalist approach envisaged under the ‘level playing field’ rationale discussed above, with the purpose of ensuring upward social convergence by harnessing the full potential of labour standards in terms of pre-distribution of wealth and income. The idea of ‘pre-distribution’, as originally developed by Hacker in his 2011 paper ‘The institutional foundations of middle-class democracy’, essentially postulates that policy making must focus on ‘reforms that encourage a more equal distribution of economic power and rewards even before government collects taxes or pays out benefits’<sup>56</sup>, with employment and labour reforms, including those supporting trade union activities, playing a crucial role. In consideration of the extremely limited expenditure (and fiscal) competencies of the EU, this is a particularly relevant rationale for regulatory action at a supranational level, as it allows a modicum of equitable sharing of the benefits generated by market integration, and a ‘levelling-up’ of the European project, but without requiring a politically difficult expansion of EU competencies in the fiscal sphere.

This type of intervention could be deployed along three main areas, the first one being a new wave of regulatory standards in the labour sphere aiming at upward convergence and social progress, a more ambitious objective than minimum harmonisation. The second area would focus directly on supporting and encouraging the role of social partners, both at a national, transnational, and European level. The third area of intervention would revert around the ‘external dimension’ of the single market, with FTAs concluded by the EU seeking to establish a level playing field in the social and environmental domain, including health and safety and other process related standards as a pre-condition for free trade.

As far as the adoption of new labour standards, under this scenario the EU would be channelling its regulatory efforts along three key directions. Firstly, revisiting all existing standards with the view of ‘raising the safety net’ and eliminating loopholes (opt-outs, exceptions, etc.). The Working Time Directive is a prime example of an instrument that, two decades since its latest update, could benefit from this approach, with working time progressively reduced, and the various opt-outs reined in. Secondly, identifying new areas of regulation with a direct impact on ‘levelling up’, for example introducing an EU wide definition of ‘socio-economic status’ and prohibiting both disparate treatment in connection with this new ground. EU institutions should subject all their activities to an equality impact assessment, with a focus on all protected characteristics and on territorial inequalities. Thirdly, the EU should address directly the issue of wage regulation (which, depending on the

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<sup>56</sup> [https://www.jacobhacker.com/assets/hacker\\_pn.pdf](https://www.jacobhacker.com/assets/hacker_pn.pdf)

intensity of its action, may require a treaty amendment) by ensuring that statutory minimum wages guarantee that each worker can earn a decent and similar quality of living across all Member States. The levels of statutory minimum wages should be regularly reviewed to ensure their adequacy.

As far as enhancing the role and function of social partners, the EU would be playing a crucial role. This could be achieved by three sets of actions. Firstly, the EU should ensure that none of its policy has an adverse effect on industrial relation models (as it has happened in the recent past, during the ‘austerity years’) and should in fact introduce a ‘duty to promote’ free trade unions and employer’s organisations. Secondly, the EU should make it its responsibility to promote centralised forms of national collective bargaining, primarily for the purposes of wage setting, with clear standards in terms of coverage of collective agreements across all sectors and industries. Thirdly, social partners at the EU level should be given a role in coordinating and facilitating an EU wide wage policy, to ensure that every European worker can earn a decent and similar quality of living across all Member States. Performing these roles might require clarifying further the treaty bases in the domain of collective bargaining and freedom of association, and an alignment with international standards in the domain of freedom of association for trade union purposes.

Under this scenario the single market would remain characterised by the concept of competitiveness, as per scenario 1 above, but the EU would want to invest on its external dimension, to ensure that international trade and exchanges take place on the basis of a level playing field and a progressive convergence of fundamental labour and health and safety standards. Global supply chains should be shaped by genuine comparative advantages and not by exploitative working conditions. Initiatives in this domain could include those aimed at ensuring that decent work standards are fully applied along the global value chains, including EU production and supply processes and that goods which are imported comply with qualitative ethical standards, sustainable development, and human rights standards including workers’ and trade union rights, offering certification for products abiding by this legislation. Revising FTAs and reforming EU’s Generalised Scheme of Preferences (GSP) to include strong conditionality provisions and effective and appropriate monitoring and sanctioning processes, with a more active role for European social partners and by reference to a broader set of international and EU labour and social standards would be important levers to consider in this scenario. While competitiveness would remain a foundational principle, in order not to stifle the pre-distributive potential of labour and social regulation, Treaties should be amended to clarify that social rights are fully protected and safeguarded in case of conflict with economic freedoms including via the introduction of a social progress protocol. We note that, in this domain, the European Commission has recently adopted a series of novel policy initiatives, including some aimed at allowing greater participation for civil society in the monitoring and the lodging of complaints on violations of sustainability commitments included in FTAs.<sup>57</sup>

### **Scenario 3: An ‘integrated social market economy’ - Correcting the re-distributive failures of the single market (S3)**

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<sup>57</sup> European Commission (2022c), The power of trade partnerships: together for green and just economic growth COM(2022) 409 final.



This scenario refers to a situation where European regulation in the labour and social domain seeks to address the problem of inequality by means of actions inspired by an ‘equality of outcomes’ and ‘transformative equality’ rationales. That is to say actions that seek to intervene directly in correcting inequalities (e.g. by the use of quotas, or strong redistributive action) as opposed to indirectly, (e.g. by means of ‘equal opportunities’ legislation, or –re-distributive action). This approach would also seek to ensure a certain degree of ‘transformative equality’ by redistributing power (e.g. power in decision making processes within capitalist corporations) as well as wealth. This would be the scenario where actions are more focussed on reducing inequalities in the shortest period of time, a scenario that may be necessary should current inequalities (or worsening inequalities) prove to be utterly destabilising and risked jeopardising progress in terms of the two transitions and the European economic integration project as a whole. The approach would require treaty reforms in terms of the EU’s competencies in the domain of taxation, social security, and employment policy. It would also require or benefit from a stronger involvement of the ‘state’ in running markets (certainly labour markets but possibly also markets and industries of strategic importance). It is understood that in terms of labour law and labour market regulation, this scenario would rely on the ‘widening’ and ‘deepening’ of, respectively, scenarios 1 and 2 above.

Three different set of actions could be envisaged under this scenario. Firstly, the EU should take regulatory actions aimed at fostering equality in labour market outcomes by incentivising the hiring by public and private employers of those groups that are usually most subject to discrimination (e.g. youth, elders, women, minorities, people with socio-economic disadvantages), including through subsidies and quotas (whose effects would be monitored regularly). In this respect EU regulatory action should also introduce a ‘Public sectors equality duty’ requiring EU and national institutions and public authorities to exercise their functions in a way that is designed to reduce the inequalities of outcome which result from socio-economic disadvantage, gender, race and nationality, and all other characteristics, including dual/multiple disadvantages. The scope of Article 157(4) TFEU should be clarified and expanded. All areas referred to in Article 153 TFEU should be regulated by majority vote.

A second set of action should aim at facilitating the transformation of the single market in line with the dual transition priorities by ensuring strong redistributive mechanisms and that substantial guarantees are offered to those who lose their jobs and incomes as a consequence of the transitions. In this respect it is important to remember the lessons learnt from emergency instruments such as Council Regulation 2020/672, that established S.U.R.E., and their positive impact in terms of ensuring a safe transition for millions of households whose income and jobs were disrupted during the Covid-19 pandemic, to the post-pandemic new normal. A similar mechanism could be established at a pan-European level to reduce transition (and attrition) costs. The mechanism should be coordinated with European Green skills deal and boosted and streamlined with structural and investment funds. It is clear that for such redistributive activities to occur, the EU should gain clear competencies in the fiscal domain. This should lead to harmonizing and coordinating tax policies within the Member States of the EU in order to prevent tax evasion and avoidance, avoiding tax havens within the EU and targeting offshoring within Europe, including by ensuring that decisions on tax matters can be taken by qualified majority in the Council of the EU. In addition, all companies in the EU should pay their fair share of taxes where their profits are made and a common corporate tax base or a minimum effective rate should be introduced at a pan-European level. As part of this discourse the possibility of using trade agreements as a means to enforce fair

taxation on corporate profits (perhaps by reference to the OECD's Base Erosion and Profit Shifting rules to combat tax evasion and avoidance) should attract further interest.

Thirdly, under some of the scenarios explored in the previous sections, internal market regulation may need to play a greater role in order to foster an accelerated dual transition process, in which Europe achieves a critical mass of capital accumulation in strategically important digital and green technology sectors, with a relative and perhaps temporary easing of state aid legislation and competition law, and with procurement legislation assisting in the process by giving preference to contractors and suppliers that abide by certain principles of social and environmental sustainability demanded by EU and international standards. These processes of concentration could result in the direct or indirect emergence (or even nurturing) of a new generation of 'European champions', a process that may be compatible with the idea of a competitive social market economy if this emergence took place in markets with a demonstrably strong global competition.<sup>58</sup>

Such a process however would need to be managed very carefully and be accompanied by actions aimed at mitigating the inevitable pressures that capital concentration and dominant market positions have on labour, wages, and the democratic fabric of the polity. According to economic theory (Posner 2021)<sup>59</sup> monopsonies, and to a certain degree oligopsonies, depress employment opportunities and wages. While these European champions would typically emerge in high-skill segments of the labour market, it is arguable that their dominant position would have a negative effect on both jobs and salaries. In addition, while Europe is accustomed to dealing with (national and to a certain extent European) industrial champions, with the common and single market fostering their emergence in previous decades (Maincent and Navarro 2006<sup>60</sup>), it is fair to say that – in the past – many of these companies were under some form of state control or influence, in a way modern mega corporations, especially in technologically advanced sectors, tend not to be. In order to ensure a socially balanced and democratically sustainable emergence and management of these new 'champions', the EU should introduce a new role, and new powers, for trade unions and the public interest in their corporate governance, including by means of social dialogue. From strengthening the role and prerogatives of European Works Councils and of worker representatives in the boards of companies to an open discussion about the possibility of introducing some degree of public or government control through the use of golden/priority shares at least for certain types of management decisions, there is no shortage of examples of industrial democracy institutions that would need to be revised and strengthened. Recent work by Simon Deakin has clearly established a strong link between well-functioning industrial relations and industrial democracy institutions and lower levels of inequality, in both companies and societies at large.<sup>61</sup>

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<sup>58</sup> <https://www.bruegel.org/2019/03/the-alstom-siemens-merger-and-the-need-for-european-champions/>

<sup>59</sup> <https://oxford.universitypressscholarship.com/view/10.1093/oso/9780197507629.001.0001/oso-9780197507629>

<sup>60</sup> <https://ec.europa.eu/docsroom/documents/1923/attachments/1/translations/en/renditions/native>

<sup>61</sup> Deakin, S. (2021) "Industrial Democracy and Inequality", chapter 6 in the ETUI 'Benchmarking Working Europe 2021 – Unequal Europe', ETUI Publications, Brussels available at [https://www.etui.org/sites/default/files/2021-12/01-ETU%20BM2021-Chap6-Industrial%20democracy%20and%20inequality\\_1.pdf](https://www.etui.org/sites/default/files/2021-12/01-ETU%20BM2021-Chap6-Industrial%20democracy%20and%20inequality_1.pdf)



## 5. The 'strategic autonomy' axis

### Introduction

Recent supply chain frictions have – again – put the question of Europe's external trade links on the table. While the EU is, on the whole, a relatively open trading block, it is also quite self-sufficient: before the Covid-19 pandemic and Brexit, the bulk of its trade has been with other EU member states and with the EEA, Switzerland (and, since 2021, the UK), broadly within the framework of the Single Market. However, that general favourable position hides two important points. First, the EU is highly dependent on imports in a very small number of sectors such as energy, semiconductors and raw materials that find their way into sophisticated products made in the EU. The Commission lists 137 critical products out of 5,200 (6% of EU imports). 34 out of 137 critical products deemed even more vulnerable (0.6% of total EU imports); while these are relatively small shares, they have large consequences. The collapse of the semiconductor supply chain – some of the cheapest parts in a car – has paralysed large parts of the automotive industry since mid-2020. Moreover, the lack of wire harnesses that are produced in Ukraine put additional strain in the same industry (Amann and Carey 2022; Hancké and Mathei 2021). Second, the EU's reliance on Russia for energy, and on China and other Asian states for cheap manufacturing products has grown significantly – precisely at a time that geopolitical tensions destabilise these tight links more fragile.

While there is no hard push yet for a revision of free trade deals, concerns over the EU's dependence on China and other Asian parts producers have sparked a debate on 'Open Strategic Autonomy' (OSA), the EU's capacity to develop the ability to provide critical goods and services, many of which are now imported. It is likely, however, that the EU will revise its external trade arrangements in the near future. New instruments and clauses such as CBAM, supply chain due diligence regarding forced labour, inwards FDI screening mechanisms, anti-coercion instruments, and EU standard setting will become more important in the EU's trade policies.

Thinking about OSA also implies thinking about industrial strategy and policy. The demise of 'traditional' industrial policy since the late 1980s – roughly coinciding with, though initially not triggered by, the construction of the single market – has led to an underappreciation of the complexities of OSA-oriented policies. Discussing OSA is impossible without locating it into the single market regime as it has evolved since the early 1990s, and without examining how this has shaped the options for industrial strategy and policy. Since all industrial policy is subject to single market rules regarding state aid, competition, and procurement, this triangle (OSA-single market-industrial policy) forms the central framework for analysis, reflection, and policy. Gone are the days when governments could simply subsidise a new sector or product line into existence, followed by preferential treatment in government contracts.

Successful industrial policy that would increase Europe's strategic autonomy is also subject to a series of first- and second-order institutional and economic conditions: how do we balance the potential benefits of building more resilient local supply against the potential costs of setting up such sectors where they do not or barely exist now? This question is particularly important in the case of the semiconductor debate, and the electrification of automotive transport. When setting up such sectors *ex nihilo* proves too costly or viable in the EU, we

discuss alternative options and strategies that could strengthen the resilience of the supply chains.

## **5.1. What is open strategic autonomy?**

Open Strategic Autonomy is a vague concept, without a standard definition – even its proponents do not fully agree on what OSA is and are vague about what it is not. The area it covers is also a matter of debate: for some, it must include security and defence capacities, while others concentrate almost exclusively on industrial policy dimensions. More recently, arguments have been proposed to increase its dimensions also to cover social and environmental considerations as the latter define the ecosystem in which OSA-related policies operate and how they are perceived by the public (Akgüç 2021a; 2021b). Moreover, on the overall concept of OSA the bloc is divided: most large member states are positively predisposed to the idea, while the ‘Group of Twelve’ remains sceptical of any initiatives that go beyond the rules on state aid and the architecture of the single market.

As a result, OSA policies themselves are not only subject to political discussion, but the very definition of OSA, both what it includes and what not, is not even fixed. Definitions matter, not as an academic exercise, but as a way of drawing boundaries between strategies and distinguishing a phenomenon from another. OSA, it seems, is an idea that makes a lot of intuitive sense, conceptually and politically, but loses much of that sharpness when we try to pinpoint it. Nevertheless, proper conceptualisation and further reflection on the social, economic and environmental dimensions are essential to have an overarching approach to the broader concept of the OSA, which will underpin EU priorities. This also requires a careful consideration of the coordination of distinct policy competences at the EU and national levels as well as interlinkages and feedback loops across different policy areas.

In this chapter, we concentrate on the industrial and economic aspects. Defence is important – can Europe defend itself while keeping links with others, especially the US and Japan, open? – but because this is primarily dictated by geopolitical considerations (cf. Ukraine) and there are very few direct links with the single market, we sidestep this issue here.

While the basic ideas around (O)SA have been circulating for several decades, since De Gaulle raised it as a necessary component of European defence, the focus on industrial and economic aspects re-emerged in 2020 as part of a set of ambitious Commission proposals for an industrial strategy for Europe, and with an increased sense of urgency in the wake of the supply-chain crises following the worldwide Covid-19 lockdown (see Van den Abeele 2021, among others). A lack of crucial medical equipment and raw material was quickly followed by bottlenecks in assembly industries and other sectors that relied on imports of raw materials and parts from outside the EU, especially Asia. The unpredictability of China as a rising power added a crucial geopolitical dimension to the problem.

A study by the European Parliament in autumn 2020 offers the broadest and analytically clearest definition of (open) strategic autonomy:

*This study defines EU's 'strategic autonomy' as the ability to act autonomously as well as to choose when, in which area, and if, to act with like-minded partners. The capacity to act autonomously implies both the ability to decide and to implement decisions in an autonomous manner. 'Strategic autonomy' is not about self-sufficiency but about*

*means and tools to reduce external dependencies in areas deemed strategic and where dependencies could compromise autonomy, whilst continuing to cooperate with partners in a multilateral setting. Its effectiveness derives from the ability to achieve the expected outcome. The prerequisites for achieving an effective 'strategic autonomy' are political will, common strategic vision and the capacity to act.'* (European Parliament 2020a: 3)

OSA therefore has several sides. The more 'defensive' one, is developing the EU's potential capacity to provide vital, necessary services and goods, while keeping open most trade links in these areas under normal, non-crisis circumstances. In some instances, this may amount to actually developing the capacity, as in the Chips Act, while in others it may suggest a less proactive stance (similar to the strategic stockpiling of oil reserves in the US which is there but rarely used). The other is, more proactively, to produce conditions in which new advanced sectors can emerge or develop that have an important strategic component for the European economy – especially sectors that produce goods and related services which put the EU at the forefront of technological and industrial innovation. Strategic partnerships with like-minded countries ('friend-shoring'), particularly in areas where the EU has dependencies, are programmes to diversify of supply chains to decrease vulnerabilities in times of crisis.

The debate on OSA raises a few concerns. One is how OSA is articulated with the constraints that the Single European Market imposes on government intervention in the supply side of the economy. In general terms, projects need to produce strong transversal benefits for all of the EU (and not just in the country or countries involved). It should not target individual companies but produce conditions for all companies in a sector to benefit, or for all related sectors to do so. And monitoring is necessary because of the balancing act between free trade within the EU-EEA, and between the EU and its trading partners, on the one hand, and the need to promote EU industry. Finally, the link between OSA and successful industrial policy needs to be explored and clarified.

Expanding the OSA concept to include relevant but new dimensions – such as social, economic and environmental – can also be challenging, as this is still a concept in the making, which could be differently interpreted and prioritised in the current context of green and digital transitions. Moreover, it should be noted that OSA is not a static notion but an evolving concept that is likely to grow in scope and depth. Some more recent elaborations have expanded the concept to include additional policy elements and dimension.<sup>62</sup> In the aftermath of Russian invasion of the Ukraine, the concept has once again acquired a more marked defence oriented profile, visibly so after the [March 2022 Versailles Declaration](#),<sup>63</sup> envisaging an enhanced cooperation for the purposes of 'bolstering ... defence capabilities', 'reducing energy dependencies', 'building a more robust economic base'.<sup>64</sup> The European trade union

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<sup>62</sup> Van Den Abeele, E. (2022), 'From Globalisation to Geobalization – the EU's transition to a virtuous strategic autonomy' article to be published in the collective work 'The end of globalisation', CIDOB International Yearbook 2022 (forthcoming).

<sup>63</sup> <https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf>

<sup>64</sup> Ibid.

movement has positioned itself in this debate demanding that OSA develops with a strong social and democratic dimension.<sup>65</sup>

## 5.2. Fragility, dependency and comparative advantages

What, then, are the key concepts that define the basic cost-benefit calculus on strategic autonomy, including re-shoring? Assessing the logic, costs and benefits of reshoring production capacity to the EU requires distinguishing between supply chain fragility and dependency. In a first-best world without trade barriers or disrupting shocks, thin and long global supply chains – i.e., those that involve many producers with a minimum amount of inventory and spread across multiple locations across the world – are the most cost-efficient solution<sup>66</sup>. However, each chain is only as strong as its weakest link and more links, each of which produces a different component of the final good, create a higher risk of fragility. Greater diversification of suppliers, for instance, by having redundant suppliers for the same production step can reduce contingency risks related to idiosyncratic shocks (e.g., a plant closure due to a geographically limited natural catastrophe). Hedging against a systemic black swan event such as Covid-19, which hits all producer locations at roughly the same time, however, is much more difficult. In fact, in this case even a geographical concentration of the entire supply chain in one region would not have fully protected firms from disruptions.

Supply chain dependencies are different from fragility in GVCs. In the limiting case, an upstream supply chain can be suitably short and well-protected against adverse shocks, but it might be entirely located in a single country. If the imported goods cannot be substituted through supply diversification or domestic production, the EU faces a case of dependency. Moreover, particular vulnerabilities exist in supply chains where the EU is dependent on imports from countries with different political objectives, such as China.

The European situation is complex, therefore. While firms in the EU currently suffer from disruptions that hit fragile supply chains, the EU faces a relatively small risk of dependency on imports from third countries (expressed in value added). Out of more than 5,000 products the EU imports from third countries, the Commission's (European Commission 2021b) quantitative bottom-up mapping of strategic dependencies identified 137 goods (accounting for roughly 6% of the extra-EU import value of goods) in which the EU is particularly dependent on imports from third countries. Of these 137 products, 34 (representing 0.6% of the extra-EU import value of goods) were considered as particularly vulnerable dependencies because of their low potential for further international diversification or substitution by EU production.

But the implications for EU firms may be more important than the low numbers in terms of import value might suggest: among the most critical goods are also often those that create the largest bottlenecks, as the impact of the semiconductor crisis on the European automotive industry has demonstrated. Reshoring strategies would, therefore, make sense only in the

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<sup>65</sup> <https://www.etuc.org/sites/default/files/document/file/2022-06/Adopted%20-%20Positioning%20the%20ETUC%20for%20an%20EU%20strategic%20autonomy%20with%20a%20strong%20social%20agenda.pdf>

<sup>66</sup> Note that the cost-efficiency of global supply chains partly arises from the lack of carbon accounting in the fossil-fuel based international transport sector. Once the relevant emissions are accounted for in a carbon price, a substantial part of the cost advantages of GVCs will likely disappear.

high-dependency supply chains, and probably best considered as a measure of last resort. A complete repatriation of production is likely to eliminate the efficiency and welfare gains associated with international trade and specialisation, without significantly reducing the risk of supply chain disruptions (Eppinger et al. 2021).

The complexity of supply chains, and the fact that firms are the first victims of disruptions, complicate the problem. Since supply chain disruptions have a negatively impact on firms' operations and sales, managers therefore already face strong incentives to create more resilient value chains. While the dependency on imports from a low number of third countries is often presented as an exclusively political issue, it should also be included in risk assessments, as any adverse political decisions by third country governments (e.g., export restrictions) could also disrupt a company's operations. Yet, particularly in long and internationally scattered supply chains, individual firms often do not have the means to identify these distant dependencies, because they might occur in upstream production steps over which a company further down the chain has no control.

Even more importantly, the decision by firms to delocalise their supplier base or outsource their own production to third countries tends to be sticky: managers face considerable fixed, and effectively sunk, costs (Antràs 2020: 22). Establishing a supplier relationship or a third-country greenfield plant involves various investments: firms need to collate information about suitable suppliers or plant locations; both the firm and supplier have to invest in often customised physical assets; and in the case of imperfect contracting, customers and suppliers have to invest in 'relational capital' to ensure sufficiently high levels of trust. Selling or redeploying highly customised physical assets is difficult at best, and intangible assets immediately lose their value once a reshoring decision has been made.

In addition, reshoring the supplier base implies that firms have to deal with the same expenses again in their home countries. Moreover, establishing local production capacity, in an effort to replicate the entire value chain, is related to even larger up-front capital expenditure and often high operating costs. While policymakers can incentivise investments in domestic production plants with public funding, firms can only amortise the often very significant up-front capital expenditure and operating costs if they command a comparative advantage, which ensures that they are competitive on world markets. But herein lies a crucial paradox: since the offshoring decision was usually based on considerations of comparative advantage, reshoring will imply, all else equal, location in a less optimal location. Since this jurisdiction will not have the same comparative advantages, and possibly significant comparative disadvantages, reshoring will ipso facto raise production costs, therefore prices, and cause a loss in competitiveness. In this perspective, reshoring makes sense only as a (mandatory) relatively uniform strategy across an industry, backed by significant public funding, and with relatively strong protections for the (ironically now new infant) industry.

A policy focusing on reshoring might work in industries that previously prospered in the EU, such as, for example, mining or refining of raw materials. However, many strategically important sectors rely on technologies in which the EU has limited experience at best, or in which European firms require significant upgrading before they could compete. Battery production, for instance, is not new to the EU but the focus, including R&D efforts, will have to shift from lead-acid to lithium-ion batteries. And while fossil fuel-based hydrogen can easily be produced at scale, green hydrogen requires entirely different production technologies. In



some of these areas, relevant industries exist in embryonic form but they will have to be scaled-up in order to increase competitiveness in strategic supply chains (or parts thereof).

### 5.3. Strategic dependencies in the EU

In a recent document, the European Commission has identified six areas where the EU is highly dependent: active pharmaceutical ingredients, API, critical raw materials, lithium-ion batteries, semiconductors, hydrogen, and cloud computing. While APIs are already being produced in the EU, which means it could develop the sector if necessary, cloud is almost entirely located in the US – a strategic ally and therefore less of a dependency than in the remaining four areas, on which we will concentrate here.

**Raw materials:** While the green (and digital) transition reduces the EU's dependency on foreign fossil-fuel imports, it shifts them towards non-energy raw materials – metals and minerals – instead. Global demand for raw materials has doubled since 1990 and is estimated to increase by 40% in 2040 and by 90% in 2060, compared to 2017 levels (OECD 2019). At the same time, raw materials are in politically highly sensitive countries (e.g. China, Turkey or South Africa) and often affected by export restrictions (European Commission 2022b). European mining capacity has declined by almost 30% in the last 20 years (Reichl and Schatz 2021) and the lead times for new mines can take up to between 10 and 20 years (Umbach 2022). Finally, higher wages as well as social and environmental standards add to the comparative disadvantage of European mining. While product innovations and circular economy approaches could reduce the need for virgin raw materials, strategic stockpiling and international supply diversification might be more promising short-term solutions.

**Lithium-ion batteries:** The raw materials shortage also affects sectors further down the supply chain which are crucial for Europe's green and digital transitions. As the vast majority of global lithium reserves is refined in Asia – most notably China – firms from the region dominate the market for large lithium-ion batteries that power electric vehicles (EVs). Due to the European regulatory push towards e-mobility, the EU is becoming one of the biggest markets for EVs (and, hence, batteries and their cells), which attracts domestic and foreign investments in the battery supply chain. While 'gigafactories' can cost up to several billion euros, private investors – first and foremost European carmakers – and public support measures incentivise a large and growing number of battery producers to set up shop in the EU. The continent's strong R&D performance as well as the availability of a relatively large skilled (and in Central and Eastern Europe cheap) workforce – due to job reductions in the traditional automotive industry – further makes Europe an attractive investment location. Nevertheless, considerable lead times, shortage of raw materials and a general technological volatility in the battery market means that European car producers will have to rely on Asian lithium-ion battery cell manufacturers in the short run.

**Semiconductors:** Also driven by the green and digital transitions, the demand for semiconductors has surged recently, leading to substantial bottlenecks in global industries. While shortages of more mature chips have hit the European automotive industry hard, future demand for more advanced semiconductors – 3 nanometre nodes – is expected to create even more important dependencies. As no country can so far produce these cutting-edge chips at a comparative advantage, there might be space for EU production. However, establishing new production capacities can cost several billion euros and, as the margins are very small, the plants must operate at very high levels of capacity. Furthermore, relatively low levels of

subsidies due to state aid rules and comparatively high wages create often prohibiting operating costs. Entering mature chip production is, therefore, certainly a dead end for the EU while advanced semiconductor manufacturing might be a more viable option. Most importantly, however, the EU should focus on the development and production of state-of-the-art manufacturing equipment, a growth area in which it already has a significant comparative advantage.

**Green hydrogen:** Lastly, the production of green hydrogen is another area which is crucial to support the decarbonisation of hard-to-abate industries. Although the EU has a leading role regarding the installed electrolyser capacity – which is complemented by its leading role in electrolyser manufacturing – the scale-up of the sector faces several challenges. On the one hand, the sector remains small and fragmented and while European companies are leaders in more advanced – but also more expensive – technologies, Chinese manufacturers have a significant cost advantage for standard alkaline electrolysers. Multiple public funding initiatives such as the EU’s Hydrogen Strategy, therefore, seek to support the expansion of European green hydrogen supply. On the other hand, the dependency on critical raw materials remains a challenge but the reliance on China is not as large as in other areas and the EU has a strong role in processed materials and components manufacturing. Finally, the large-scale availability of low-cost renewable electricity is not yet achieved in Europe, which means that additional supply of green hydrogen will likely have to be sourced from international partners.

#### **5.4. OSA and industrial policy: the conditions for success**

As the previous sections suggest, the concept of OSA is impossible to entertain without a discussion of industrial policy. In essence, industrial policy follows two broad patterns in the EU: vertical and horizontal industrial policy. The former (VIP) refers to government interventions of a financial and regulatory nature that benefit particular sectors and possibly companies, without significant spill-overs (beyond local employment, tax revenue, and similar indirect aggregate effects). Typical examples are subsidies and beneficial tax regimes. The latter, horizontal industrial policy (HIP), refers to broader interventions further ‘upstream’, which will in principle benefit all companies in a market. Typical examples here are industrial innovation hubs, or advanced STEM training for engineers in advanced sectors.

One of the key reasons for the demise of VIP is that governmental actors are not always very successful in picking or constructing winners. The history of industrial policy lists alongside the unmistakable cases of success like – such as the French nuclear programme – also many cases of very mitigated success (at best) and outright failure, but which are often less prominently displayed in reviews (see Terzi et al. 2022). Two cases that come to mind here are the attempts to revive the British car industry in the 1970s, or to build a domestic computer industry in France from the 1960s until the mid-1980s. In the context of the burgeoning single market in the mid-1980s, these failures ultimately led to strict limitations on state aid and forced supply-side interventions into the realm of HIP – governments can support broad early stage, usually non-competitive activities, such as public R&D or infrastructure, which potentially benefit all firms, while direct intervention in market processes is essentially no longer allowed. Since the mid-1990s, industrial policy is primarily of the latter type, and any industrial policy related OSA initiatives will therefore have to follow that HIP framework.

But there is more. The definition of OSA above suggests that the combination of ‘political will’, a ‘strategic vision’, and ‘capacity to act’ is a sufficient condition for OSA to work. Even if we

ignore that member states seem unable to agree on a common strategy in many areas, the link between OSA and industrial policy makes this idea problematic. To be clear, policymakers obviously play an important role in any policy, including industrial policy. But very often thinking about industrial policy stops at this stage, and ignores two logically prior, much harder conditions, which determine the chances for policymakers to get things right. One is the match between the industrial policy targets and the institutions that govern labour, capital and product markets. An OSA strategy geared towards high value-added markets, for example, will require different workforce skills, (patient) capital and inter-firm cooperation than a strategy which privileges lower value-added market segments. The second precondition is the existence of (pre-)competitive firms in the new market (or at least the possibility for them to emerge rapidly), who have the capacity to internalise the institutional opportunities and constraints and recognise and exploit the public goods that the institutional frameworks indirectly produce.

The literature in this area, which is captured in the concise OSA definition presented earlier, concentrates on policymaking and policymakers, and how top-down initiatives can be defined or resuscitated. However, historical-institutional and firm-driven approaches put the focus on the necessary first-order conditions for industrial policy to have a chance to succeed. If capable firms are absent (and/or cannot easily be encouraged), and if OSA initiatives are not articulated with existing institutional frameworks in labour, capital and product markets, the first-order conditions for policy success are absent. Put differently, OSA is an asymmetric issue: OSA initiatives are extremely likely to fail if policy targets, existing (often embryonic) firm capabilities, and the institutional governance of labour, capital and product markets are not mutually reinforcing; OSA policies *can* succeed if these three are aligned, depending on the design of the policy, the resources available, and if other elements are also in place.

OSA initiatives in the EU therefore need significantly more than political will, vision and capacity to act. What they require most of all is a careful examination of the existing, often embryonic, capacities of firms – the central actors in product markets – and of the comparative advantages associated with particular institutional frameworks as well as existing resources and assets (both human and capital). Any strategy, from industrial policy to OSA, that ignores these two necessary conditions, is very likely to fail.

This basic idea has many consequences. One is that some OSA-related strategies will look for close proximity to existing industrial innovation capacities. Others can (and probably will or should) be located elsewhere in the EU, depending on the link between local arrangements and comparative (institutional) advantages: for one of the key successes of the single market has been the fragmentation of value chains resulting from the expansion of trade between member states. Any project that ignores these relative specialisations is bound to lead to outcomes that are hard to reconcile with the promises of the single market. And the need for firms (or at least the development of potential private sector activities) requires a critical look at the possibility of those firms to engage with the public goods in their environment, such as skills and technology transfer. It also means some form of prospective local management of those resources – how to assure a workforce when demographics are at odds implying a shrinking and ageing EU, develop relevant skills faced with labour shortages and links between companies and technology hubs, and the local and regional second- and third-order effects of new activities on housing stock, road quality, and public services.

OSA policies also need to be articulated with existing rules of the single market. In principle, this is a two-way process, whereby single market rules influence the depth and range of OSA-related policies, and OSA policies may redefine aspects of the single market. One obvious entry point here is the distinction between horizontal (HIP) and vertical industrial policy (VIP), and how this distinction imposes constraints on OSA.

Finally, it is important to understand that OSA does not take place in a historical, institutional, economic and social vacuum. The basic orientation of Europe's economic model – the social market economy – forms the backdrop for any such policy. While largely uncontested concepts within the EU – though implemented with varying degrees of enthusiasm and success across member states – the basic notion is that economic and social progress should evolve in lockstep. That inevitably sets limits on political processes such as the single market and OSA, which often forces a choice or at least prioritisation between the economic and social objectives. Environmental considerations also influence the ecosystem where OSA-related policies are designed and implemented. What follows considers these alternative dimensions, which are often absent from the debate.

## **5.5. Socioeconomic dimensions of OSA and the single market**

The social dimensions of OSA are manifold and still emerging. In this section we will only highlight a few key elements. The starting point is the European social market economy, which combines the fundamental principles of a free market economy with specific social policies and generous welfare state provisions to ensure a fairness and level playing field in the single market (Marktanner 2010; Wrobel 2010). The importance of fairness has been specifically underlined in various recent policy initiatives. Social fairness constitutes one of the six priorities of the Commission for 2019-2024. More broadly, building and maintaining a fair and well-functioning Europe and strengthening its social dimension is one of the key political priorities of the EU. The social dimensions constitute an indispensable element for the EU's OSA, because leaving it out is likely to reduce the success and sustainability of policy, leading to social discontent, divisions and instability.

Combining analysis of the labour market with the discourse on OSA, suggests skills and demographics as the main long-term challenges. The problem with skills is both simple and complex, as we discussed earlier in chapter 3. We know we will need new skills, but we do not know which ones, and in many instances, we have at best relatively weak mechanisms to find and organise that information. Solving this basic information and coordination problem requires developing information clearing mechanisms that involve all relevant actors and forums where they can negotiate new skill profiles, while considering the different interests of the relevant stakeholders. The EU and the member states therefore need to strategically define the key areas and fields for the future workforce or alternatively attract new talents to the EU. There are efforts to forecast skill needs of the future (Cedefop) or strategically map the future (needs) of the labour markets (various JRC reports). These and more of such studies should be valorised to better forecast the future needs and plan accordingly. Supporting the workplace and investing in training for jobs in the face of dual transitions, modernising education and training systems to make them fit-for-purpose in the digital age, expanding life-long learning, promoting reskilling and upskilling the workforce – particularly vulnerable groups and SMEs that are the backbone of the EU economy – in the face of transforming world of work constitute key elements to achieve well-functioning labour markets and fill in the labour and skill

shortages. Embracing new forms of work and providing fair working conditions and guaranteeing minimum social standards to cover all workers would show the commitment of the EU to the social standards in its social market economy while pursuing its strategic goals. These will boost the capacity and ability of EU to advance its OSA in allowing, for example, investment and production in strategic industries employing workers with required and critical skills. It will also increase social acceptance of policies if workers are supported in new jobs equipping them with right skills during dual transitions, reducing negative employment effects and socioeconomic resentment.

Another key issue is the ageing workforce – the availability of labour (with the right skills) in the future as a key challenge for the EU's OSA. Ageing population and declining workforce raise questions on who will fill the jobs in the future. Some regions in the EU are experiencing severe demographic challenges with rising depopulation and outmigration from rural areas (e.g., regions in Romania, Latvia, Italy, Portugal etc.). While the recent refugee flows from Ukraine to the EU will certainly lead to some shifts in the EU labour markets, the composition of refugees is very particular, whereby the majority consist of single mothers with kids and elderly, which may not be able to change the diagnostic – as confirmed by a number of demographic projections – that Europe will need to fill its labour shortages with labour migrants from elsewhere. Besides increasing active ageing and attracting talents from abroad, it is also essential to focus on the youth for preparing the future workforce that will lead the economic prosperity of the EU in the next decades. The previous financial crisis has led to alarming levels of youth unemployment (nearly 25% on average, and 40% in some member states), the recent pandemic has also left some scars in the labour markets; the bitter experiences of the past should be avoided through targeted policies and initiatives. Scaling up active ageing and most importantly engaging with youth today would contribute to offsetting part of the risks of labour shortages, which is a critical challenge for advancing the EU's OSA.

## **5.6. Environmental dimensions of OSA and the single market**

Developments of systemic nature such as climate emergency and environmental degradation pose challenges that certainly orient OSA initiatives. Climate change “increasingly heightens the likelihood, frequency, and magnitude of natural calamities, putting more stress on high-risk areas (e.g., coastal regions) while exposing previous ‘safe spaces’ to similar threats” (Hancké and Mathei 2022). In other words, climate change will trigger environmental developments that will modify the global availability of materials and resources and the sustainability of supply chains, which will have an impact on OSA initiatives, by changing the set of critical assets or dependencies.

Moving away from the dependence on fossil fuels and towards cleaner energy sources implies dependencies on other rare earth or critical raw materials that the EU does not possess. For instance, the reserves of lithium, which is an element of growing importance as it is used in batteries in cell phones, laptops, and electric vehicles, is mainly possessed by countries in South America, Australia and China, all together accounting for 96% of world lithium production in 2019. In other cases, the EU might substitute some of the raw materials in its possession with local production. However, the latter has its own challenges – let alone higher costs of extraction and other regulatory barriers – and creates further risks for environmental pollution and degradation, which is then likely to face backlash by civil society (Hancké and Mathei 2022). All these aspects have a bearing on the EU's OSA since the dependencies will

shift with decarbonisation pathways and there are additional risks of environmental degradation (in the EU and beyond). The success of the plans and strategies in climate change mitigation and adaptation that will underpin EU's OSA will depend on the rate of climate change, public and private buy-in of policies and strategies of external actors, whose acts might have spill-over effects.

## **5.7. Discussion and outlook**

This chapter examined the debate on OSA in the EU in light of the problems that the EU and its member states have faced in the last few years, analysed the conditions for successful industrial policy at the basis of OSA, and linked those debates to the social and green dimensions of the single market. While we have concentrated here on the links between OSA, the single market and industrial policy, the prefix 'Open' in OSA is an important part of the concept. This refers to what we could think of as the 'external dimension of OSA – the links between Europe and the rest of the world. Two aspects in particular matter here. One, the relation with multilateral arrangements such as WTO and the transatlantic alliance; and two, the trade policy instruments of the EU, such as CBAM, inward FDI screening, anti-coercion instruments, some of which have recently undergone significant changes. Unless managed well, the possibility exists that open strategic autonomy will lead to significant frictions in the EU's external trade.

How, then, do we see OSA developing? In essence, we think there are three tracks along which the OSA strategies could develop. In fairness, all of these are simultaneously possible: the discussion of the key areas of dependency earlier and the later reflections on the social and green dimensions of the single market suggest, every problem has its own history, context, and urgency associated with it. But even with this internal variety, the possible future trajectories seem to cluster in three scenarios.

### **Scenario 1: Supply chain diversification (S1)**

One option would be simply to leave the initiative to a large extent to companies, perhaps nudged by some government policies or EU initiatives. When risk increases, an investor diversifies their portfolio; companies do the same with their supply chains. At the latest since the Covid crisis, and accelerated by the war in Ukraine, companies have become painfully aware of the fragility of their supply chains, and many are actively searching for alternatives to the current dependencies. Compared to most alternatives, this option to handle the supply chain bottlenecks is relatively inexpensive, as it is mainly carried by the private sector and strategic behaviour in markets will lead to optimal outcomes. Yet we are not facing calculable risk but deep uncertainty. Geopolitical tensions and global health crises are impossible to predict with standard statistical models, because they are 'black swan' events: on average not extremely likely but catastrophic when they happen.

### **Scenario 2: OSA and semi-autarky (S2)**

This second scenario could also be called the ‘maximalist’ strategy. Where possible, the EU develops initiatives to re-shore large parts of value chains, especially in industries where new products are emerging and/or where dependencies are high. Battery and semiconductor production are the leading examples here, but active pharma ingredients and possibly even cloud computing could find a place here, since nothing stops the EU from fencing off those sectors and using subsidies and IPCEI to construct these sectors ex nihilo. While that would secure future supply and stabilise employment, it has two very important negative repercussions: all other things equal, consumer welfare will drop with rising prices (lest robots take over production, but then resistance might ensure); and it does not resolve problems further up the supply chain – raw materials and especially lithium. Increased recycling could alleviate pressures on the latter, but that is expensive.

That brings us to the second consideration: such a (for want of a better word) semi-autarchic strategy is very expensive. Semiconductor fabs and battery giga factories cost several billion euros to build and operate; stable supply would require the number of plants to be about an order of magnitude more than currently planned. It also implies that this can be done in a low-risk way, despite the uncertainty surrounding necessary input factors such as skills and raw materials, and the highly volatile demand for different types of chips. The cost and uncertainty suggest a more careful approach to OSA than what is circulating in the debate. Scenario 3 below suggests such a more balanced approach.

Finally, there are the intangibles: does Europe have the right skills and workforce for a sustained OSA project? Part of that will depend on what happens elsewhere. For example, large negative employment effects of the digital and green transition in the car industry may spur initiatives to (re-)patriate parts of the supply chain to the EU to stabilise the sector (and the regions where the sector is located). But to a large extent, such a wide and deep OSA strategy will require a lot of accurate foresight – which is probably impossible, and therefore risky, both for companies and employees.

### **Scenario 3: Strategic partnerships and trade (S3)**

The third strategy is built around a selective version of OSA: it involves the EU developing capabilities that function as a bargaining tool vis-à-vis third countries in the supply chain, and/or concentrate its actual manufacturing and service activities in market segments where it already has or could relatively easily develop competitive advantages. Those can then be used as a guarantee in the case of trade with not necessarily ‘friendly’ countries.

Somewhat schematically, in each of the six areas that the Commission defined this third scenario would look something like the below. In semiconductors, the EU could concentrate on markets such as advanced AI chips and lithographic equipment, along the lines of what IMEC and ASML have done. In these segments, the EU has developed almost unique globally leading positions that are relatively easy to replicate in the future since they build on existing comparative institutional advantages in innovation systems and manufacturing skills. Controlling such a strategic area would probably give the EU sufficient clout to safeguard the supply of batteries and raw materials in the foreseeable future. In the production of green hydrogen, the EU could ink that to its broader policies in the southern Mediterranean, and trade green energy for favourable single market access. And in advanced pharmaceutical products and cloud computing, the EU could develop and showcase its production capabilities to both negotiate favourable supply conditions and scale up in the case of an emergency.

In sum, such a targeted, selective OSA strategy combines autonomy where necessary, trade with friends where possible, and develops tactical quid pro quos where indispensable. It also builds on the existing socio-economic strengths of the EU – world-class research, excellent education systems, and high skills. Its fit with what we know today is therefore not only high, it also means that adjustment costs will be marginal – not necessarily extremely low (the margin can be large), but almost certainly easier to digest than the wider OSA policy embodied in the second scenario.



## 6. Scenarios

### Introduction

This chapter presents and examines the five key scenarios that follow from the analysis in the three preceding chapters. They cover a broad range of options, from a market-centred to a socially and politically embedded adjustment path, and – while having roots in current policies and debates in Europe – are in many ways significant departures from the status quo.

Scenarios do not predict the future. Instead, the purpose of scenario-building is to sketch possible future processes and outcomes with their implied costs and benefits and, where possible, identify political levers to influence them. Methodologically, scenario-building relies on complex information, reduces that to its essentials, mixing quantitative and softer, qualitative, information, and examines likely and plausible processes and interactions in different areas. All such exercises have scope limits: here we think ahead over the next 10 years (roughly the early to mid-2030s), and broadly limit the geographic scope to the EU27.

*Methodology.* Chapters 3, 4 and 5 concluded with three sub-scenarios associated with each of these thematic areas. Combining these led to 27 combined scenarios that integrated the three themes in chapters 3-5: the dual transition, social sustainability and OSA axes. After examination of consistency and political viability of all 27 scenarios, five were retained overall. We proceeded in five steps detailed below.

Raw integrated scenarios. The building blocks for the scenarios in chapter 6 are the conclusions of chapters 3, 4 and 5, which develop three broad topic-specific sub-scenarios. Combining all the logically possible sub-scenarios across these three chapters produce ( $3^3=$ ) 27 scenarios (These are listed in table X in Appendix).

Evaluate internal consistency. While logically possible, many of these raw scenarios are not internally consistent. For example, a sub-scenario that builds on free contracting between parties in the labour market is not easily compatible with a sub-scenario in the area of the green and digital transition that builds on economic governance through business groups, employers' associations and trade unions in these areas, and a sub-scenario in the field of strategic autonomy that emphasises the central role of the state. (Please note that the latter two may be compatible – but not with the former). If a scenario produces such incompatibilities, in which the logic and effects of one sub-scenario contradicts the logic of at least one of the other sub-scenarios, we score that zero (0). If the sub-scenarios produce positive interactions, we score that combination 6; when the combination has neither positive nor neutral mutual interaction effects, it receives a score of 3. (We used 0-3-6 as scales to make differences less ambiguous than a 0-1-2 scale would allow us to do. Note that these are ordinal scales – the larger numbers just sharpen distinctions between ranks but do not substantively change the ordinal logic underlying the ranking.)

Political viability. A parallel logic guided us in 'scoring' what we loosely call 'political viability'. Here the operational question is whether a combination of sub-scenarios has the potential to produce a blocking minority, loosely along QMV decision lines, or can be expected to meet with relatively little resistance. While such an approach is undoubtedly incomplete – many decisions are, as we know from the history of European integration, linked to negotiated

outcomes in related, adjacent or even entirely unrelated fields – this method allows us to evaluate the *ex ante* political viability of a combination of sub-scenarios. Again, if political viability was considered impossible to find (for example because it pitted at least two large, entrenched groups of member states against each other) we scored it 0. If we considered that the combination was highly viable (i.e. would elicit relatively little resistance and/or require few side payments to become acceptable), it received a score of 6. The remaining residual combinations of sub-scenarios obtained a score of 3 – neither politically impossible nor relatively likely, but probably without a coalition of member states to carry it through.

Raw scores and deliberation. The scores themselves resulted from a combination of expert judgments and deliberation among experts – a standard combination in evaluation projects of this type. All four members of the team are considered experts in the overall theme covered by the report for this scenario-building exercise; we included one person outside the team *stricto sensu* as a control. These five judges were asked to score each one of the 27 possible combinations on the 0-3-6 scale. Their scores were then discussed in group in Delphi-style feedback round, and this process was repeated until the team developed a consensus on a score for each of the combinations (we reached a consensus by the second round). The scores in for each of the scenarios are therefore the measured collective consensus opinion of the team.

The very first scenario may require a short additional explanation: even though it was considered politically unviable, the team agreed to include it because of two considerations. One, it could be seen as a minimal (market-oriented) baseline for other scenarios; two, failure to negotiate positive scenarios, ie those that require active intervention, may tip the balance in favour of a ‘lowest common denominator’ (or ‘negative’ scenario). The team therefore felt that a combination of scores 6 and 3 does not fully do justice to the ranking of the scenario – hence the scores 6 and 4 to give it that special status.

Final ranking of integrated scenarios. On the basis of these scores, we then distinguish between three groups of scenarios: those that are inconsistent and/or unviable (receiving a score of 0 on at least one of the dimensions); those that may be consistent or politically viable but not both (a combination of 6 on one and 3 on the other), and those that score high on both dimensions (plus the baseline scenario mentioned above). This exercise led to four scenarios with 6 on both dimensions, and the market-confirm the combination of 6 and 4. The text in chapter 6 unpacks these five scenarios.

*Presentation.* The presentation of the scenarios in this chapter follows the same broad structure throughout. We start with the key *Characteristics* of the scenarios, which refer to the three constituent elements including dual transition, social sustainability and OSA axes and their interaction. The next heading, *Disruptions*, addresses the issue that linear and semi-linear processes encapsulated in the scenarios are subject to unforeseen events, often of a ‘black swan’ nature with a low likelihood but dramatic consequences. The decade between the aftermath of the great financial crisis (which itself has many characteristics of a black swan) and today (summer 2022) has seen its fair share of important non-linear events. We label these events descriptively as ‘disruptors’ and they include the Covid-19 crisis and its socio-economic effects, the Ukraine war and its economic effects, China’s economic woes and its decline as the world’s workshop, and the potential bottlenecks in essential raw materials and basic parts for the green and digital revolutions associated with geopolitical tensions. Some of these will reinforce the problems we identify as well as their current solutions and may act as accelerators, while others might have the opposite effect and produce conditions for less

optimistic coalitions to emerge. Every scenario will include a short section identifying the relevant disruptions and how to think about their effects in that context. Finally, the *Areas of action* address such questions as the division of competence between EU-level, national, and sub-national authorities, the broad policy areas that are at stake, and where possible any leverage socio-political actors may have in this area. Although the following sections offer some pointers in terms of policy action, these scenarios do not purport to offer a detailed blueprint for their implementation and delivery. Their purpose is, as stated above, to offer plausible and feasible views of future processes and outcomes with their implied costs and benefits and, where possible, identify political levers to influence them. It is envisaged that once one or more of these scenarios were selected, a follow-up to the present working document could flesh out in greater details the type of actions and activities that would be necessary to pursue and implement them.

*The scenarios in a nutshell.* Table 1 presents a visual version of the five core scenarios that follow from our conclusions in chapters 3-5, with the basic information for each of them. These five scenarios ranked highest on two separate dimensions that we evaluated independently: the internal consistency of the trio of sub-scenarios in different areas, and the political viability (or plausibility) of these combinations. The scenarios in Table 1 list the four that scored the maximum, and one that scored slightly below (the score of 4 reflects that this is a politically plausible ‘negative default’ scenario, as explained below). We have labelled these five scenarios as 1. Market Conform Adjustment; 2 Economics rule, politics respond; 3. Adjustment through social investment; 4 A new Industrial policy; 5. Good jobs in a strong and green economy.

**Table 1: Scenarios overview**

	<b>Building blocks of scenarios from different axes</b>				
	<i>Dual transition axis</i>	<i>Social sustainability axis</i>	<i>OSA axis</i>	<i>Consistency</i>	<i>Viability</i>
<b>Market Conform Adjustment</b> <i>Negative default, i.e. when nothing else can be agreed</i>	Social Minimalism (S1, chapter 3)	Capacity Building (S1, chapter 4)	Supply chain diversification (S1, chapter 5)	6	4
<b>Economics rules, politics responds</b> <i>Positive default (BAU): markets and passive social measures</i>	Reactive Social Market Economy (S2, chapter 3)	Capacity Building (S1, chapter 4)	Supply chain diversification (S1, chapter 5)	6	6
<b>Adjustment through social investment</b> <i>Play to EU strengths, and turn social adjustment tools into competitive advantages</i>	Reactive Social Market Economy (S2, chapter 3)	Capacity Building (S1, chapter 4)	Selective OSA (S3, chapter 5)	6	6
<b>A new era of industrial ecosystems</b> <i>Important steering role of state in economy and industry</i>	Proactive and inclusive (S3, chapter 3)	Integrated Social Market Economy (S3, chapter 4)	Encompassing OSA (S2, chapter 5)	6	6

## 6.1. Market conform adjustment

*Characteristics.* This first scenario essentially builds on the lowest common denominator of coordination among policies and member states in the EU – the market. It builds on the notion that if all other attempts at building a future fail, history will nonetheless continue, but mainly through markets underpinned by government policies to support them and/or make them more socially palatable. The digital transition is left to unfold along the lines of what benefits individual business, while skills and R&D follow. The green transition will be accelerated through tax incentives but little more. The labour market and social policy areas will adopt both a minimal passive adjustment track, while competitiveness is the main concern for adjustment. The OSA debate will primarily be held in terms of how to avoid bottlenecks in the short-term future, without a significant longer-term industrial policy component. Combined, therefore, this scenario leaves the leading role to business and markets, with government intervention providing the social ‘grease’ to improve competitiveness.

*Disruptions.* In the short run, this scenario is strengthened by the disruptions that have come the EU’s way in the last five years. Brexit has increased the sense of urgency on domestic capacity, especially in the financial and related services sectors, with a central place for the Amsterdam, Paris, and Frankfurt stock exchanges. Similarly, after the initial Covid-19 procurement debacle, the EU has played a more central role in letting science and technology do their work and play more of a supporting than a steering role in these efforts. The Ukraine war has made painfully clear that energy alternatives need to be developed soon. In the short run, however, green alternatives that will raise costs for business (including in a green transition, as the debate on Russian gas and oil suggests) will take a back seat. The current inflationary pressures emanating from energy and food shortages, can only abate if real producer prices, including wages, can be curtailed. The slow decline of China, finally, accelerated by the Covid lockdowns, has made the EU aware of its supply chain weaknesses and elicited calls for re-shoring parts supply or developing new industries (e.g. battery production) at home. Governments subsidies and EU funding provide the incentives for private business to engage those transition processes.

*Political evaluation.* Judging only from recent clamours emanating from Brussels and some of the capitals, large parts of this scenario already exist. But that may overplay the scenario’s (positive) political viability. A large group of member states is not very keen for markets to set the terms of adjustment unilaterally and workers and citizens to follow. Both the member states where organised labour plays a large role in economic management in the north-west of the continent, and the more state-centred economies in the south, will demand more active political intervention than this scenario would offer. In addition, this scenario imposes significant costs on workers – in terms of short-term job loss and loss of qualifications – and on dedicated, specific business investment in old, pre-digital or ‘brown’ technologies. If such market action produces a social reaction, as it has invariably done since the Industrial Revolution, the emergence of very strong, ‘conservative’ producer coalitions, willing to defend

their capital and skill assets against the market-led forces of progress is as good as guaranteed. Both their emergence and their possible defeat will have tremendous political consequences – first holding back the transitions and subsequently wiping out entire industries, occupations, and communities.

*Areas of action.* This scenario would require minimal change in the current course of direction of the EU in terms of its approach to market integration and the three key axes on which the scenario itself builds. This scenario is based on markets, competitiveness and social plans without much active intervention. While this scenario would still benefit from some joined up thinking in terms of the implications for the three axes for the single market project, it essentially demands staying the course. The areas of action needed to institutionalize this scenario would mainly rely on strengthening the ‘minimum harmonisation’ level playing field for competitive markets, internally and externally (i.e. in trade agreements), enforcing rules effectively, and providing market based incentives for businesses to behave in a socially and environmentally sustainable way. Examples such as the current Green Finance initiative come to mind, as well as regulatory instruments aimed at strengthening the level playing field in the social and environmental domain both through social directives, a wider use of WTO compatible sustainability clauses in FTAs, and subsidies for IPCEI-type plans, led by the private sector. For a more detailed overview of these measures, we refer our readers to the previous three chapters.

*Conclusions.* The economic, social and political costs of an essentially market-led adjustment path should (and do) concern leaders, interest groups and citizens in the EU, who raise questions about leaving the initiative solely to markets while remaining socially passive. However, this scenario has a potentially significant ‘negative’ likelihood: unless one of the other scenarios becomes the ‘default’ adjustment option, market conformity could win out not by the strength of its own logic, but by the absence of viable alternatives. While in the past, the UK’s liberal euro-scepticism has led much of the EU down the dominant path of market integration without a political counterpart, today’s reluctant member states are found throughout the EU-27. Without their support, any attempts at deeper political integration are doomed to fail: the institutional design of decision-making in the EU thus lifts this adjustment path from a mere possibility to a not-insignificant probability. The market-centred adjustment path will, however, likely imply increasing social and political instability because of the asymmetric short- and medium-term costs in terms of life chances for many middle- and low-income households.

## **6.2. Economics rule, politics responds**

*Characteristics.* The second scenario is a likely alternative to the market-led ‘negative’ default. It combines three tried and tested responses to adjustment shocks: while fundamentally leaving the initiative to businesses and markets, it builds on extensive, mainly passive and expensive accompanying social measures such as social plans and regional reconversion funding to compensate the losers in the process. Active interventions are primarily geared towards increasing competitiveness, especially in the areas of skills and R&D support, and infrastructure, but without touching on the free trade area within the single market, external trade arrangements, and the ‘four freedoms’.

*Disruptions.* Recent shocks to the system provide a strong rationale for this scenario. Supply chain shocks related to Covid, the Ukraine war, and China’s recent economic woes

demonstrate the need for profound adjustment. Yet they also suggest that business is best-placed for steering the adjustment process – either because of a convenient ideological concern about competitiveness or because of a more philosophical Hayekian position that experimentation among freely contracting parties will yield the optimal framework (i.e. what is necessary but nothing more). Governments then play the role of protecting this fundamental economic freedom within this new global context.

However, the definitions of these problems are not self-evidently given, and neither are the potential solutions. For example, how to read Covid-19? As a temporary socio-economic blip, a chance to reinvigorate the social contract of upward inter-generational mobility after four decades of erosion, or a sign that the complex political-economic arrangements that involve global free trade, institutionally constrained neo-Keynesian domestic macro-economic policies, and liberalising supply-side policies have come to an end? Depending on the answer to this question, we will also explore different repertoires of possible answers, with varying degrees of market, society and state in the mix.

*Political evaluation.* In many respects this scenario offers the path of least resistance. Not only does it build on dominant ‘doctrinal’ lines in the EU about market primacy supported by a strong social safety net, but also on the core EU institutions such as the single market and the strengths of administration in the member states and EU. It can therefore be seen as the scenario that requires relatively little additional political will beyond what is already mobilised. It thus avoids the Pandora Box of treaty revision altogether. If leaders want to do something, and want to be seen to be doing something, this forward-looking ‘business as usual’ script can easily gather a large majority, among national governments, European institutions, and social partners.

*Areas of action.* In terms of actions needed to operationalise this scenario, the ones explored in the previous ‘market conform’ scenario would remain relevant, but a gloss of structural and investment funding would be necessary in terms of providing more robust policy responses and support beyond the mere market incentives referred to before. Social policy initiatives would be also aimed at correcting undesirable outcomes of the single market, with only occasional departures from the ‘minimum harmonization’ rationale. So, a greater use of structural, investment, and ad hoc funds to steer and support the three axes would become necessary, albeit within the parameters currently set by the existing EU treaty structure. The rationale for policy intervention is market adjustment and correction and the establishment of supply-oriented initiatives (restructuring, skills, mobility, etc). The bulk of social investment is not provided at the EU level and the market plays an important role in delivering, with some (minimal) policy steering, nudging, and support.

*Conclusions.* While this adjustment scenario has worked reasonably well in the past. A glance across the Atlantic to Detroit and much of the industrial ‘Rust Belt’ conveys a sense of both the social catastrophes that have been avoided and the possibilities of industrial regeneration that exist in Europe, largely as a result of such social and economic accompanying plans. But the policies underlying this adjustment scenario have so far only been used primarily in cases of sectoral restructuring (for example in textiles and steel) or regional adjustment (e.g. in Wallonia, northern France, eastern Germany and Yorkshire), but never the two combined. (Note that the transition in Central Europe was of an entirely different nature, mainly FDI-led, with the EU in a somewhat passive role on the acquis. In terms of the discussion here, the first twenty years were hardly a uniform, resounding success.) This alerts us to the scale of the

readjustment ahead, which dwarfs the predecessors on which this scenario is built. We simultaneously face deep industrial transitions with significant social consequences, massive regional dislocation and national restructuring, and a shifting geo-political context for the EU. Since neither the EU nor its member states have ever faced such a series of simultaneous, interlocked challenges, the prima facie familiarity of this scenario may well be a mirage. Put differently, the combination of market predominance and subordination of the social may well reach its limits in this world of encompassing and multidimensional change.

### **6.3. Adjustment through social investment**

*Characteristics.* What if we agree on the primacy of markets and the need for social measures, but think that the latter could and should be more ambitious? Instead of thinking of social policy as a necessary complement and corrective tool to markets, as has been the dominant perspective throughout the post-war period, we could see social policies as actively contributing to the functioning of markets. They could help the unemployed into jobs, lift the bottom part of the labour market out of relative poverty, provide incentives for the middle 60% to acquire new, advanced skills, and allow or nudge companies to move into higher value-added product market segments. In this scenario, markets rule, but for a variety of reasons – from social justice to collective hold-up problems that may delay the digital and green transitions – they need a dense framework of supporting (and not just accompanying) policies.

*Disruptions.* While the global disruptions have the same ambiguous effects as above, showing the need for adjustment but not the direction of travel, they play a minor part in this script. The social investment agenda often associated with these active labour market policies has been well under way for the better part of a decade. If we needed reminding, the pandemic has alerted us again to the deep inequalities in job quality in the labour market; the energy and food crises following Russian invasion of Ukraine have lifted the veil on deep inequalities at the bottom of the income distribution. But the possible decline of China, coupled with a re-shoring of parts of the supply chain offer, in this scenario, opportunities for the low-skilled: they can raise their income (slightly) by raising skills to make relatively low-cost parts or provide low-cost services.

*Political evaluation.* There is no denying that this scenario was a serious contender for dominance before the Covid-19 and other shocks. Since at least (or even before) the Danish success with ‘flexicurity’, governments have looked at labour market activation policies as the solution to the dual employment and productivity slowdowns. In addition, if the success of the digital and green transitions in industry is built on the ability to reconfigure workforces through new skills, and new occupations come into being to replace the disappearing ones or to address new social needs, the social investment paradigm seems the most appropriate ‘non-business-as-usual’ way forward. It also has the advantage of setting substantive goals without detail on procedures, which can be adapted to the opportunities and needs of the member states. Sweden will likely require different active welfare and labour market policies than Germany, Portugal, or Croatia, for example.

Yet any supply-side adjustment policy, including social investment, faces two perennial problems. The first is the classic Keynes-Say debate: does supply create its own demand? Unless new (high-VA, but therefore also high-price) products and services are desired, thus the argument, no sensible business will make large investments in new equipment and skills. But without those, the high wages that are necessary to buy the high-price products and

services (even in the social care sector) will never materialise. Since business will not invest without a sense of profits, the system needs jump-starting through demand. Second, even assuming that the aggregate demand problem could be overcome, how could you know what types of skills and other activation measures you need (Hancké 2020a; Hancké 2020b)? In some countries this knowledge problem is resolved through well-functioning, thick, deliberative institutions that govern labour markets, and which can be mobilised to address skills gaps. But these have always required capable government institutions, encompassing and able trade unions that can balance different types of needs, and employers' associations that see the collective benefits of these institutions. Thinking about skills in a practical way, in other words, requires organisations within established institutions – and building those is not a zero-cost operation. Building collective action institutions is itself a collective action problem that cannot be resolved without political intervention, often in areas where European governments have only recently, and then very reluctantly, started to operate. The upshot: social investment works well when social partners and government policies are already well articulated. While not exactly a tautology, it comes worryingly close.

*Areas of action.* This scenario envisages a broader and more ambitious, i.e. deeper, set of policy and regulatory activities, but without departing from the 'highly competitive social market economy' vision that the EU, and its treaties, has of itself. In terms of breadth, it is clear that this scenario would require pushing the limits of existing EU regulatory competencies, in the domains for instance of social security and employment policy, in order to stimulate to the maximum the 'flexicurity' approach that has underpinned the social investment model. It would also require an expansion of competence and qualified majority rule in other areas, from the regulation of the termination of employment to the rights of third country workers, but also a renewed ambition in the domain of social and environmental clauses in public procurement legislation, in order to ensure the broadest possible level playing field for companies to compete on fair and socially and environmentally sustainable terms. This scenario would in essence require the 'floor' of rights to be 'thicker', with more initiatives such as the current Adequate Minimum Wage draft directive. Some of these standards may also perform a pre-distributive function functional to the social investment rationale of this scenario. Competition still takes place, but the bar is higher. Where this scenario significantly departs from the status quo, is in the institutional and policy effort that will be necessary to genuinely enhance, in a more coordinated fashion, the EU skills agenda, with the structural funds being reformed both in terms of their priorities, (more tripartite) structures, and coordination with national institutions.

*Conclusions.* Social investment is a major contending scenario that transcends the limitations of the previous two scenarios. And despite its central, insurmountable, logical problems – the primacy of the market, the chicken-egg aggregate demand question, and the epistemological issues of knowing the future – many governments see it as a way out of the high social cost problem that plagues scenarios based on business as usual, while retaining the primacy of markets. In terms of political optics, it also allows to do just enough more for domestic audiences than the passive adjustment scenarios, while handing the EU a set of relatively easy targets, usually compatible with existing employment strategies. If the two previous scenarios can be understood as negative and positive default options, the social investment scenario keeps what both shares, but adds a government- and society-centred dimension that appeals to political actors in times of deep economic, social, and political crisis.



## 6.4. A new era of industrial ecosystems

*Characteristics.* The primacy of the market that organises the previous three scenarios was never fully uncontested in Europe, however. The continent's tragic history in the 20<sup>th</sup> century can easily be read as markets (and varieties of market based economic and social arrangements) vying with other social orders – fascism and communism – for supremacy. The post-war period in the old member states, in fact, offered a third option, which resonates until today: a mix of market-led economic processes where possible, and government policies where (deemed) necessary. Only 25 years ago, large parts of critical infrastructure – in sectors such as telecoms, roads, energy, and rail practically everywhere, but often many more in some of the southern-European member states – were government owned. While the liberalisation of these sectors has benefited consumers in most places (though not all consumers and not in all countries, as liberalisation processes are vastly diverse), it has also reduced the scope of many direct and indirect industrial policy instruments. This matters: if the 'this time is different' version of the current crises is by and large correct, we may be witnessing challenges that can only be addressed through integrated strategic policies. Hence the combination of an inclusive transition, integrated with social policy; this goes well beyond a 'just' transition that compensates, since an inclusive transition builds technology and green policies in such a way that their effectiveness is enhanced by social adjustment. In addition, the encompassing nature of (re-)shoring balances the needs of industries, employees, and consumers slightly in favour of the first two.

*Disruptions.* Ignoring for a moment the OSA question because it constitutes the core of the problem in this scenario, the economic and social success of the dual transition will likely require a complex mix of state policies and market forces, and the disruptions since the mid-2010s simply strengthen this rationale. In addition, the rapidly shifting geopolitical context almost imposes a combination of progressive industrial policy built on a new social contract. Re-shoring will inevitably create possibilities for good jobs in new industries and could possibly lead to a resurgence of the old European social model that served the continent well for most of the post-war period.

*Political evaluation.* On balance, while industries and workers are likely to benefit from the encompassing short-term industrial responses within a high-level social dimension, taxpayers and consumers are likely to lose in relative terms. The former because any policy aimed at developing, accompanying and furthering new industrial ecosystems is also likely to produce many expensive inevitable failures alongside the successes; the fact that the private sector is unwilling to take on the risks on its own suggests that returns are, at best, unpredictable (and at worst feeble or inexistent). Governments will, therefore, have to underwrite the policies. But basic economics and political economy raise a few red flags in this regard. First of all, shorter supply chains are also very likely to entail higher relative producer prices in the long term (at least until transport costs rise to reflect environmental damage more accurately). One of the characteristics of the integrated single market in Europe, stated explicitly by Jacques Delors in his speech to the TUC in 1988, has been that the single market will be disruptive and will therefore need social measures to accompany its dynamic capacity for creative destruction and reallocation. More concretely, the single market has allowed economic activities to be located where it makes most sense to have them: design and other high value-added activities in high-wage jurisdictions, and low-cost activities in relatively low-tax and low-wage ones. Changing this notion of mutual gains from trade between specialised partners can, *ceteris paribus*, only

result in higher prices. And since every consumer is also a voter, that may have political repercussions.

In addition, the dual transition and OSA require policies that in themselves depend on two conditions: a population of at least embryonically competitive firms, and an institutional framework that supports the orientation of the policy. Unless these two conditions are met, policies to build new industrial ecosystems are likely weak or ineffective. Europe should therefore look at furthering sectors where non-European incumbents do not hold a dominant position with policies that reflect the high-value added, high-wage and high-skill economy that the EU is striving for. That, then, raises questions about developing sectors such as mature semiconductors, while nudging that industry in the direction of producing high-end lithographic equipment or advanced logic chips (Hancké and Garcia Calvo 2022). This logic would also warn against the production of low-end batteries for electric vehicles and concentrate efforts in higher-end R&D in that sector.

*Areas of action.* This scenario requires action in several areas. First of all, a new charter for industrial policy, combining IPCEI, state and regional aid, possibly procurement legislation. This would have to be combined with a fully-fledged ‘pre-distribution’ oriented set of European social directives. This scenario may see the emergence of large conglomerates in certain strategic sectors. It may even lead to a concentration of capital facilitated by state aid and competition legislation, as coordinated with a new approach to EU trade. Assuming a consensus can be found on the shape that such a strategic reorientation would take, these processes of capital concentration may require some re-balancing, including by means of greater worker participation in the decision-making processes of these ‘European champions’ and some degree of public or state control (mechanisms such as a European golden share initiative, may be part of the actions to be considered). The skills base for these industrial champions would have to be nurtured and serviced accordingly. Including by means of targeted and joint pan-European training initiatives (including language skills) to allow different companies to build virtual networks that feed into conglomerates. That probably also suggests that some substantive skills certification method is developed (to allow company A in country X to recognise what workers in company B in Y are doing).

*Conclusions.* This government-centred scenario, based on policies to develop new industries and revitalise existing ones, has its appeal. At a time of rising inflation because of supply-side shocks, political control over the supply side and the development of a proactive high value-added oriented labour market policy is a script that will almost mechanically generate its own constituency of companies, workers, governments, and even consumers. However, the problem is – as so often in economic policies – a level deeper: without a clearly articulated link between policies, institutions and markets, the encompassing OSA scenario could lead to a series of expensive failed industrial policies that benefit one group at the expense of the economy as a whole. Combined with the possible imminent price shock that follows from a suspension of free trade (wanted or not) and a re-shoring of supply, this suggests that the political obstacles to a government-led adjustment model may be difficult to overcome. Some member states are already reluctant for national governments, let alone the EU, to intervene directly in industry, the single market is built on the core notion of free markets, and the notion of spending vast sums on uncertain industrial futures (in an era of austerity?) makes this option lose a lot of its appeal.

## 6.5. Good jobs in a strong and green economy

*Characteristics.* In the final scenario the nature of the digital and green transitions is strongly shaped by social considerations: can green jobs and technological innovation be constructed to maximise the social returns on the investment? In addition, it makes, where possible, re-shoring, home-shoring or ‘friend-shoring’ dependent on gains from trade (effectively using trade as an economic development tool, at home and abroad). It avoids, in other words, the drawbacks of the wider OSA strategy in the previous scenario by being more selective regarding sectors to develop, while also emphasising that markets can be made to follow social and political concerns. Building up a central, almost monopolistic, position in strategic subsectors allows Europe to negotiate with third parties from a position of strength: if China needs EU equipment to build and export its lower-end chips to Europe, both gain immensely from trade (and suffer from a suspension). High social development (in the shape of skills, job security and wages) thus combine with competitiveness as a result of targeted policies, and geopolitical needs that balance free trade with autonomy.

*Disruptions.* As earlier, the uncertain global context is grist on the mill for this approach. In addition, a strong strategic position in one crucial link in the supply chain confers on the EU the possibility of a strategic tit for tat in the case of supply chain disruptions. Rather than concentrating on product markets such as energy and parts, this scenario concentrates on (better) green and digital jobs built on high skills, and bargains with suppliers from a position of relative strength.

*Political evaluation.* The far-reaching strategies in each of the sub-scenarios could probably reach political viability on their own – but as is so often the case in the EU, the combination of all three may be less palatable than each individually. There is also the problem that some member states will find adjustment in one of the legs of this scenario easier to reconcile with their domestic priorities, legacies, and possibilities. In the past, such reluctance was overcome through side payments to hesitant member states. Even though the EU now has many more institutional solutions to overcome disagreements than in 1990 and is emboldened by experience with the funds from the Recovery and Resilience Facility as a recovery from the Covid-19 pandemic, the fundamental problem of buy-in remains, especially against the background of domestic realities. Yet, this institutional blockage may obscure two major benefits of the scenario. One, the relatively lower costs associated with a more selective OSA strategy may also appeal to politicians and voters who are wary of expensive industrial policy experiments. And two, because this scenario has a positive-sum character, whereby all parties can gain (though not all will necessarily gain to the same extent), economic, social and therefore also political losses are minimised.

*Areas of action.* In this scenario the main rationale for policy action is to encourage a greater degree of risk taking to accelerate the twin transition and OSA processes by means of the social and economic stabilisers provided by robust regulatory and institutional intervention in the social domain, chiefly aimed at redistributing the risks inherent to the transitions, dispersing them away from citizens and workers. This scenario therefore relies on the broadest and deepest forms of regulation outlined in chapter 4 in particular, with the purpose of both reducing existing inequalities and spreading future risks. The scenario is more selective than the previous one (‘new era of industrial policy’) in terms of the instruments and sectors requiring capital concentration for the purposes of facilitating the transitions and OSA, as it

assumes that these processes will benefit from the returns on the important levels of social investment and social development.

*Conclusions.* In sum, the good jobs-led adjustment scenario combines economic benefits and social steering, which explains its political appeal. It combines many of the stronger and politically more acceptable features of other scenarios into a mix where losses and gains are minimised and more equitably distributed. And it keeps, as much as possible, Europe embedded in an open world order. But it also faces institutional hurdles, related to the fragmented nature of decision-making in Europe, and because of the diversity of old capitalist systems, each often with its own logic, in the west and neo-capitalist systems in central Europe.

## **7. A Single Market at the service of an environmental, social and technological transition**

The previous sections of this report elaborated on a number of pressing strategic challenges that will shape the future trajectory of the process of European economic integration. These are, in particular, the challenges arising from the ecological and technological dual transition, those connected to Europe's fragile – but ever important - social dimension, and those currently emerging in the context of the 'open strategic autonomy' debate, a debate that is developing rapidly in the shadow of the currently ongoing, military invasion of Russia at the expenses of the Ukraine.

The report pointed out that rechanneling the regulatory framework of the single market around the successful pursuit of the dual transition, of social sustainability, and of the OSA priorities could both revitalise the single market project itself and put the weight of the single market project behind the realisation of what is arguably the most pressing mid-term policy priority: the delivery of a just green transition. We noted that this recalibration of the single market project would also blow some life into the provisions of TEU grounding the EU project onto a highly competitive social market economy that also respects environmental sustainability.

Having elaborated on each axis and its possible future developments in chapters 3, 4, and 5, the report went on to depict, in chapter 6, five alternative possible 'scenarios' that combine different manifestations and possible interactions between the three axes. Chapter 6 does not suggest that any of the scenarios is intrinsically 'better' or 'worse' (this is ultimately a deeply political question). What it does is to set out possible future processes and outcomes, with their risks and opportunities. Each of these scenarios is, however, possible, in the sense of being internally consistent and politically viable (at least in an abstract sense).

In this concluding chapter, we would like to sum up the main features of the two scenarios that, in chapter 6, scored the highest in terms of the two criteria that our scenario building methodology relied upon (consistency and viability), and that – at the same time – offer two starkly different visions for the future of the single market project that depart, more visibly, from the status quo: the scenario that is premised on a new era of industrial policy (scenario 6.4) and the scenario that is most likely to deliver good quality jobs in a strong and green economy (scenario 6.5, in the previous section). For each of the two scenarios we also outline some key policy areas underpinning the particular vision on which they rest, accompanied by a (non-exhaustive and in some respects broad brush) series of examples of possible policy reforms, formulated in the form of policy recommendations. Their purpose is not to set out a detailed blueprint for regulatory reform at the EU level, but rather to provide some input, at a strategic level, in respect of the key policy areas that would need to be addressed and re-oriented, in order to bring to fruition either of the two scenarios. For the record, the authors of this report are neutral about the political desirability of either scenario.

### **7.1. 'A new emergence of industrial ecosystems'**

#### **Key features**

Under this scenario Strategic Autonomy considerations are of paramount importance and are developed and implemented under a strong directive (as opposed to merely regulatory) role of public institutions (national and European) actively supporting capital concentration in a comparatively large number of strategic markets. This scenario borrows from the vision enshrined in the ‘A Franco-German Manifesto for a European industrial policy fit for the 21st Century’ of 2019 (referred to in Chapter 2 of the report) while some of the social and industrial recommendations seek to mitigate some of the negative consequences (social, political, industrial) arising from the oligopolistic and oligopolistic markets that would, inevitably, emerge if its policy orientations were to be pursued fully. Under this scenario strategic autonomy is considered an important goal not only in its own right, but also to ensure successful green and digital transitions, with measures ranging from creating sustainable quality jobs to ensuring recycling valuable raw materials. The emphasis is on strategic autonomy, not necessarily on ‘open’ strategic autonomy. Under this scenario, the single market project would be reformed to support this strategic reorientation of Europe’s industrial ecosystems, aimed at accelerating the ecological and technological transformation, while ensuring that the social costs of this transformation are contained to a minimum (under the watchful eye of a more present and vigilant ‘state’). It would promote the emergence of large conglomerates in certain strategic sectors as well as trigger sustainable supply chains, with capital concentration facilitated by state aid and competition legislation, as coordinated with a new approach to EU trade. In terms of its social dimension, greater emphasis would be placed on selected pre-distributive social policies, workers’ participation, and effective enforcement, but the main public expenditure would be channelled into industrial policy rather than redistributive welfare policies. Again, it is important to emphasise what while this scenario is internally consistent and viable (at least in the sense that it would likely elicit little resistance from the EU’s two largest countries, France and Germany), it would require a paradigm shift in the way the EU understands the significance and implications of the Treaty based concept of ‘highly competitive’ social market economy.

## **Examples of possible policy recommendations, by policy area**

### **Policy Area I: Single market regulation: competition law, state aid, public procurement, level playing field**

*I – Consider the possibility of revisiting the EU Merger Regulation to take greater account of competition in ‘global markets’, ‘potential’ future competition, and the time frame when it comes to looking ahead to the development of competition to give the European Commission more flexibility when assessing ‘relevant markets’,*

*II – Consider the possibility of introducing a right of appeal of the Council, which (subject to certain voting requirements) would be able to override Commission merger decisions in a number of ‘strategically important’ markets and subject to a number of conditions,*

*III – Consider the possibility of making the Temporary Framework for State Aid<sup>67</sup> the ‘new normal’,*

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<sup>67</sup> Communication from the Commission, Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak, C (2021) 8442, 18.11.2021.

*IV – Consider improving the enforcement of the ‘social’ level playing field through internal market instruments, for instance by giving effect to Article 18(2) of public procurement Directive 2014/24/EU (and the other directives) and ensuring that breach be made mandatory grounds for exclusion in line with Article 57(1); fostering sustainable public procurement,*

*V – Consider strengthening further the EU regulatory mechanisms that limit or restrict access to the EU market to companies that benefit from market distortive subsidies, or benefit from a regulatory environment that does not meet EU standards in the domains of environmental and social policy,*

### **Policy Area II- Social policy and industrial democracy**

*VI – Consider strengthening EU labour law and social policy directives to enhance their pre-distributive potential and level playing field rationale (as discussed in section 4. 4 (scenario 2), above).*

*VII – Consider strengthening EU corporate governance rules, including by means of new directives and regulations, in order to ensure greater workers participation (in particular in large companies and in companies with substantial market power along supply and value chains) and greater public participation (e.g. European ‘golden share’ rules),*

*VIII – Earmark a combination of EU-level and national funds to support local social and economic restructuring and redevelopment.*

### **Policy Area III – Sustainable Industrial policy**

*IX – Refine an EU industrial policy based on an ecosystem (enabling) approach that should strengthen and broaden the scope of instruments such as IPCEIs and industrial alliances (among others) in key areas e.g. in batteries, chips, hydrogen etc., by ensuring a level playing field and that both large and small Member States benefit from it,*

*X – Develop a legal, institutional and operational framework for the recycling of valuable and rare raw materials, fostering circular economy, also along the lines of the ongoing policy discussion around the EU Critical ‘Raw Materials Act’*

*XI – Develop a regulatory and funding framework (including by means of public schemes and public contracts and concessions) for companies investing in transition technologies, i.e. technologies that provide clear environmental dividends in the short run but that are likely to become quickly obsolete by newly emerging technologies, so as to provide an adequate return on the understanding that capacity will be shut down early.*

*XII – Develop closer cooperation between universities and industry in applied science and engineering areas, possibly through a dedicated research and development fund, in order to foster breakthrough innovation in strategically important domains,*

*XIII – Incentivise companies to take job design for new products and processes into account early in the adjustment processes.*

## **7.2. ‘Good jobs in a strong and green economy’**

### **Key features**

This model strives to combine strong social and ecological outcomes with competitive markets. Market processes may require steering to mitigate negative externalities adversely affecting social and ecological outcomes, while a combination of incentives and regulation will ensure that ecological and social considerations are actively taken into account in business decisions. This adjustment model emphasises the distributive (both pre- and re-distributive) potential of social regulation and of demand side effects linked to green transition policies. The authors of this report believe that a full redistributive mode could only be achieved if the EU were to overcome its current competence limitations as emerging from the present Treaty structure. However, given the political complexities of any such reform, we do not include a specific recommendation for this particular policy area, and simply refer our readers to some of the ideas discussed in Chapter 4 of the report. Social and green policies would stabilise the single market and encourage the risk-taking and innovation needed to maximise the potential of the digital transition, while offering the skills necessary to pursue it. Importantly, competitiveness follows, in logic, as much from internal processes as from exposure to actual competition in this model. Open strategic autonomy concerns would therefore be assuaged by reducing negative externalities and would contribute to both the socio-ecological sustainability of the single market. A narrow set of very strategic key markets could be targeted with specific policies aimed at facilitating re-shoring beyond the socio-ecological concerns mentioned above. But this would be an exception to the rule of ‘openness’ and competitiveness. Overall, under this scenario, high social development (in the shape of skills, job security and wages) combine with competitiveness as a result of targeted policies, and geopolitical needs that balance free trade with strategic autonomy. While remaining neutral about the political desirability of this scenario, the authors of this report feel it would provide a more suitable match for the treaty-based vision of an EU premised on a ‘highly competitive social market economy’, as well as a strong alignment with the UN’s SDGs.

### **Examples of possible policy recommendations, by policy area**

#### **Policy Area A: Single market regulation: competition law, state aid, public procurement, level playing field**

*I – Consider making the Temporary Framework for State Aid<sup>68</sup> the ‘new normal’ in sectors closely linked to the dual transition and in assistance of restructuring processes arising from ‘supply chain’ impact assessment,*

*II – Explore the possibility of adopting a more flexible interpretation of efficiencies (and consumer welfare) in the EU Merger Regulation to incorporate the notions of environmental and social sustainability, quality of product and its eco-design as well as resilience of production,*

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<sup>68</sup> Communication from the Commission, Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak, C (2021) 8442, 18.11.2021.



*III – Explore the option of using the EU’s standard setting capabilities as a key lever for the EU to remain fit for the challenges of the dual transition; new generation of FTAs with broader social and environmental sustainability chapters, highest European standards as well as stronger (USMCA like) enforcement mechanisms. FTAs also used as means to enforce fair taxation by reference to the OECD’s Base Erosion and Profit Shifting rules to combat tax evasion and avoidance,*

### **Policy Area B - Social policy and industrial democracy**

*IV – Consider expanding the EU treaty base in the social domain, by removing the excluded areas and unanimity requirements from Article 153 TFEU, expanding competencies in the domains of social security, to be followed by a new wave of socially ambitious directives with a broad scope and a social progress rationale and the adoption of an ‘Enforcement Directive’,*

*V – Consider the update of existing equality directives as well as the adoption of new ones aimed at achieving equality of outcomes (quotas, public sector equality duties) and addressing socio-economic inequalities,*

*VI – Making ‘SURE’-like initiatives (i.e. initiatives that offer incentives for income support or income replacement schemes during transitions) the ‘new normal’ in all sectors and industries affected by restructuring processes connected to the ‘dual transition’. A reform and bolstering of EU Structural funds, expansion of Just Transition and Social Climate Funds to support the transitions, and better integration with RRF and NRRPs.*

*VII – Enhancing democracy at work with a greater role for social partners and social dialogue across a number of EU policy and governance areas, from ECB to sector level regulation, to corporate governance and develop local and national forums involving all relevant stakeholders to assess skill needs, skill gaps and provision.*

### **Policy Area C – Sustainable Industrial policy**

*VIII – Introduce an impact assessment of supply chains to assess costs associated with negative externalities arising from (hitherto hidden) environmental and social liabilities and costs,*

*IX – Revising public procurement rules in order to optimise the achievement of green and social sustainability goals (e.g. explicitly request contracting authorities to require suppliers to have effective social and environmental sustainability policies in place as part of selection criteria; increase the range of sustainability standards; introduce sustainability targets etc.),*

*X – Introduce social and ecological impact assessment procedures as part of EU or national funding plans,*

*XI – Involving of consumers and SMEs as a driver of dual transition, increasing their information set about product cycle, quality, sustainability and recycling practices as well as promotion of eco-design products (similar to the battery*

*regulation) with transparent information on traceability of their ecological footprint, sustainability and recycling in the single market.*

### **7.3. Conclusions**

At the heart of this report lies the belief that the major challenges associated with the European Green Deal and, in the interim, the ambitious targets included in the ‘Fit for 55’ package will require a rebalancing of the functioning of the single market in a way that can both facilitate reaching these goals and, at the same time, ensure the political stability and viability of the European integration project for the years to come. In simpler terms, the report explored ways in which it would be possible to recalibrate some aspects of the single market’s functioning in order to make it fit for the next – challenging – decade whilst facilitating the strategic objective of meeting the pressing demands of the green transition, the technological and digital transition, the EU’s aspirations to greater strategic autonomy, and its social sustainability dimension.

Following a detailed analysis of the strengths, weaknesses, opportunities and threats to the single market project, the report engaged with the key challenges posed by the dual transition, by growing inequalities, and by the changing industrial and geopolitical landscape surrounding the single market and the European project as a whole. The report sought to capture the potential developments of, and possible responses to, each of these three key challenges by developing a number of micro-scenarios, that were eventually combined and merged in order to develop a limited number of macro-scenarios, two of which were examined at greater length in the present chapter.

These are the two scenarios that scored the highest according to the two criteria on which our scenario-building methodology was based (consistency and viability) while also offering two starkly different visions for the future of the single market project. These visions represent a very visible departure from the status quo: one is premised on policies aimed at fostering the rapid emergence of industrial ecosystems while the other is most likely to deliver good-quality jobs in a strong and green economy. Each of them would deal with the key challenges analysed in the course of this report, but each would do so in its own way and with different social, economic, and industrial outcomes. For each of the two scenarios, this chapter also outlined some key policy areas underpinning the particular vision on which they rest, accompanied by a strategically oriented, and non-exhaustive, series of examples of possible policy reforms.

The authors of the report are neutral about the political desirability of any of these scenarios. They note, however, that the scenario outlined under the ‘Good jobs in a strong and green economy’ label, arguably provides a better fit for a vision of the EU as premised on a ‘highly competitive social market economy’ aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment, a vision that – as noted in the opening pages of this report – is currently enshrined in the EU treaties. This important point aside, the major advantage of this scenario is that of investing further in some of the existing strengths of the European single market project, such as a proven track record in incremental innovation, a highly skilled workforce, robust standards in a number of domains (from consumer protection to environmental ‘product-related’ standards), and the capacity for innovation and job creation among small and medium-sized enterprises (SMEs). At the same time, its policy suggestions seek to remove some of the single market current weaknesses, especially those linked to growing inequalities, increasingly precarious working

conditions in some segments of the labour market, the unfulfilled exportability of ‘process-related’ standards, and a certain inability of labour market institutions to perform the redistributive function that, arguably (before the deregulatory and austerity phase at the turn of this century), they once performed rather effectively. This scenario is the most capable of ensuring that green and social policies stabilise the single market while offering the skills necessary to affect the three main transitions the EU is currently dealing with in a holistic manner. Overall, this scenario is less likely to deliver what the report refers to as ‘blockbuster’ innovation (arguably a strength of the previous scenario), but by stabilising markets and extending and raising social and environmental standards it is likely to foster the ‘risk-taking’ attitude that is equally conducive to innovation and faster (if not accelerated) transitions.

These few considerations aside, the authors of this report remain cognisant of the deeply political implications attached to each scenario pertaining to the future regulatory and policy trajectories of the single market project (itself a fundamentally political project in the first place), and of the crucial importance that political choices are primarily driven by democratic mandates rather than by technical expertise alone. As noted in the opening paragraphs of this report, which scenario will prevail is ultimately a matter of politics – of collective choices made in the deliberative institutions that define European democracies – and of policies, the tools to pursue collectively defined targets, within a historical, institutional and political context.

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