

EU economy

## Who killed Europe's single market dream?

A decades-long effort to tear down internal trade barriers has stalled, leaving the EU economy 'tagging along behind'

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Europe's economy felt undercharged, and under siege. Its advanced tech sector had fallen behind, while the US and Asia's manufacturing powerhouses were riding high. For business, even moving the simplest things within Europe seemed to involve bureaucratic torment.

"Is it over-optimistic to announce a decision to eliminate all frontiers within Europe and to implement it?" asked one of Europe's leaders. "Those who have nothing to propose are soon forgotten or held in contempt. Those who do not have the means to match their ambitions are rapidly reduced to tagging along behind."

The politician was Jacques Delors, the year 1985. From his European Commission emerged a vision: the single market, the world's largest integrated cross-border economy that came to span 450mn consumers.

Yet 40 years on, that project has failed to deliver on the ambitions of Delors, Margaret Thatcher and the generation that championed change. While many internal barriers on goods were removed by 1992, they remain — seemingly immovable — within the EU for services, capital and some labour. As Delors warned, Europe's economy is “tagging along behind”.



European leaders gather in Luxembourg in 1985 before reaching agreement on the Single European Act, which was intended to form the basis of a common market © Marcel Mochet/AFP/Getty Images

Obstructions to trade within the EU are equivalent to a 100 per cent tariff for services, and a 65 per cent tariff on goods, according to the European Central Bank. The tangle of protectionist rules is such that even breadmaking is hampered: in some 25 years only one French baker has been recognised by Germany as a *meister* permitted to run a bakery.

The grand single market project still exists as a political totem for the EU. But its energy and momentum stalled long ago. One of the world's most successful liberalising projects of the late 20th century has fizzled to leave Europe's economy as the story of secular decline in the 21st.

This is the first in an FT series examining what went wrong — and why it is going to be so difficult to revive the single market as a growth engine for Europe.

The whodunnit for modern Brussels: who killed the single market dream?

“We are sitting on a huge reserve of growth at a time when it is needed for the green transition, digitisation, defence and an ageing population,” said Pascal Lamy, a former EU trade commissioner and chief of staff to Delors. “Much remains to be done. We have clearly been way too slow.”

The warnings are growing ever louder. Christine Lagarde, the ECB president, last month pleaded with Europe’s leaders to remedy “years of inaction” and re-engineer an economy “geared towards a world that is gradually disappearing”.

Mario Draghi, left, with European Commission president Ursula von der Leyen, published a report last year criticising Europe’s fragmentation © Wiktor Dabkowski/ZUMA/Reuters

Her predecessor Mario Draghi last year sought to jolt the EU into action with a searing report on fragmentation in Europe that was having a “cascading effect on our competitiveness”. High-growth companies were driven overseas, investment opportunities reduced and the development of Europe’s capital markets stunted.

Europe’s leaders have duly vowed to unleash reform to address the productivity chasm that has opened with the US. President Ursula von der Leyen’s Commission published a single market strategy this summer, and has promised a “road map” by the end of the year to re-energise the project.

Yet even that road map is mired in turf wars within the Commission and between national capitals, officials involved in the process in Brussels say, bogged down by the same national interests, political red lines and lack of vim that has stymied substantial progress for decades. One senior official warned of “paralysis by analysis”.

Vested interests, rising Euroscepticism and other crises sucking up policymakers’ attention have hampered further liberalisation in the past and are likely to do so in the future. Meanwhile new national rules on products and services have undone some of the earlier progress. Central enforcement of common rules — essential for any reforming momentum — has petered out.



## A wide gap in productivity has opened up between the US and the EU

Productivity (GDP per hour worked, \$ PPP 2020 prices)

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Source: OECD • Current EU and Euro area member state

Above all the EU has struggled to muster the same sense of purpose that marked the single market’s inception in the mid-1980s, which owed much to Delors, who took over as Commission president in early 1985.

Member states were keen to revive their sclerotic economies, and the Frenchman realised the most consensual way for him to relaunch the European project was by removing internal barriers to trade.

Progress was rapid. Six months after taking office Delors had a detailed action plan drawn up by the British commissioner Arthur Cockfield and the go-ahead from national capitals, despite British objections to the extension of majority voting as a way of streamlining lawmaking. The entire project was enshrined in law a year later with a target date: “Objective 1992”.

The EU has struggled to muster the sense of purpose that marked the single market's inception in the mid-1980s, which owed much to then-European Commission president Jacques Delors © Brian Harris/Alamy

Delors was the driving force, said Lamy, his chief of staff at the time. “There was a real authority to midwife something that, by the standards of the time, was extremely ambitious.”

The commission has never again matched Delors' authority and single-mindedness, Lamy added.

In reality, the single market only applied to goods, when services even then and more so now accounted for a larger share of the economy. Liberalisation and integration of telecoms and energy markets were seen as impinging on national sovereignty and so were deferred to a later date, which proved slow to arrive.

What went wrong? Lamy blames his fellow commissioner Frits Bolkestein, a bluff Dutchman, for setting back the cause of integration with a politically ham-fisted attempt to liberalise services.

Bolkestein's original draft directive would have allowed companies to offer services in another member state according to the rules of their state of origin. It caused a fierce backlash in several countries, where critics conjured up the spectre of the immigrant "Polish plumber" undercutting the wages of locals. A heavily watered-down version was passed in 2006. Little progress has been made since.

"The politics of that weren't cooked properly, given the sensitivity in many member states," said Lamy. "It basically backfired and left a scar on the issue that takes a lot of time to fix."

Mario Monti, internal market commissioner from 1995 to 1999, blames 'economic nationalism' for the project's stalled momentum © Alessandro Bremec/NurPhoto/Getty Images

Mario Monti, who served as internal market commissioner from 1995 to 1999, said momentum behind the project had dissipated because of rising "economic nationalism" in member states and a loss of faith in markets, especially after the financial crisis.

Monti also said "the overwhelming support that was there at the beginning from the business community faded out a bit" as companies became more global in their outlook and as their attention turned instead to monetary union.

The Italian economist wrote a report in 2010 for the commission on how to reboot the single market. But he said the response to his and subsequent reports amounted to a “triangle of hypocrisy”.

Business and national governments say the EU must wake up, implying Brussels is to blame when “we know that in reality most of the obstacles are there because national governments want the obstacles to stay there”. Brussels, Monti said, then feels intimidated by the blame game and becomes “even more shy” of enforcing the rules of the market.

Meanwhile, businesses that collectively support the idea of more market integration at the same time “lobby their respective governments to protect them from the winds of the open market”. Recent moves by Germany and Italy to thwart banking-sector consolidation were good examples, Monti said.

As the EU’s largest economy and most powerful member, Germany carries special responsibility for the stasis.

“Germany has historically lacked a comparative advantage in services and resisted integration for fear of competition from countries stronger in this area,” said Sander Tordoir, chief economist at the Centre for European Reform. “In the long run, Germany too would benefit from deeper capital and services markets, but in the short run, integration means more competition and disruption.”

The sputtering momentum behind the internal market is playing out visibly in the economic data. GDP per head remains just 72 per cent of US levels, according to the IMF.

There is no shortage of evidence of the economic benefits of more integration.

IMF research published last month shows that big economic hubs across the continent are failing to reach their potential because of trade barriers. Reducing those impediments, alongside domestic reforms stripping away growth-unfriendly labour market and tax rules and boosting skills, could raise EU output per worker by over 20 per cent, it estimates.

“When you’re looking at European companies, they grow in each of their 27 markets and the cross-border nature of their operations is impeded by these intra-European trade barriers,” said Alfred Kammer, director of the European Department at the IMF. “The second part is what Europe is missing, a deep capital market, it just doesn’t exist.”

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## Trade between EU countries lags well behind trade between US states

Trade in goods as a share of GDP (%)

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Source: [Danish National Bank](#), Eurostat, US Freight Analysis Framework

Costs to workers of migrating between EU countries are about eight times higher than for migration between US states, the Fund says, reflecting factors including difficulties shifting pensions across borders and navigating professional licensing requirements.

Matthias Bauer, a director at the European Centre for International Political Economy, a think-tank, said the EU still lacked the common rules to properly bind the single market together.

“The EU might even have made things worse [adding] new layers of EU regulation on top of very complicated and growing national regimes that govern everything from consumer protection to labour law to taxation,” he said.

Business leaders bristle over regulatory overload in some sectors. “There’s always good intentions with regulatory development,” said Jesper Brodin, former chief executive of Ingka, which runs most Ikea stores. “But eventually it’s like a hedge — it grows and grows, until the only thing left to do is cut it.”

The boom in technology investment that is currently under way in the US is dwarfing anything being undertaken in Europe. Investment by the so-called Magnificent Seven tech giants in the US is more than half the entire EU total spend on R&D, according to analysis from McKinsey.

There are numerous reasons for this, but one of them is an absence of sufficient venture capital for new high-tech companies to scale up in Europe, and the continued proliferation of barriers that make it easier to grow across the Atlantic.

“We have so much potential, but we really have to unleash it,” von der Leyen said this month. “This however requires a shared sense of urgency and all hands on deck.”

But national governments say the sense of urgency or economic peril required to force compromises is still absent, with policymakers instead settling for minor tweaks to EU regulations in the name of simplification.

“It seems that every meeting, every speech, every interview ends with us saying: ‘And of course a key priority is improving competitiveness and fixing the single market’ or whatever,” said one EU member state ambassador. “We claim it’s not an afterthought but, with all the other issues going on, so often it is.”

One solution is to proceed in smaller groups of EU members, an idea favoured by Carlos Cuerdo, Spain’s economy minister. Cuerdo is pushing for a “coalition of the willing” to accelerate integration. It would encourage countries to move forward for “fear of missing out”, he said.

“These bottom-up approaches can serve as a catalyst. It is difficult to go from 27 fragmented markets to one in one go, but we can work in steps and hopefully that will help.”

A more radical idea put forward by academics Luis Garicano, Bengt Holmström and Nicolas Petit in a new paper would be for the EU to focus all its efforts on its “core mandate of economic integration” using its full “federal” legal powers.

This would involve prising open markets using EU regulations, which permit no national variation, eliminating national regulatory powers in areas of “exclusive” EU competence and establishing EU commercial courts to enforce mutual recognition of national standards.

“The EU does not need a new treaty or new powers,” they write. “It just needs a single-minded focus on one goal: economic prosperity.”

*Additional reporting by Peter Foster in London and Richard Milne in Oslo*

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