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The Increasing Geoeconomic Usage of the Single Market for Financial Services*

KEY MESSAGES

- **The Single Market in financial services has increasingly been used for geoeconomic purposes, that range from incipient geoeconomic use to outward weaponization of the Single Market in finance**
- **This geoeconomic usage can be illustrated in a few salient cases that involve the EU and other major jurisdictions: (1) the post-2008 crisis transatlantic tug-of-war; (2) the Brexit negotiations; and (3) during the full-scale war in Ukraine**
- **We adopt four metaphors to characterize the geoeconomic deployment of the Single Market and the EU's geoeconomic actorness. These are shield and sword; testudo; phalanx and scattered commandos**
- **A mix of external and internal factors accounts for this pattern, for instance, changes to the international economic and political system as well as the development of the EU's ability to deploy its Single Market geoeconomically**

The European Union (EU) has created a Single Market in financial services (traditionally, banking, capital markets, and insurance, see Quaglia 2010), the evolution of which has become entangled with geoeconomics, i.e., "the systematic use of economic instruments to accomplish geopolitical objectives" (Blackwill and Harris 2016, 1). The main rationale of geoeconomic measures is not the achievement of mutually beneficial economic gain, but rather the pursuit of geostrategic advantages by seeking relative rather than absolute gains.

We examine the geoeconomic use of the Single Market in financial services by focusing on the period since the Great Financial Crisis of 2008, which was a turning point in global finance. We consider three case studies that concern international players that are of importance to the EU: the United States (US), the United Kingdom (UK) and Russia. Using these cases we explore variations in the geoeconomic use of the Single Market and the factors that may account for the observed pattern, ranging from the only incipient geoeconomic use to the outward weaponization of the Single Market. The cases are discussed in chronological order: the transatlantic tug-of-war about the governance of global finance after the Great Financial Crisis; the Brexit negotiations in finance after the 2016 referendum on the UK's withdrawal from the EU; and the adoption of EU's financial sanctions against Russia in 2022 and 2023.

Borrowing from ancient military jargon, we adopt four metaphors to characterize the geoeconomic deployment of the Single Market and EU's geoeconomic actorness. Having identified four ideal-typical usages of the Single Market in financial services, we argue that a combination of external and internal factors accounts for these patterns. First, at the systemic level, there were growing challenges to the liberal international order. Second, at the domestic (here: the EU) level, there was the EU's ability to use its Single Market for geoeconomic purposes.

A FRAMEWORK TO EXPLAIN THE GEO-ECONOMICS OF THE SINGLE MARKET IN FINANCIAL SERVICES

Our analytical framework combines external and internal factors at the international and domestic levels. The first dimension of our explanatory framework concerns the systemic level – the international context in which the EU interacts. Major changes in the international economic and political system have been conducive to the geoeconomic use of the Single Market for financial services. The second dimension of our explanatory framework concerns the domestic level. Taking as a given the considerable size of the EU's market for financial services and the EU's regulatory capacity (i.e., the EU's ability to regulate this market), we argue that the cohesiveness (i.e., unity or otherwise) of the EU has had an impact

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on the deployment of the Single Market for geoeconomical purposes.

Conceptually, we identify four possible outcomes of the geoeconomics of the Single Market in finance. We offer four metaphors – ideal types – borrowed from ancient military formations and tools, to characterize the geoeconomic usage of the Single Market for defensive and offensive purposes. The EU can deploy its Single Market as (1) a "shield" (for instance, to deflect the extraterritorial effects of third-country regulation) and as a "sword" (to project its regulatory power externally), sometimes in an uncoordinated manner. The EU can deploy its Single Market (2) as a "testudo," which is a military formation whereby a group of soldiers protect themselves on all sides by using their shields in a coordinated manner. The EU can use its Single Market as (3) a "phalanx," i.e., a military formation whereby a group of soldiers deploy shields and spears in a coordinated manner for defensive and offensive purposes. Finally, groups of member states can deploy the Single Market as (4) "scattered commandos," in an uncoordinated manner (Figure 1).

By combining our two explanatory factors and the outcomes, we construct a matrix. Used as a heuristic device, our explanatory factors and outcomes are placed nicely into boxes; reality is of course much messier. Next, we apply the analytical framework outlined above to three selected case studies. For each case, we outline the international economic and political context; we examine the intra-EU dynamics; and we explore the use of the Single Market for geoeconomic purposes.

TRANSATLANTIC REGULATORY TUG-OF-WAR AFTER THE GREAT FINANCIAL CRISIS

The tug-of-war between the EU and the US on the governance of global finance, after the Great Financial Crisis of 2008, provides the first case study. Both the EU and US adopted more stringent domestic regulation, after the 2008 crisis, in a variety of financial services, but, initially, they did so in an uncoordinated way. Both these powers acted unilaterally and set out to export some of those rules to third countries, including each other. On the one hand, the EU's support for more stringent post-crisis financial regulation was driven by social purposes and not primarily by geopolitical concerns. Yet, the transatlantic regulatory tug-of-war had geoeconomic implications: US-EU regulatory disputes could (and, sometimes, did) trigger the fragmentation of cross-border financial services (notably, derivatives), which was unpalatable to the financial industry on either side of the Atlantic. EU negotiations with the US were driven more by relative than absolute gains: business communities were eager to avoid disputes.

The simultaneous tightening up of the US post-crisis domestic financial regulation led to a range of disputes (Quaglia 2014). Transatlantic regulatory disputes, defined as disagreements between jurisdictions about the content and/or scope of each other's regulations, were particularly heated with reference to hedge funds and derivatives. Three points are particularly noteworthy. First, while these disputes involve seemingly technical matters, the core issues were who should set the rules for global finance, whose domestic rules should prevail, how such an agreement would affect global financial stability, as well as the competitiveness of domestic financial industries. Second, the EU was able to deploy its market power (including its increased regulatory capacity) as a "shield" and a "sword," to protect its Single Market and to gain better access to foreign markets for the EU financial industry. Third, in some of these regulatory disputes, notably on hedge funds and, somewhat less, on derivatives, the EU was internally divided as the UK sided with the US.

Post-crisis transatlantic regulatory disputes were resolved mostly by "mutual accommodation," whereby the EU and the US adjusted domestic rules (or their application) so as to minimize cross-border regulatory clashes (Posner and Quaglia 2023), whereas previously, whenever transatlantic regulatory clashes in finance occurred, the EU usually gave in to the US. Overall, the EU used the Single Market in financial services as a shield to deflect and to push back against the extraterritorial effects of US financial regulation, and as a sword to project its regulatory power externally.

Figure 1
The Analytical Framework with Metaphors and Case Studies

International level	EU level: Internal divisions	EU level: Internal unity
Limited challenges to LIO	Transatlantic regulatory disputes after 2008 (shield and sword)	Brexit (testudo)
Major challenges to LIO	"Differentiated" adoption of financial sanctions by member states (scattered commandos)	Financial sanctions against Russia (phalanx)

Note: LIO = liberal international order.
Source: Authors' compilation.
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BREXIT – MAINTAINING A UNITED FRONT

A second notable instance of the geoeconomic use of the Single Market in financial services, this time as a testudo, occurred during the Brexit negotiations, i.e., the negotiations concerning the UK's departure from the EU and the subsequent EU-UK economic and political relations. Following the Brexit referendum, it was not clear whether the EU would find and maintain a united front when negotiating with the UK (Cini and Verdun 2018). Prime Minister Boris Johnson repeatedly declared that he wanted to "have his cake and eat it" (Dallison 2017), meaning that the UK would cease to be a member of the EU, while continuing to take advantage of many of the benefits that ensued from EU membership (Verdun 2023).

Instead of allowing internal differences to prevail, the EU was in this case able to speak with one voice thereby protecting the integrity of the Single Market. Throughout the negotiations, the European Commission, the European Parliament (EP), and the member states made clear in concrete terms that the four freedoms were indivisible and that there would not be a special deal for finance. Although exceptions would have been economically advantageous for the UK, as well as for EU financial operators engaged in cross-border business, financial interest groups based in the EU were told not to campaign publicly for a special deal for finance (James and Quaglia 2021).

The German and especially the French governments insisted on the need for a tough EU negotiation position vis-à-vis the UK and to maintain the integrity of the Single Market ruling out a special deal for finance. They also saw Brexit as a good opportunity to lure business away from London and to encourage financial entities and activities to relocate to the main continental financial centers, notably, Paris and Frankfurt, what Howarth and Quaglia (2018) have called the "battle for financial services," with the main continental financial centers "competing for a share of the pie" (Verdun 2023, 113).

The EU's negotiating stance was maintained over time and no special deal for finance emerged. The UK-EU (2020) Trade and Cooperation Agreement made no specific provisions for financial services. It was accompanied by a non-binding Joint Declaration committing the UK and the EU to "agree to establish structured regulatory cooperation on financial services." A subsequent four-page EU-UK Memorandum of Understanding (2021) only discussed non-legally binding regulatory cooperation (HM Treasury 2021), while not addressing the issue of market access.

Financial services are crucial to the UK as that country is, still today, the world's largest exporter of these services. At the time, approximately one-third of that export went to the EU. Thus, this issue was of considerable economic and political significance given the impact of Brexit on finance in the UK and the EU. The EU acted as a block forcing the UK to accept EU terms, ensuring that the interests of the EU as a whole and the integrity of its Single Market were protected. The way in which the EU negotiated with the UK, we argue, was informed by some geoeconomic considerations because EU positions were driven more by relative than absolute gains. In fact, both UK and EU financial sector businesses were interested in a special deal; yet it were more the goals of keeping the Single Market intact and maintaining clearly demarcated inside/outside borders of the EU polity that prevailed over considerations of economic gain.

THE WEAPONIZATION OF THE SINGLE MARKET FOR FINANCIAL SERVICES DURING THE WAR IN UKRAINE

The third case study examines the deployment of the Single Market in financial services as a tool of economic warfare against Russia. Although the EU had already imposed sanctions against Russia following the annexation of Crimea and the destabilization of Ukraine in 2014, those sanctions mostly pertained to the diplomatic dimension, targeting individuals, and an embargo on Crimea (Portela et al. 2021). It was only after the full-scale Russian invasion of Ukraine, from February 2022, that the EU "weaponized" (Farrell and Newman 2019; Quaglia and Verdun 2023) its Single Market in finance vis-à-vis another major international power (European Union 2022). The financial sanctions against Russia had defensive and offensive purposes. Two factors account for this geoeconomic use of the Single Market in finance as a phalanx: a significant shift in the external environment and intra-EU agreement to deploy its market for foreign policy, specifically, security-related, goals.

At this time, the international context features the shrinking space for multilateral negotiations in trade policy, but also in other areas, such as environment and climate change. There are also growing concerns about the security and strategic implications of economic interdependence. Another change is the rise in US-China systemic rivalry. Challenges are also posed by the potential unravelling of European economic and political integration following the UK's departure from the EU in 2020. These changes add to the overarching spread of populism, nationalism, sovereignism, and nativism at the domestic level. Moreover, multilateral cooperation faces opposition from anti-globalization forces. These major shifts in the international economic and political system, and specifically, the multiple challenges to the liberal international order, provided increasing pressure on the geoeconomic usage of the Single Market.

Intra-EU developments also played a role. President of the Commission Ursula Von der Leyen and her College of Commissioners appointed in 2019 were a self-proclaimed "geopolitical Commission," to take a more prominent global stance after having had difficulties taking on political leadership previously. This idea did not originate from von der Leyen. Rather, the national leaders who appointed her, particularly French President Emmanuel Macron, favored this change in direction (Müller-Hennig 2019). High Representative of the EU, Josep Borrell (2019), described the international context as characterized by "power politics," where 'international law is…..undermined and … trade, technology and finance are used as tools of international competition. They become political weapons." Borrell also pointed out that for the EU "geopolitics begins at home."

In addition to intra-EU agreement, the sanctions against Russia were coordinated with the other countries of the Group of Seven (G7) namely, Canada, France, Germany, Italy, Japan, the UK, and the US. The first set of sanctions was adopted on February 28, 2022. They consisted of the following components: the removal of selected Russian banks from the SWIFT messaging system to disconnect these banks from the international financial system and harm their ability to operate globally; restrictions concerning the access of certain Russian entities to EU capital markets; prohibition for EU banks to accept deposits exceeding certain amounts by Russian nationals; prohibition for EU central securities depositories to hold accounts of Russian clients; prohibition to sell euro-denominated securities to Russian clients; restrictive measures to prevent the Russian central bank from deploying its international reserves in ways that undermined the impact of the economic sanctions adopted against Russia, de facto, the prohibition of transactions with the Central Bank of Russia and the freezing of all its assets (Walker 2022). It was also agreed to limit the sale of citizenship to Russians (European Commission 2022).[1]

Three points stand out with reference to the weaponization of the Single Market in finance. First, the EU had a cohesive stance. After the general agreement by the G7 countries, the various sanctions packages were adopted unanimously by the Council of the EU and endorsed by the European Parliament. Furthermore, the EU was not arm-twisted by the US to adopt these sanctions, unlike what happened in the past. Second, the quest for intra-EU consensus was more elusive with reference to economic sanctions concerning the import of oil and gas from Russia as member states had different degrees of dependency on Russian fuel. It was difficult for the EU to decide whether to limit the price of gas as the winter of 2022–2023 approached after nine months of full-scale war. Yet, intra-EU consensus prevailed on the need to have financial sanctions. Third, this geoeconomic usage of the market may serve as a double-edged sword: it is at once an instrument of foreign policy, but also creates incentives for players that are being pushed out to set up alternative financial instruments or markets, and risk the orderly functioning of the global financial system.

POLICY CONCLUSIONS

We have examined variations in the use of the Single Market in financial services by identifying four ideal-typical geoeconomic usages. During the EU-US regulatory disputes post-2008, the EU mostly acted as a market power, seeking to externalize its domestic rules (shield and sword). During the Brexit negotiations, the EU maintained unity (testudo) vis-à-vis the UK to protect the integrity of the Single Market. When imposing sanctions against Russia, by contrast, the Single Market in finance was deployed for geopolitical reasons (phalanx) to constrain Russia. Moving forward, it could happen that, if the coalition of supporting EU member states falls apart, or if the EU deploys other financial instruments (e.g., the euro or Banking Union) against Russian aggression, a risk to the unity of the EU's geopolitical use of its economic power could transpire (scattered commandos). This situation might occur especially if member states have competing preferences. Should such a moment arise, it would fill the fourth cell of the matrix (the left bottom in Figure 1), which includes instances in which the EU is internally divided, while the liberal international order is under siege.

[1] Similar financial sanctions were subsequently adopted against Belarus. More packages were agreed to in subsequent months; at the time of writing the last one was agreed to in June 2023.

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