The ever incomplete single market: differentiation and the evolving frontier of integration

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ABSTRACT Progress in market integration over the past two decades has come at the expense of growing flexibility in the laws that govern the single market (SM) as well as the way that these laws are implemented. This differentiated integration comes in four forms: soft; informal; multi-speed; and opt-out differentiation. We examine how the completion of the SM has been held back in the varied implementation of EU competition policy and variation in national corporate law, energy markets, services and taxation. These sectors and issue areas form the frontier in which the main political struggles over the future shape of the SM take place, and in which differentiation is most clearly manifested. The SM notion supposedly entails a concrete set of substantive policy commitments that form the basis of the ‘ever closer union’. However, increasing differentiation undermines the identification of the EU’s core constitutional commitments.

KEYWORDS Competition policy; differentiated integration; economic integration; energy markets; implementation; services; single European market.

INTRODUCTION

The single market (SM) of the European Union (EU) is the world’s most advanced and sophisticated multi-national project of economic integration. Its stated goal, as enshrined in the 1957 Treaty establishing the European Community (EC), is to enable the free cross-border flow of goods and services, labour and capital (the so-called four freedoms). With time, the EU member states have increasingly undertaken a comprehensive approach to this project, and market integration has increasingly encroached on national sovereignty. The 1987 Single European Act (SEA) was adopted to reinvigorate the process of market integration by way of the reassertion of existing goals but also institutional reform.

In view of the enormity of this task, the member states accepted that progress towards achieving the four freedoms in practice would be gradual, relying on Commission and Council initiatives and European Court of Justice (ECJ) rulings. This gradualism has several aspects. First, it means that agreed liberalization measures can take long periods to be implemented, whether a prolonged transition period is agreed in advance or political difficulties prolong the
implementation process in practice. Second, even where they share a vision of
further market integration, it takes time for the member states to agree on practical
measures to implement integration in ever more sensitive issue areas, and to trans-
fer more authority from national to transnational and supranational bodies. Third,
the completed SM is an essentially contested concept and what is acceptable in the
different member states is in constant evolution. As technology and societies
develop, the project is reinterpreted and new ambitious goals are formulated.
Thus, the SM is an incomplete project and it is difficult to envisage its completion.

The approaching silver anniversary of the SEA and the 10th anniversary of the
Lisbon agenda provide cause to assess the state of European market integration
and, more specifically, focus attention upon those economic sectors where inte-
gration is far from complete or has stalled at the frontier of market integration.
This collection is not an attempt to re-examine the causal variables behind the
project. Nor does it seek to analyse the implications of the SM for European
and world politics and economics, nor to study the SM in a historical perspective
(Egan 2010). Rather, this collection brings together contributions that apply the
tools of political economy and political science to explain the success and failure of
recent efforts to further market integration in a range of economic sectors.

By way of introduction, we argue here that progress in market integration
over the past two decades has come at the expense of growing differentiation,
which is particularly present in the evolving frontier of economic integration.
The next section explores the concept of differentiated integration in the
context of market integration. This concept is then applied in the third
section to examine how further integration has been held back because of
varied implementation of EU competition policy and persistent differences in
national corporate law, energy markets, services (especially financial services,
transportation and telecommunications) and taxation. These sectors and issue
areas form the frontier in which the main political struggles over the future
shape of the SM take place.

DIFFERENTIATION IN THE SINGLE MARKET

Being at the core of the EU’s constitutional order, the SM is supposed to be free
from discrimination among its member states. However, the laws that govern the
SM as well as the way that these laws are implemented demonstrate a surprising
degree of flexibility in integration, or differentiation, which implies discrimi-
nation. Differentiated integration in the SM comes in four forms (Andersen
and Sitter 2006). The first two forms are soft and informal. Soft differentiation
arises from legitimate discretion in the implementation of EU legislation by
member states, whereas informal differentiation refers to the variance in de
facto member states’ compliance with EU legislation. Both forms represent discre-
tionary differentiation, which is particularly relevant with regard to the implemen-
tation of SM, health and safety, and environmental legislation (Scott 2000).

There are three main reasons for these forms of differentiation. First, member
states can design directives to be less specific in order to allow for greater
national margin of manoeuvre in implementation (Andersen and Sitter 2006). Second, policies that have been agreed at the EU level may encounter opposition from regional and local governments, which will result in distorted implementation. Finally, some rules designed to improve the SM may generate competitive disadvantages for producers interacting outside the European market. Temporary Commission toleration of non-compliance is one way in which the EU addresses this tension (Smith 2010).

The average EU transposition deficit (the share of directives yet to be transposed into national law and implemented by each member state) has fallen dramatically since the mid-1990s, from 6.3 per cent in 1997 to 0.7 per cent by the end of 2009. Likewise, the percentage of outstanding directives which one or more member states have failed to transpose in relation to the total number of SM directives has declined from 27 per cent in 1997 to 5 per cent in 2009 (European Commission 2010b). By November 2009, seven member states failed to meet the revised 1 per cent target and only four were far off. However, this improvement in transposition disguises the large number of directives that have yet to be fully transposed by all member states by the due date. By November 2009, there were 74 directives (five per cent of the outstanding total) still awaiting full transposition, with 16 of these being more than two years overdue (European Commission 2010b). Transgression in transposition is greatest in financial services, energy and transport markets. The Lisbon Treaty creates the possibility of imposing penalty payments upon member states for late transposition of directives, which will provide further incentive for member states to comply rapidly with their legal obligations.

While transposition delay has declined considerably as a source of differentiation, incorrect transposition and implementation of SM directives continues to contribute significantly to differentiation, with infringement greatest in taxation, customs union, environmental issues, energy and transport. Little action has been taken by the majority of member states to reduce the number of open infringement proceedings brought by the Commission in recent years and, at the end of October 2009, there were 1,206 open infringement cases (European Commission 2010b). Several member states are also often slow to comply with ECJ decisions, the average compliance delay being over 18 months (European Commission 2010b). There are substantial differences in terms of member states’ responses to decisions on infringement.

The third form of differentiation, multi-speed, comes by way of temporary derogations from SM and SM-related secondary legislation. Temporary derogations are provided for either through specific legislative provisions or accession treaty provisions adopted with regard to the application of policies that have significant cost implications for industry. Named member states are explicitly exempted from an obligation but usually for only a specific period of time. One recent example of multi-speed differentiation is the regulation of chemicals (see Smith 2008, 2010). The Regulation, Evaluation and Authorization of Chemicals (REACH) directive allows for the application of a socio-economic analysis to permit derogation, and to the extent that this
might create a national bias the result is scope for more patterned and permanent differentiation.

Unlike treaty opt-outs, secondary legislative differentiation and transition periods for new member states on the SM still function ‘within the context of a broader constitutional commitment, in the sense of an overall shared commitment to the same normative project’ (De Búrca 2000: 143). The European Commission (1978) has optimistically presented such differentiation in secondary legislation as fulfilling, rather than breaching, the non-discrimination principle. The addition of Article 20 by the SEA established a treaty basis for existing practice. It allowed only for a particular kind of temporary, ‘least disruptive’ differentiation and on the basis of only one, albeit broadly conceived, justification: ‘the extent of the effort that certain economies showing differences in development will have to sustain’ (Single European Act 1987).

Opt-out and general derogation on secondary legislation form the fourth form of differentiation – the explicit legal sanction of potentially permanent differentiation in either treaties or legislation. General derogations or exceptions are established on grounds of public policy, public morality, public security and public health, as well as the protection of the environment, the working environment, health and life of humans, animals or plants, and industrial and commercial property. Explicit protocols appended to treaties have allowed for opt-outs or special provisions to specific member states. The 1991 Treaty on European Union (TEU) introduced differentiation through the opt-outs provided to the United Kingdom (UK) and Denmark on Economic and Monetary Union (EMU). A TEU protocol also allows Denmark to maintain its existing legislation on the acquisition of second homes.

Most multi-speed differentiation in secondary legislation is allowed for well-founded socio-economic reasons, notably capacity (level of economic development) and national economic structures. Indeed, in the wake of the recent enlargements of the EU, soft, informal, and especially, multi-speed forms of differentiation have increased exponentially. However, some cases of differentiation incorporated into SM legislation cannot be justified in terms of different levels of economic development. Other considerations have shaped multi-speed differentiation, general derogations and opt-outs, such as ideology (Della Sala 2010; Gerber 2001; Wilks 1996), domestic political circumstances and technical preferences.

DIFFERENTIATION AND THE SINGLE MARKET’S CHANGING FRONTIER

Competition policy and corporate law

EU competition policy tackles a range of non-tariff barriers to the four freedoms: market-distorting state subsidies; mergers leading to dominant market share; abuse of dominant market share; and discriminatory government procurement. That being said, the TEC allowed for some limited exemptions to the application of EU competition policy for the sake of interventionist national industrial policies.
In particular, state aid of a social character or aid designed to develop poor regions was deemed compatible with the SM. In addition, national competition law (affecting the operation of companies that are located primarily in the national market and thus not subject to EU competition policy) continues to be distinct (Eyre and Lodge 2000). Exemptions to the EU’s state aid policy also include ‘Services of General Interest’ (i.e., energy, telecoms, transportation and water). However, even allowing for these exemptions, non-compliance by member states with EU competition policy constitutes an important contribution to differentiation in the SM. At least some of this differentiation reflects the persistence of different national forms of industrial policy. These forms include the provision of state aid, the maintenance of state ownership and intervention in mergers and acquisitions to protect some sectors from foreign ownership.

State aid policy is one of the most politically contentious aspects of the EU’s competition policy. The provision of state aid to industry (within or outside EU law) varied considerably among the member states even before the distortions of the recent financial crisis. Sweden, Austria and Germany were large providers, while Britain provided relatively little state aid (European Commission 2007 and 2010a). The beneficiary sectors also varied among member states, but prior to the financial crisis the bulk of state aid in most member states went to manufacturing. The Commission was granted constitutional authority in the TEC, but it only slowly acquired formal implementing powers. Relying also on discretion, it managed to reduce aid in the 1990s and 2000s (Zahariadis 2010).

Several member states intervene regularly to encourage or block potential mergers and takeovers by foreign firms, action that can contravene both EU competition policy and the free movement of capital. France, Italy, Germany and Spain have engaged in interventionism on mergers with the aim of maintaining national ownership in identified ‘strategic’ sectors. For example, in 2005–2006, against EU law, the French government prepared a list of 11 strategic sectors, in which it planned to resist foreign ownership. Even companies such as Danone (dairy) and Carrefour (supermarkets), which are not strategically important and are not government owned, were brought under this policy. The ability of member state governments to block mergers rests in part on state ownership or control (through golden shares) of companies, which is not necessarily contrary to EU rules. Despite large privatization programmes over the past two decades, France and Italy in particular have several large companies in which the state retains part-ownership. However, European Commission and ECJ action has worked to undermine national protectionism, including a direct challenge to ‘strategic sector’ legislation. For example, the ECJ (2007) overruled a German law that protected Volkswagen from acquisition. Some member states – notably the UK and the Netherlands – maintain a more laissez-faire position and support the rigorous enforcement of EU rules.

Since the launch of the SM project in 1986, the Commission has sought to challenge public procurement by national governments that discriminate in favour of national firms and against foreign competitors. An evaluation of the public procurement market demonstrates persistent differentiation. Those
member states with relatively informal procurement legislation before the adoption of EU directives – notably Germany, the Netherlands and Denmark – and those which have more decentralized procurement practices (again Germany and the Netherlands) have more problems with compliance and more compliance costs. A list of infringement cases brought by the Commission against member states for failing to follow public procurement rules demonstrates the same trends seen in the implementation of EU competition and SM policy (Smith 2010). The Scandinavian countries are the most compliant, whilst Germany and Italy have the greatest difficulty following EU rules, followed by Spain and France. Member states with strongly centralized procurement policies (like the UK or Portugal) are more likely to respect EU rules.

Efforts to harmonize corporate law in the SM traditionally have encountered severe difficulties as they exposed the rift between the Atlanticist and continental approaches to corporate–government relations (Clift 2009; Hanczé et al. 2007; Menz 2005). In the early 2000s, Commission initiatives seemed to lean in the Atlanticist direction, including, for example, an attempt to eradicate the practice of non-equal rights between company shareholders, and to require shareholder approval before taking defensive measures against takeovers. Indeed, a growing majority of European companies have implemented the principle of one vote per one share throughout the decade. However, a significant number of firms still issue some shares with prioritized voting, and in 2007 the Commission abandoned its attempt to incorporate the principle of one vote per one share into European law. The key elements of the European Takeover Directive, agreed in April 2004, were made optional, allowing firms to continue with established corporate governance practice on takeovers. The directive gives legal sanction to existing differentiation.

In the same year the European Company Statute regulation came into force (Council 2001). The Statute makes cross-border activities potentially easier, avoiding the need to establish subsidiaries. However, few EU member states took legislative steps to assist companies to take advantage of the Statute. The slow implementation of national laws leaves unanswered questions about taxation and the status of shareholders. Since various ECJ rulings smoothed cross-border activities anyway, few firms bothered to register as European firms.4

Energy

National monopolies have long been the norm in the energy sector. There has been persistent domestic political opposition to privatization and liberalization, with strong trade-union, party-political and public hostility – encouraged by the fear that gas and electricity prices would rise after liberalization. Furthermore, competition concerns have clashed with security concerns, as Europe imports much of its energy sources from politically unstable and potentially quixotic Middle Eastern and ex-Soviet countries. Recently, pipeline shutdowns in the wake of Russia’s disputes with its neighbours seemed to suggest that European competition in energy plays into Russian hands. Similarly,
attempts by government-controlled Russian companies to buy privatized or break-up assets strengthened supporters of national energy champions.

Against this backdrop the Commission has been striving for more than a decade to create a SM in electricity and natural gas production and supply based on free competition. The TEC equipped the Commission with the legal power to unilaterally break up national energy monopolies, and it has pushed to eradicate trade barriers, approximate tax and pricing policies and lay down foundations for common norms and standards. From December 1996, industrial energy consumers were gradually freed to shop for electricity among competing suppliers. A similar liberalization followed in the gas market.

Nevertheless, differentiation has persisted in the energy sector (Andersen 2001; Howarth 2010). Some member states, notably the UK, business and consumer groups supported the Commission’s push for liberalization. Others, notably France and Germany, were sceptical if not hostile to full liberalization and the unbundling of production and supply. As a result, some member states have moved quickly towards liberalization, while others have dragged their heels.

German and French governments stuck to the minimum requirements of the 1996 and 1998 directives to liberalize, respectively, the electricity and gas sectors, while EU-level legal action forced some movement. Third-party access to transmission networks for electricity and gas was blocked by several member states through the discretion allowed in the 1998 directive: a combination of ambiguous wording and omissions. Member states were allowed to choose between regulated and negotiated third-party access, and to develop or maintain their national regulatory models. In several member states, public take-up of alternative energy providers has been minimal and market access restricted. Homogenous integration worked only with respect to limited policy initiatives in the energy sector such as price transparency for electricity and gas contracts. The Commission, encouraged by Britain and a minority of member states, pushed for a complete unbundling of production and supply.

Another round of reforms followed in the mid-2000s. In 2003 a directive was adopted for the full liberalization of the energy market, which allowed all consumers to purchase energy from any EU company as of 2007. The directive also mandated that electricity suppliers separate the processes of generation and transmission, and make prices more transparent. However, there remained physical limitations; some national grids do not easily connect. Some governments time and again resisted the process. In 2005, the Commission took five member states to the ECJ for not implementing the 2003 directive. Chauvinistic attitudes on the part of the member states were especially apparent in the mid-2000s when, for example, the German and French governments supported the expansion of EON and EDF respectively into foreign markets, and Hungary’s MOL bought back some of its own stock in order to prevent a takeover by Austria’s OMV (Clifton et al. 2010).

This trend led the Commission to criticize in 2007 the competition barriers in the energy sector, and especially the vertical integration of EON, RWE, EDF and GDF. Nevertheless, in 2008 the Commission’s efforts were essentially
defeated. The member states agreed to embed into EU law the right for individual governments to choose one of three different models of unbundling: full ownership unbundling (selling a parent company’s transmission networks to a different firm); the independent system operator model (parent companies retain ownership of the transmission lines, but transfer managing control over networks to a separately managed and owned operator); and the independent transmission operator model (a parent company retains ownership of transmission networks, but is subject to heavy supervision by a national regulator).

The soft form of differentiation in the energy sector was transformed into a more permanent legislated differentiation.

While the new directive will bring about a change in national practice in member states that traditionally opposed unbundling, it remains a dangerously unprecedented piece of EU legislation that explicitly recognizes differentiation in the operation of national energy markets. Indeed, at the end of the 2000s, competition in the energy sector remains very limited in most member states and consumer prices vary significantly. Very long-term contracts (10–15 years) between the suppliers and consumers are common.

General services

The service economy has grown steadily in recent decades as a proportion of the member states’ national output, and accounts for more than 70 percent of jobs in the EU. In 2005 the Commission estimated that full liberalization of the service market will create 600,000 jobs and increase output by 33 billion euros (Jensen et al. 2005). Despite its place as one of the four freedoms of the SM, relatively little integration has been achieved in services, especially compared with industrial goods. This is not for want of trying. The Commission’s attempt to promote liberalization was epitomized in the 2006 Bolkestein Directive, which was far less ambitious in its final version than its initial draft. Crucially, the directive excludes banking, telecommunication, transportation and health, as well as the ‘country of origin’ principle (according to which satisfying regulation in the home member states of the service provider allows provision in all member states).

The difficulty in completing the SM in services stems from the clash between the deregulation of services on the one hand and national wage regulation and social policy-making on the other (Menz 2010). Re-regulation of service provision by governments is crucially affected by the lobbying efforts of trade unions and employers. Being often labour-intensive means the competitiveness of service providers depends greatly on labour costs. However, there are also concerns for established culture and lifestyle (as reflected in rules on shop opening hours and the maximum work week).

Financial services

Although capital mobility is often described as one of the four freedoms at the heart of market integration, for many years the SM was really based only on
three and a half freedoms. This is because the TEC was interpreted (including by the ECJ) to enshrine capital mobility only to the extent necessary for enabling free flows of goods and services. This line of thinking was inconsistent of course, as there can be no freedom to provide financial services without the freedom to move capital within the SM.

Efforts at creating a SM in financial services only began with the first banking directive of 1977, and intensified only after the liberalization of capital movements in the 1988 directive. However, the SEA did little in practice to promote the SM in financial services and, in 1992, European financial market integration was still in its infancy. Many European banking systems remained largely closed to foreign operators except in niche markets. In part, this was compensated for by global financial liberalization, but continental European securities markets lagged behind American, British and Asian markets.

The Financial Services Action Plan (FSAP) and the introduction of the Single Currency in 1999 gave new momentum to financial market integration in the EU. Most of the measures proposed in the FSAP concerned securities trading, and they subsequently found their way into the four Lamfalussy directives. Of these, the most important one is the Markets in Financial Instruments Directive (MIFID), which came into effect in 2007 and applies the ‘country of origin’ principle to wholesale and retail trade in securities. However, as with many directives, much detail was left for the member states to fill in, allowing for soft differentiation. The Lamfalussy directives proved to be politically controversial, their design influenced by two competing coalitions: the ‘market-making’ coalition, formed by ‘Anglo-Saxon’ and Northern member states; and the ‘market-shaping’ coalition, formed by southern member states (Quaglia 2010). This split was based on conflicting material interests as well as diverging belief systems.

**Transportation**

Most of the progress in integrating European transportation services has recently taken place in rail networks. The 1994 Essen European Council agreed to prioritize 14 Trans-European Networks (TENs) infrastructure projects, focused largely on high-speed rail. The TENs involve EU funding to reinforce European market integration and contribute to European social and economic cohesion. Thus, the TENs are, by their nature, selective in membership. Differentiation has arisen through the selection of particular projects and particular countries or groups of countries (Howarth 2010; Wallace and Wallace 1995: 54). Within a decade, this drive to better integrate rail has served also to integrate ports and airports (Stephenson 2010). However, train services remain as nationalized as naval and air transportation. Most trains still change drivers at borders.

**Telecommunications**

Since the 1990s a new, liberalized policy environment in telecommunications (and electricity) enabled previously inward-looking national suppliers to
transform into world class Multinational National Corporations (MNCs) (Clifton et al. 2010). These national champions invested mostly in buying (or setting up) firms based in other member states within the SM. In 1994 the Council endorsed the Commission’s proposal for the full liberalization of the entire land line phone markets beginning in January 1998. Free competition in cellular communications commenced in January 1996 and in all telecommunication fields in January 1998. This liberalization drive was a response to the spread of internet and mobile phone technology and to competitive challenges from the United States, Japan and beyond. Liberalization was also based on the realization that only a European project could encourage all member states to liberalize without the fear of falling into the familiar Prisoner’s Dilemma’s worst case of losing national assets in these strategic sectors without being able to gain similar assets in other member states. Nevertheless, countries implemented liberalization in different ways and speeds, sometimes delaying or restricting liberalization and promoting national champions after all (Eyre and Sitter 1999). The liberalization of the telecommunications sector is thus another example of multi-speed differentiation. Indeed, in the mid-2000s, cross-border cellular rates were still significantly higher than national ones.

**Tax harmonization**

There is a high level of differentiation in tax policies in the EU, dividing the low-corporate tax Atlantic and eastern member states from the high-corporate tax continental and Mediterranean member states. Clearly the SM is incomplete without a single tax system, but fiscal policy has historically been a central element of national sovereignty, and thus many member states are hesitant about progress in this issue-area. In spite of difficulties in pushing forward formal agreements on taxation, there is a process of incremental harmonization of value-added taxes and excises in the SM (Kemmerling 2010). The SM fosters this harmonization by conditioning policy co-ordination and learning among the member states.

The SM also accelerates competition among member states in corporate income taxation, by fostering market integration, through deregulatory competition and through the application of EU law. Specifically, ECJ decisions prohibit taxation that discriminates among EU citizens and firms. Some indirect harmonization also results from member states’ campaigns against tax evasion by MNCs, because ECJ decisions against MNCs also apply to local firms. Furthermore, the ECJ has continuously decided against taxes and laws that hinder business mobility among member states (for example, the ECJ [2006] ruling in favour of Cadbury-Schweppes’s right to freely establish itself in low-tax Ireland). This competition in corporate income taxes has so far been a source of divergence of tax rates, but may in the future bring about their harmonization.
CONCLUSIONS

This contribution explores the range of differentiation in the SM, which in effect contributes to discrimination and undermines market integration. With EU enlargement and further attempts to push market integration forward, there is greater risk that proliferating forms of differentiation will increasingly undermine the EU’s sense of coherence or purpose and fragment its legitimacy and authority. However, it is clear from several recent legislative developments, including the directives on takeovers and energy production and supply, that differences among the older member states also drive legislated and, likely, permanent differentiation. The 2008 directive on energy production and supply challenges the official justification for legislative differentiation, as temporary and linked to socio-economic difference. In newly important sectors and issue areas, from competition, to environment, to services and taxation, differentiation continues to be used to forge compromises that supposedly further market integration in the EU. Thus, there is a tension between the role of differentiation in impeding SM development and its role in facilitating progress. Differentiated integration, like issue linkage and side payments, is one instrument for addressing the problem of collective action: that an outcome that is to the advantage of most concerned is blocked by a minority (Dyson and Sepos 2010: 3).

De Búrca (2000: 149) notes that ‘the history of secondary legislative differentiation suggests that derogations which may infringe the core principles and commitments of the EU are unlikely to be particularly significant or numerous’. However, the TEU opt-outs and recent European energy market legislation challenge the core commitment of EC and EU membership. This kind of non-temporary differentiation is likely to affect the perceived legitimacy of the polity, in the sense that differential treatment on the basis of ideological preference or political obstructionism, rather than identifiable socio-economic difference, may gradually undermine the idea of commonality which underpins not just the SM core but the EU more broadly. While adopted to contain conflict, rising differentiation in the SM thus undermines the core constitutional commitment of the EU, the definition of the common good and the future of the EU as a political entity.

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NOTES


2 See Armstrong and Bulmer (1998); Craig and G. de Búrca (1999); Menz (2005); and Thatcher (2009).

3 For further discussions of the different definitions of differentiated integration see Dyson and Marcussen (2010) and Dyson and Sepos (2010). Dyson and Sepos (2010: 4) define differentiated integration as ‘the process whereby European states, or sub-state units, opt to move at different speeds and/or towards different objectives with regard to common policies. It involves adopting different formal and informal arrangements (hard and soft) . . . In this way relevant actors come to assume different rights and obligations and to share a distinct attitude towards the integration process.’

4 An important exception was Allianz, Europe’s largest insurance firm.

REFERENCES


