Irreconcilable Differentiation:

Central Authority vs. Flexible Integration in Today's European Union

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Abstract
Many European leaders and observers have argued that the European Union's multiple recent challenges call for more "differentiated integration." At first glance the EU may seem to lend itself quite well to such an approach, with already variegated memberships in the Euro area or Schengen borderless travel zone. What proponents of differentiation tend to overlook, however, is that the Union's core commitments are not set up to permit much internal variation at all. Indeed, in the EU's two flagship policy areas – the Single Market and the Eurozone – the defining institutional principles rule out differentiation to a striking degree. To elaborate this claim, we show that the rules in these areas are considerably more constraining of EU member states than are analogous federal constraints within the United States of America. We then highlight how these tightly limiting principles of EU economic governance have shaped recent negotiations with Greece in the Eurozone and the United Kingdom in the Single Market. While the EU's core constraining principles make calls for differentiation all the more comprehensible, they also underscore that differentiated options may require rather fundamental change to the current institutional status quo.

Key words: Brexit, differentiation, European Union, Eurozone, integration, Grexit, Single Market, United States.

Introduction: Towards a Differentiated EU?

On March 25, 2017, European dignitaries gathered in Italy's eternal city to commemorate the sixtieth anniversary of the signing of the Treaties of Rome. The mood was downcast and solemn rather than celebratory, since the European project had been hit by a series of major challenges. EU officials were still reeling from the June 2016 UK referendum vote to leave the Union. Uncertainty continued to hover over Eurozone financial markets after years of crises. Political conflict over huge waves of refugees had led to the reinstatement of temporary national border controls in the Schengen area of passport free movement. The governments of Hungary and Poland were challenging fundamental EU principles of liberal democracy and the rule of law. New and old populist parties on both left and right were surging across the continent, and mainstream centrist parties had become more Eurosceptic in response. Externally, recently elected American President Donald Trump had dismissed the EU as a "vehicle for Germany" and declared NATO "obsolete," while an emboldened Russian President Vladimir Putin continued his saber rattling along the EU's Eastern border in Ukraine and the Baltics (Matthijs, 2017a).

Though European leaders predictably proclaimed that the EU could handle these challenges, their response still marked a notable break from the past. Previously, the customary elite response to perceived crises of integration had been bold calls for "more" Europe. Jean Monnet's famous dictum, that "Europe will be forged in crises, and will be the sum of the solutions adopted in those crises," usually helped to reassure EU officials and statesmen that building an "ever closer union" was the appropriate answer to most of Europe's problems (Parsons and Matthijs, 2015: 210). This time, as an enlarged Europe struggled with its heterogeneity, the new buzzword was "differentiation."

Among the five scenarios for "the future of Europe" that Commission President Jean-Claude Juncker published at the occasion of the 60th anniversary, the one that received the most attention in media and policy circles and that was centrally-presented, seemingly flanked by less plausible extremes, was the third option, awkwardly titled "Those Who Want More Do More" (European Commission, 2017). It came with a wave of commentary arguing that Europe's most feasible futures entailed "variable geometry," "different speeds," or something along those lines (e.g. Gotev, 2017; Blockmans, 2017; Russack, 2017; De Vries, 2018). In the typically pithy summary of *The Economist* magazine, "Europe's future is multi-speed and multi-tier" (Economist, 2017). Today it is fair to say that most observers accept some version of this notion: either the EU embraces some form of differentiation or faces potential disintegration.

This paper highlights elements of the EU that make these calls for differentiation all the more comprehensible but also underscore why many of them are likely to be frustrated. On the face of it, the EU context seems well suited to differentiation. It already features quite a bit of "variable geometry." As of this writing, nine of 28 member-states remain outside the Eurozone and six of 28 are outside the Schengen borderless travel area. Some non-EU members use the euro (Montenegro, Kosovo). Some non-members are fully inside the EU's Single Market (Iceland, Norway, Liechtenstein). Switzerland has a bespoke arrangement. Turkey is a member of the EU's customs union. What this variety in memberships can conceal, however, is that for full EU members, the Union's core commitments are not set up to permit much internal variation. Indeed, in the EU's two flagship policy areas – the Single Market and the Single Currency – the defining institutional principles rule out differentiation to a striking degree.

To elaborate this claim, we show that the rules in these areas are considerably more constraining of EU member-states than are analogous federal constraints within the United States of America. American states hold broader autonomy to retain differentiated regulation that impedes exchange and mobility in the American internal market. They are also subject to significantly less oversight over fiscal policy choices, current account rules, and structural reform than EU states face in the Eurozone. Overall, the EU is considerably less permissive than the US in requiring its subunits to open themselves to the single market and to abjure certain macro-economic policy tools. Even temporary and medium-term opt-outs of the single market's "four freedoms," or economically rational demands to be exempt from fiscal austerity and structural reforms for even a limited period of time, are simply not on the table (see Matthijs and Blyth 2018).

We then go on to show that these tightly constraining principles of EU economic governance have been on vivid display in recent negotiations with Greece in the Eurozone and the United Kingdom in the Single Market. In the discussions of a possible Grexit and Brexit, both countries sought differentiation and have been largely rebuffed. Under Prime Minister Alexis Tsipras, Greece sought various kinds of policy flexibility to avoid having to exit the Eurozone. Not only was his program rejected, but the overall EU response has been to ramp up constraints and macro-economic scrutiny of *all* Eurozone members. UK Prime Minister David Cameron tried and failed to renegotiate the terms of the UK's membership in the Single Market as a way to head off rising complaints about immigration in British politics. That set up the disastrous Brexit vote in June 2016 – and even this explicit choice to leave the EU has only highlighted more starkly how difficult it is to arrange differentiated access to the Single Market. We conclude by observing that

while there may well be modest ways to differentiate membership in the Eurozone or in the Single Market, actually meeting rising demands for significant national policy flexibility would require a level of change to fundamental EU rules that seems hard to imagine at this point.

The Difficulties of Differentiation in the Single Market and the Single Currency

Differentiation first attracted attention in EU studies in the early 1990s with British and Danish "opt-outs" from the Maastricht Treaty. Stubb (1996) offered an early breakdown of the concept, distinguishing between temporal differentiation (i.e. transitional deals), territorial differentiation in membership, and sectoral differentiation by policy area. More recently, European actors' turn toward a discourse of differentiation has led scholars to further develop the concept. Holzinger and Schimmelfennig (2012: 296) pointed out that all forms of differentiation have territorial and sectoral aspects. Leruth and Lord (2015) called for more systematic thinking on the topic. Schimmelfennig, Leuffen and Rittberger (2015: 765) suggested a useful typology of differentiation with 'vertical' (policy) versus 'horizontal' (territorial) and 'internal' (among EU members) versus 'external' (including non-EU members) dimensions.

The kind of differentiation that interests us concerns the ability of European states to adopt or maintain varying economic regulations and policies. In most cases this means "internal" differentiation, though not all: EU membership per se matters little for the constraints Norway faces in the Single Market, and the UK may be headed toward a similar outcome once Brexit becomes a reality in the spring of 2019. As Holzinger and Schimmelfenig (2012) have noted, variation in particular member states is invariably

"territorial", but also "sectoral" because it involves room for maneuver in certain areas as opposed to a distinction of full 'in-or-out' status. In temporal terms we are especially interested in permanent or temporary opportunities for differentiation within EU rules for existing members, as opposed to transitional arrangements for new members. This can include the permanent ability to invoke temporary safeguards and derogations (especially if they are only legally "temporary," but frequently used or renewable in practice). Given this brief article format, we choose to focus on major room for policy variation, not fine-grained variation in implementation or enforcement on the ground.[1]

Constraints on Differentiation in the EU's Single Market in American perspective

Consider first a comparative US perspective on how much the EU permits differentiated member-state policies that bear on the Single Market. In constitutional-level foundations, the polities seem roughly comparable. The American Commerce Clause authorizes the federal Congress "to regulate commerce… among the several states." The EEC treaty of 1957 spells out related commitments much more explicitly. It bans "[q]uantitative restrictions on imports and all measures having equivalent effect," and further committs member states to the "abolition… of the obstacles to free movement of persons, services and capital," with possible exceptions for reasons of public policy, public security, or public health (Article 3). Still, even if the American phrasing is much vaguer, all sources agree that the point of the Commerce Clause was to authorize federal action to maintain free-flowing interstate commerce. Even conservative "originalists" like Robert Bork point out, "Given the text of and purpose behind the [Commerce] Clause, Congress

certainly has the power, at a minimum, to displace state laws that discriminate against interstate commerce, either explicitly or implicitly" (Bork & Troy 2002, 852).

In both the US and the EU courts have played a major role in interpreting these central powers. Though the US Supreme Court has built up important federal powers through the Commerce Clause, it has done so in ways that permit a wide range of state-level policies that impede interstate commerce while pursuing other goals. Early on it recognized a "dormant Commerce Clause," giving federal authorities the ability to strike down barriers in state laws even without Congressional action. The mid-20th century Court extended the scope of Commerce powers to cover every conceivable aspect of economic regulation. But the dormant Clause has only been invoked consistently to bar *purposeful* discrimination against interstate commerce – like bans on out-of-state wine orders in *Granholm* (2005) – while allowing many other policies that obviously impede interstate commerce.[2] Moreover, the scope of the Clause was extended mainly to permit progressive federal policies, not to restrict a wider range of state policies. Also worth noting is that another line of jurisprudence exempts public procurement entirely from the Commerce clause, authorizing explicit protectionism in state purchasing (Julander, 2002).

In the EU, meanwhile, the ECJ has set limits on a far wider range of national laws. In goods, the 1974 *Dassonville* ruling found that the treaties forbade "[a]ll trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade" (Weiler 2000). In services, cases from *Van Binsbergen* (1975) to *Säger* (1991) and *Gebhard* (1995) established similarly that member-states could not in any way "impede" or even "render less attractive" cross-border provision of services. Exceptions are allowed, but state policies that impede

interstate mobility must be necessary for clear policy imperatives, non-discriminatory, suitable to obtain their goal, and proportional.[3] Overall, the EU subjects its members to a remarkably strong legal presumption of full and automatic openness to other member states' citizens and firms, hemming in the development of a huge range of policy areas.

As important as jurisprudence has been in both contexts, "judge-made law" is typically slow and compartmentalized, and legislation is necessary to set direct Single Market constraints on states. In the US, Congress has used its legislative authority to "preempt" state laws in many areas, but rarely in the name of reducing interstate barriers. Such concerns have been prominent in finance, like in the 1994 opening of retail banking, and partly relevant to federal laws in transport and telecommunications. But most modern preemptions relate to progressive concerns like food and drug safety, the environment, or labor conditions. They may harmonize diverse laws across the states, but their goal is not to facilitate interstate exchange (Buzbee, 2008; Epstein & Greve, 2007). For example, the current Republican-held Congress has pursued a wide-ranging agenda of loosening or removing federal regulations, with no attention to interstate barriers whatsoever.[4] GOP leaders argue for "relief" from federal requirements rather than new federal rules to promote interstate openness.

As any student of EU politics knows, the past 30 years have seen a real flood of legislation designed specifically to translate the ECJ's legal parameters for the Single Market into active policy. Rulings like *Dassonville*, *Van Binsbergen*, and *Cassis de Dijon* (1979) laid the foundations for the 1986 launch of a torrent of directives in the "Single Market 1992" program. The 1989 case *Rush Portugesa* facilitated "posting" of workers to other states while regulating them under home-country rules, leading to a legislative

attempt in the Posted Workers Directive of 1996 to limit circumvention of tougher labor regulation and costs in receiving countries. But since the directive was passed under treaty rules on "freedom of services," the ECJ later interpreted it in ways that constrained receiving-country options in the so-called "Laval quartet" of cases in 2007-8 (Davies, 1997; Barnard, 2008). Meanwhile a "big bang" in liberalizing services jurisprudence in the early 1990s (*Säger*, *Gebhard*, and other cases) set the stage for generalized services liberalization, which became the main Single Market legislative focus by the turn of the millennium (Hatzopoulous, 2012). The results were the Professional Qualifications Directive of 2005 and the Services Directive of 2006 (De Witte, 2007; Nicolaidis & Schmidt, 2007). Major legislative action in these directions continues today, despite a series of integration crises.

The EU institutions are moving along proposals from 2014 to tighten the implementation of rules in services, procurement, and company law, as well as taking new steps to regulate digital markets. Whereas US politicians have largely been content to let courts police relatively loose commerce-related constraints on state policies, then, the EU has very actively enacted legal Single Market principles that directly require change in state policies. Could it be that US federal authorities constrain their states less than the EU does simply because 250 years as a nation-state have left little state-level differentiation in policies to restrict? US states are certainly far more homogeneous than EU states in almost every way – but not when it comes to regulation that relates to the Single Market.

US states continue to make their own policies with little regard for interstate commerce concerns. First, in many areas of *goods*, US states are still largely authorized

to have their own standards and requirements, making the US "by far the most institutionally heterogeneous and fragmented of all advanced industrial countries" (Tate, 2001: 463). To give one concrete example, elevator manufacturers make different models for US jurisdictions, which have different standards. The EU worked this out with the 1995 Lifts Directive (Hoffmann, 2011).

Second, in *services*, nothing requires US states to recognize other states' professional qualifications or licenses, and they generally do not (Egan 2015, 206). Even experienced architects, lawyers, electricians, contractors, or hairdressers typically start from zero to qualify to practice in another state. Temporary provision of interstate services (where someone licensed in one state sells services in another) is generally impossible: providers must be fully licensed in each state to practice even for one day. The EU, meanwhile, has an elaborate regime that generally requires recognition of other states' qualifications and licenses. Each member state must also maintain an online "Single Point of Contact" where outside providers can receive any authorizations necessary for temporary provision of services or establishment of a business.

Finally, in *public procurement*, US states actively use their legal authorization to be protectionist. Today forty-seven states have in-state preference laws. Local providers are often awarded a 10 per cent competitive advantage, for example. Others require the use of local workers, like Idaho's law that requires that 95 per cent of workers on any public contract reside in Idaho. Some laws include outright bans: Pennsylvanian agencies may only buy coal in-state, period. In the EU, states must tender all but small or specially exempted contracts EU-wide and cannot discriminate by nationality.

These examples are not exhaustive, but they make our core point: if the US puts some limits on its states in the name of interstate commerce, the EU demands a great deal more. While building a single market across Europe's heterogeneous states is a near-infinite undertaking to which exceptions remain, the EU basically requires its states to accept default entitlements to easy interstate movement and exchange for other EU citizens and firms.

Almost any imaginable state rule can be understood as a barrier under the EU definitions, and all barriers face the burden of proof that they are well justified. The EU itself is the arbiter of such proof, with Commission oversight in administrative terms and the ECJ as the final legal instance—and these EU actors approach exceptions with systematic skepticism (Kelemen & Schmidt, 2011). The guiding principle of their ongoing legal and legislative agenda is that such openness should be automatic wherever possible, with nothing additional required for economic activity across borders. Much EU legislation concretely requires such automaticity, whether in harmonized areas (like in automatic recognition of doctors' and pharmacists' qualifications, or "financial passports" for banks) or through obligations of mutual recognition (like in many areas of standards and job qualifications). Though the US federal government could plausibly make similar demands on the basis of its Commerce Clause powers, it has never come close to doing so. Any such agenda is very hard to imagine in American politics today.

Constraints on Differentiation in the Eurozone in American perspective

Differentiated membership of the Eurozone is the single most salient and consequential sort of differentiation in the EU, as the existing literature emphasizes at great length

(Dyson & Marcussen 2010; Schimmelfenig & Winzen, 2014; Winzen, 2016). There is even evidence of interesting differentiation in how non-Eurozone members relate to it (Adler-Nissen, 2016). When we focus on the policy differentiation available to Eurozone members in comparison to analogous autonomy for American states, however, the EU again looks remarkably constraining. This has especially been the case after the multiple institutional innovations that were introduced during the Eurozone's sovereign debt crisis between 2010 and 2013, not least the ratification of the Fiscal Compact or the "Treaty on the Stability, Coordination, and Governance in the Economic and Monetary Union." Furthermore, it is worth noting that the EU constraints on national fiscal policy exist without the American advantages of sovereign debt pooling, a central bank that can serve as a real lender of last resort, and a powerful federal government's fiscal policy that can act as a countercyclical force (Matthijs and Blyth, 2015: 252).

Under the American Constitution, the various states retain all sovereign powers not explicitly delegated to the federal government. State sovereignty includes tax and spending powers, even though states are barred from taxing certain transactions, including imports, exports and interstate commerce. Some of the most important taxes, such as income and corporate taxes, are imposed by both federal and State governments, even though multiple states do not have individual income taxes.[5] In the 1840s and 1850s, States spontaneously adopted "balanced budget rules" in response to financial stress. It is important to note here however that this was not a disciplinary device mandated by the center. As Federico Fabbrini notes, "each state opted for the "golden rule" through political debates that were largely autonomous" and it did not appear that these were even promoted by the federal government (Fabbrini, 2013: 30). As a result,

the modus operandi and strictness of budgetary rules vary greatly across states. Today, Vermont is the only state without any kind of balanced budget rule. However, in the US, there is no such thing as federal oversight, let alone control, over state budgets.

State spending is typically pro-cyclical – only the federal government provides stabilization during recessions. As Henning and Kessler note, this federal stabilization, along with direct federal subsidies to state programs, renders pro-cyclical spending and balanced budget rules at the state level more palatable. The fact that the federal government alone is responsible for stabilizing and bailing out banks also contributes to the feasibility of balanced state budgets (Henning & Kessler, 2012). At the beginning of the American Republic, the federal government mutualized all existing state debt incurred during the revolutionary wars with Britain in 1790, at the insistence of Alexander Hamilton (Matthijs & Blyth, 2015: 251). Later, a "no-bailout" norm was established in the 1840s when Congress rejected the assumption of debt for several years and, as a consequence, many states defaulted on their debt. Although there is still no formal 'no-bailout clause' in the US Constitution, there has been no federal bailout since the mid-19th century (Henning & Kessler 2012). States were always allowed to default on their debt while staying within the American currency union.

When the euro was created in the early 1990s, the architects of the single currency gave it a strong independent central bank after the German model (the *Bundesbank*) and established an official 'no bailout' rule. The governing framework for fiscal policy – as agreed to in the Stability and Growth Pact (SGP) – put in place simple rules that were set up to avoid any active governance as much as possible. As is well known, the SGP included a 3 percent deficit floor and a 60 percent debt ceiling. However, this setup

proved to be largely inadequate in governing euro members' fiscal and financial imbalances, and resulted in the Eurozone debt crisis in 2010. While the crisis called for action – including bailouts of debtor member states in the 'Southern' periphery – creditor member states in the 'Northern' core only allowed this on the condition that financial assistance would be accompanied by much more intrusive and active oversight of all member states' fiscal policies. The euro crisis hence saw a flurry of legislative activity on the fiscal side of Eurozone governance (Matthijs & Blyth, 2015; 2018).

The six-pack, two-pack, and Fiscal Compact were all introduced and served to further limit member states' discretion over fiscal policy, introducing quasi-constitutional balanced budget rules, and giving the European Commission additional powers in approving (and even vetoing) national budgets before they were even voted on by national legislatures, through what is known as the "European Semester" (Matthijs, 2017b). As Fabbrini (2013: 32) observes, there is a "paradox in the new constitutional architecture of the EMU" in that "EU member states have willingly refused to embrace a U.S.-like federal model […] on the assumption that this was too restrictive of state sovereignty" while "they have established a regime that is much less respectful of state fiscal sovereignty than the U.S. one." Additionally, unlike the hands off approach the US federal government has towards highly indebted states, the Eurogroup – led by Germany – would not allow a member state to fully default on its sovereign debt held by other EU member states or central EU bodies while still a member of the Eurozone, as we will see in the case of Greece below.

When it comes to structural reforms, especially in the countries that were bailed out but also in other highly indebted member states such as Italy, the euro's central

governing institutions – the Commission and the European Central Bank (ECB) as members of the troika – were also profoundly involved in making the reforms a reality. Martin Sandbu (2015: 130) of the *Financial Times* refers to the troika's policies in Greece as the "tyranny of technocracy" which served to "infantilize the Greek body politic" with its mandatory cuts in public services and reform measures in the labor market and sheltered services sectors. The ECB also largely overstepped its mandate when its president at the time, Jean-Claude Trichet, sent classified letters to Italian and Spanish Prime Ministers Berlusconi and Zapatero asking for steps like large scale privatizations, the liberalization of their countries' labor markets and professional services sectors, pension cuts, and product market reforms. It was understood that these were strict conditions for the ECB's intervention in those countries' sovereign bond markets (Matthijs 2017b: 286).

To put today's Eurozone reality in American perspective, it is simply unthinkable that Alabama or Massachusetts would have to send in their annual state budgets for federal approval before having it debated and voted on in their own state legislatures, let alone having their budgets actually vetoed by a bureaucrat in Washington, DC. Similarly, the suggestion that the Chairman of the Federal Reserve Board could send secret letters to the governors of Wisconsin, California or Texas, giving them a laundry list of structural reforms to enact in return for liquidity support, is as far removed from American political reality as one can possibly imagine.

Recent Cases of Irreconcilable Differentiation in the EU

As the rules have been either upheld or strengthened, and additional fiscal powers have been delegated from the national to the EU level, this has made it all the more difficult for the EU's institutions to offer more differentiated integration to its member states. While this may well be possible and relatively easy to achieve in certain policy areas that are not very integrated yet – like security and defense, foreign affairs, or justice and home affairs – it has become much harder to allow for more differentiation in areas like the single market and, due to the institutional consequences of the euro crisis, the single currency.

As we will see in the next two sections, this was clear both in the case of Greece after Syriza came to power in early 2015 and in the case of David Cameron's attempt to renegotiate the UK's single market terms and afterwards in the actual Brexit negotiations between Theresa May's government and the European Commission represented by Michel Barnier. In both cases – the bailout terms for Greece and the four freedoms of the single market for the UK – the EU supranational institutions not only had superior bargaining power, but also displayed very little flexibility in finding a mutually satisfactory political compromise. In both cases EU leaders insisted that doing otherwise would eviscerate the founding principles of the EU's economic commitments.

Lack of Differentiation in the Single Currency: The Case of Greece

Much of the literature on the Greek sovereign debt crisis focuses on the role of Germany in making an example of Greece – and punishing it for blatantly violating the stipulations of the SGP – by making sure the single currency's governing rules were upheld (see, for example, Newman, 2015; Jacoby, 2015; Matthijs 2016). The point we want to make in

this paper is not that this is necessarily wrong, but that Berlin was indeed on very strong ground when it argued that the EU rules did not allow for much room for discretionary policies in Greece. Furthermore, the real consequence of the crisis has been to greatly extend those fiscal and structural constraints on public policy to every Eurozone member state, not just Greece.

As is well known by now, Greece faced vastly increased European central powers in the form of "troika" supervision and intrusive bailout terms starting in 2010. When the Greek economy continued to nosedive over the following years,[6] the Greek citizenry started clamoring for more choice and democratic input in their own economic policies. One way to achieve this would be by negotiating more favorable terms with its creditors. This need eventually found its voice in the program of the newly founded hard-left Syriza movement led by leftwing firebrand Alexis Tsipras. Syriza would go on to sweep the January 2015 parliamentary elections and lead the next government.

Syriza's election victory clearly embodied public demands for the kind of differentiation discussed earlier in this paper. Based on its Thessaloniki Program, the party had promised voters a clear choice between "European negotiation by a Syriza government, or acceptance of the creditor's terms […] by the Samaras government" (Syriza, 2014). Published in September 2014, the program demanded significant debt relief, in the form of a debt write-off similar to the one Germany received in 1953, a "growth clause" for debt refinancing, a grace period for debt servicing and much more flexibility of the Stability and Growth Pact (SGP). Syriza's manifesto also pledged to replace the Memorandum agreed between the previous government and Greece's creditors with a new "National Reconstruction Plan." Some of the measures proposed in

this plan, such as the reinstatement of the minimum wage and the country's collective bargaining framework, were designed to explicitly reverse Memorandum policies.

At first, the Greek reform proposals put forward in the spring of 2015 remained within the spirit of the Thessaloniki program, even though there were already some notable deviations. Without suggesting a debt write-off, two proposals written in May and June 2015 asked for other debt relief measures as well as demanding an end to the IMF's involvement. Red lines were drawn at further pension cuts and the proposals insisted on collective bargaining and higher minimum wages. To still meet the creditors' demands for prudent economic and fiscal policy, the Syriza government proposed economic measures such as limits on early retirement, further deregulation of product markets, conditional privatization, and the creation of an independent tax authority. With the June proposal, Finance Minister Yanis Varoufakis hoped to achieve a compromise by suggesting stricter measures such as higher health care contributions for pensioners, as well as primary surpluses much closer to the creditors' demands.

Table 1: Consecutive Greek Proposals and Eventual Agreement

	Syriza's Thessaloniki Program (13 September 2014)	**Greek Proposals to Creditors (11 May 2015/ 11 June 2015)**	**Greek Formal Request for ESM Support/ Reform Proposal (July 8-9 2015)**	**Euro Summit Statement/ ESM MOU (July 12 2015/ August 14 2015)**
Primary Surpluses		2015: 0.8 / 0.6% 2016: 1.5% 2017: 1.5 / 2.5% From 2018: 2 / 3.5%	2015: 1% 2016: 2% 2017: 3% From 2018: 3.5%	2015: -0.25% 2016: 0.5% 2017: 1.75% From 2018: 3.5%
Debt Repayment	-"European Debt Conference"; -Growth indexation & Grace period; -QE: direct sovereign bond purchases.	-Schemes to swap ECB held debt with EFSF/ESM loans; -Further debt extension and GDP growth-index debt owed to GLF & EFSF; -End IMF lending.	-No debt relief measures mentioned.	-Three year ESM loan program; -No concrete commitments to longer grace or payment periods; -No nominal haircuts; -Continued IMF assistance.
Economic Reforms	-Humanitarian measures; -More progressive income and property taxes; -Restoring higher minimum wage, employment rights & collective bargaining.	-Conditional privatization; -Collective bargaining & gradually restoring minimum wage; -Limit early retirement, recapitalization of social security and pensions, no cuts; -Liberalizing product markets; -Fiscal Council.	-Extensive privatization, transferring assets to independent fund; -Adjust income and property tax rates & raise corporate tax rate, raising VAT; -Limit early retirement, increase retirement age, phase out solidarity grant for pensioners; -Liberalizing product markets; -Fiscal Council.	-Cont'd extensive privatization with independent fund; -Tax reform including VAT & reversal of prior income tax reform; -2010-2012 pension reforms back + compensate for 2012 court ruling against pension cuts; -Review and reversal of prior labor market reforms & product market liberalization; -Long-term comprehensive Social Welfare Reform; -Fiscal Council + quasi-automatic spending cuts.

Instead, the European Commission, IMF and ECB presented their own demands for extending the bailout deal and freeing up €15.5bn of fresh liquidity to avoid a Greek default. They pushed for further spending cuts, lower pensions and a wider VAT base and outright refused any debt relief measures (European Commission et al, 2015). Unwilling to accept these conditions, the Greek government rejected the creditors' June offer. In the resulting absence of emergency financing, Athens was forced to introduce capital controls on June 29 and defaulted on an IMF loan the following day (European Commission 2015a; IMF 2015). On July 5, a referendum was held on whether Greece should accept the creditors' bailout conditions. It resulted in a resounding *oxi* (or no) – 61% of votes were cast in opposition to the bailout conditions and not a single Greek region voted in favor (Arnett and Galatsidas, 2015). Clearly, the Greek public still held on to its demand for temporary deviation from the Eurozone's governing rules that had paved Syriza's path to power half a year earlier.

Despite the public's clear-cut rejection of the creditors' proposal, Greece had little room to implement different policies. With the EFSF program having expired on June 30, the Greek government was forced to request stability support from the ESM before a longer term agreement could be reached. In its formal request of July 8, followed by a more detailed list of policies submitted on July 9, Tsipras' government begrudgingly pledged to accept the surplus targets demanded by its creditors and implement far-reaching tax and pension reform, much of which crossed its previous red lines.

Yet, even these new proposals did not go far enough for some members of the Eurogroup, notably Germany. On July 10, the possibility of Greece leaving the Eurozone

– a so-called "Grexit" – was first seriously proposed in a non-paper by the German government. Complaining that the reform concessions made by Greece were insufficient, Wolfgang Schäuble's German Finance Ministry listed two conceivable options: Greece could present "radically improved proposals" or it could take a "time-out" from the Eurozone with possible debt-restructuring. Debt-restructuring, the paper argued, was not compatible with Eurozone rules. Differentiation would therefore not be possible unless Greece actually abandoned the euro as its national currency.

Two days later, eleventh hour negotiations at a summit of Eurozone leaders in Brussels were to decide about Greece's Eurozone future. The Schäuble proposal made it into the Eurogroup's position paper and Greece was asked to implement more draconian reforms before negotiations for a new ESM loan could even begin. Absent an agreement, the option of an at-least temporary "Grexit" was now on the table (Kwasniewski, 2015). By the end of two high-stakes days of uncertainty, a preliminary agreement emerged: Greece would receive a bridge loan and negotiations for an ESM loan could begin. In return, Tsipras' government would have to reverse or compensate for much of Syriza's labor market and pension reforms, introduce quasi-automatic spending cuts to make sure it met its primary surplus targets, and accept continued IMF assistance. A debt haircut was ruled out and no concrete commitment to debt relief was made (Euro Summit, 2015).

With the threat of leaving the Eurozone looming over its head, the Tsipras government had accepted even more punitive reform measures than those rejected by the Greek citizenry only eight days prior. The eventual new Memorandum of Understanding for the ESM loan, which was finalized on August 19, came with further strict conditions, such as the reversal of Syriza's previous tax reforms, and failed to provide the debt relief

Syriza had fought so hard to get. Only the primary surpluses for 2015, 2016 and 2017 were brought back to more realistic levels, after the troika took into account the fact that the Greek economy was projected to shrink by another 3 percent in 2015, instead of growing by 2.5 percent as had been projected back in the Autumn of 2014 (Merler, 2015).

The negotiation outcome revealed the striking power imbalance at play. While the other Eurozone countries seemed no longer afraid of Greece exiting the single currency, Greece itself saw its future firmly within the Eurozone. Not only would introducing a new currency have been potentially devastating for Greece's economy, Greek public opinion remained strongly in favor of keeping the euro.[7] According to Yanis Varoufakis, he indeed proposed measures that might have triggered Grexit the day after the Greek referendum to put pressure on its creditors. However, Tsipras' inner cabinet voted him down, potentially causing his resignation on July 6 (Lambert, 2015).

Overall, Syriza's attempt at achieving meaningful differentiation within the single currency had proven irreconcilable with increased EU central authority and much stricter rules. Greece was forced to comply, unwilling to take the exit option. As highlighted in the next section, a similar lack of meaningful differentiation within the single market may have contributed to the United Kingdom opting to do just that – exit.

Lack of Differentiation in the Single Market: The Case of the United Kingdom

With the euro crisis smoldering in the background and in order to appease his Eurosceptic backbenchers while staving off the electoral threat from UKIP on his right flank, David Cameron announced in January 2013 that he would hold a referendum on the UK's EU

membership if his Party won a majority at the next general election (Matthijs, 2013). The Conservatives would go on to win that election in May 2015, which set in motion a whole series of events that eventually resulted in a two-year process to negotiate a British exit from the European Union ('Brexit'). Prior to holding the actual referendum in June 2016, the Conservative Prime Minister attempted to renegotiate the United Kingdom's existing terms of membership in the European Union.

One of the main worries the Cameron government addressed during the renegotiation was the economic governance of the Eurozone and its impact on non-Eurozone members. In this area, it was at least able to achieve a symbolic compromise. Even that was too much when it came to its other key concern – free movement of labor. In between the 2013 Bloomberg speech announcing Cameron's intention to hold a referendum and the renegotiation effort three years later, intra-European migration had reached significantly higher levels and therefore its political salience within the UK had substantially increased. Yet, the deal David Cameron finally negotiated fell well short of the stated aim of radically reducing migration inflows. If the UK wanted to impose effective restrictions on such a core EU principle, it would have to leave the Union.

Over the two years prior to the official renegotiation, the Tories' demands on economic governance took shape, first in their 2015 election manifesto and then in David Cameron's letter to the EU demanding the renegotiation of the UK's membership terms. HM government asked for safeguarded access to the single market, no financial liability of non-Eurozone countries for measures to support the single currency, changes such as the introduction of a banking union remaining voluntary for non-Euro countries, as well as a formal recognition of multiple currencies within the EU. The one point of contention

was France's worry that Britain was trying to win exceptions to EU rules for the City of London. This resulted in a line emphasizing the "level-playing field" for financial institutions within the internal market in the final agreement.

Clawing back powers from the EU and increasing national sovereignty would prove much more difficult. Doubt about the feasibility of treaty change that might meaningfully limit the EU's central authority emerged immediately. In December 2012, President of the European Council Herman Van Rompuy warned that "cherry picking" could "cause the EU to fall apart" and voiced doubts over treaty change after years of crisis (Traynor, 2012). In 2013, President of the European Commission José Manuel Barroso declared that renationalizing competences of the EU was "doomed to failure" (Waterfield, 2013). By June 2015, even David Cameron had to admit that treaty change would be unlikely prior to the EU referendum (Cameron, 2015a). In the absence of such change, all the UK could achieve in its negotiations was a red-card mechanism in which 55 percent of national parliaments could jointly block commission proposals. It also gained symbolic recognition that the UK did not have to strive for an "ever closer union."

For those who wanted to see the UK remain in the European Union, the country's inability to limit immigration under the rules of free movement was even more damaging than the lack of competencies flowing back. Since 2013, migration and free movement had become increasingly toxic in the British political debate. Against the repeated promise of the Tory government to limit migration to "tens of thousands," net migration rose to over 300,000 in the years of 2014 and 2015 (ONS, 2018). The prospect of Romanian and Bulgarian citizens receiving unlimited access to free movement in 2014 sparked calls to delay their 'right to work' by Tory MPs and led David Cameron to rush

in measures that would limit migrants' immediate access to benefits (Grice, 2013). Former Prime Minister Sir John Major openly floated the idea of a short-term cap on the freedom of movement, which represented only one of many demands for caps and emergency breaks on migration put forward during that period (BBC, 2014).

At the European level, such proposals were met with heavy resistance. Martin Schulz, the President of the European Parliament, proclaimed that the principle of free movement was "not up for negotiation" (Withnall, 2014). Meanwhile, Barroso entered into a war of words with Tory MP Grant Shapps and David Cameron after telling the BBC that there was "no possibility of the UK reducing the number of immigrants from EU to UK" (McSmith, 2014). Restricting free movement was a red line the EU and its member states were unwilling to cross, even if that meant risking Brexit: A report in 2014 suggested that the German Federal Government had started considering Brexit a real possibility and regarded a quota on EU migrants as a "point of no return" (Spiegel, 2014).

While the UK government wanted to radically reduce immigration, much of which stemmed from within the EU, it was also one of the staunchest proponents of an integrated single market. In light of EU opposition, David Cameron decided against proposing a cap on migrants. Instead, he focused on restricting migrants' access to the UK's social security system, fighting abuse of the system such as sham-marriages and restricting access to free movement in future rounds of accession (Cameron, 2014).

The latter two measures were already available to the UK before renegotiation took place. The most significant changes proposed were therefore to limit EU-migrants' access to in-work benefits and to prohibit sending child benefits abroad. Although this was already a far cry from introducing caps or emergency breaks, it still proved to be the

main stumbling block in the renegotiation, as the Visegrad countries were weary of any form of discrimination against their citizens (Visegrad Group, 2015). After two long days of negotiation, the eventual compromise that emerged from the EU summit was much weaker than David Cameron's proposals. Child benefits could still be sent abroad, but may be indexed by the receiving country's living standards. In-work benefits would be phased in over four years rather than withheld for a full four years after arrival. Even this could only occur under a seven-year "emergency break." To add insult to injury, the existence of an actual emergency had to be determined at the EU level. This deal was unlikely to deliver the reduction in immigration that the Conservatives had promised.

Since the UK voted to leave the European Union four months later, the agreement Cameron renegotiated never came into force. After 'leave' unexpectedly won the referendum with 52 percent of the vote, Cameron resigned and Theresa May was left to pick up the pieces as the new Tory Prime Minister. The long run up to the triggering of Article 50 to leave the EU and the actual Brexit negotiations between the May government and Michel Barnier, the chief negotiator for the EU, would once again prove how hard differentiation is within the single market, even if a country wants to go from being a member to a non-member.

Boris Johnson's initial proposal to have "access to the single market with limited migration" in June 2016 was quickly rebuffed by Angela Merkel who said in the Bundestag two days later that the Brexit negotiations would not be a "cherry-picking exercise" and that the UK could only enjoy access to the single market if it accepted "the four basic European freedoms – that of people, goods, services and capital" (Johnson, 2016; Merkel, 2016). In her Lancaster speech in January 2017, May suggested that the

future UK-EU relationship would be shaped by an agreement that could take some elements of current single market arrangements, like on the export of cars, or the freedom to provide financial services across borders (May, 2017). Michel Barnier quickly responded that there could be "no cherry-picking" from the single market by the UK in the upcoming talks (Barnier, 2017).

A month after the UK triggered Article 50 of the Lisbon Treaty on March 30, 2017, which formally notified Brussels of its desire to leave the EU, the European Council responded with its official negotiation stance in which it stated that "preserving the integrity of the Single Market excludes participation based on a sector-by-sector approach." It went on to say that it "welcomes the recognition by the British government that the four freedoms of the Single Market are indivisible and that there can be no "cherry picking"" (European Council, 2017). A year later, in her Mansion House speech on the future of UK-EU relations in March 2018, Theresa May once again repeated that the UK would be leaving the single market, wanted freedom to negotiate trade agreements with the rest of the world, but would also like to continue its frictionless border with the EU (May, 2018). One senior EU official noted to the *Financial Times* shortly after the speech: "Cake, more cake and buckets of cherries. Nothing concrete on how leaving the customs union and single market would attain the goals she wants" (Parker and Barker, 2018).

In the UK government's so-called Chequers Plan in early July 2018, the May government agreed to a free trade area for goods, de facto committing to staying in the Single Market for goods only, but expressing its desire to have different arrangements for services and also to control immigration (HM Government, 2018). Michel Barnier,

speaking at the US Council on Foreign Relations in New York once again responded in kind: "Everybody will understand that we will protect the single market which is based on the indivisibility of what we call the four freedoms, of movement for people, goods, services and capital. The British government has always had a very high degree of influence in building the single market. They know the rules. They know the indivisibility of the four freedoms" (Barnier, 2018).

Conclusion: Irreconcilable Differences in European Integration?

We do not mean to dismiss the notion that the EU's future will likely include more differentiation, and that it may well help solve some of its policy challenges and alleviate some of its political pressures. Our point is simply that useful analysis of such options must begin by understanding what kinds of differentiation are permissible within current EU rules, and thus what exactly would need to change to open new room for variation in national policies. Differentiation in the Single Market and the Eurozone can obviously be achieved – there is nothing immutable about the existing rules – but pursuing it in ill-informed ways is a recipe for disaster. Just ask Alexis Tsipras or Britain's brash band of Brexiteers, neither of whom understood exactly what they were dealing with.

We can have some sympathy for their mistakes, certainly, since it is easy to exaggerate how much the EU is a smorgasbord of flexible policy collaborations. Hold-outs, opt-outs and exclusions from the Eurozone and Schengen, together with the transitional statuses of newer and prospective members, can make the EU seem like a bewildering mix of 'acronymed' memberships that states can mix and match at will. More generally, the fact that the EU is legally an international organization still places it

in a conceptual category that even well-informed elites assume to be defined by its flexibility: ultimately nation-states will do what they will and as they please in diplomatic relations. Prominent academics have worked very hard to encourage this view of the EU (e.g. Moravcsik, 1998, 1999, 2002).

But this has not been an accurate picture of the EU for a long time (if ever). It was explicitly created to be different from international organizations, with unprecedented emphases on supranational authority and automatic interstate openness. A ratcheting construction process built a remarkably binding framework on these foundations, with a series of boosts from pro-integration leadership (Parsons, 2003) and an entrepreneurial Commission (Jabko, 2006), together with crucial legal dynamics of "integration through law" (Cappelletti et al, 1986; Augenstein, 2012). Membership expanded as this process developed, such that increasingly requisite authority was extended over a far more heterogeneous space. In both southern and eastern Europe, this extension was often portrayed as desirable in itself, with EU accession pursued explicitly to leverage a wide range of economic and political reforms. The six original members also often found themselves supporting more EU authority, despite their own misgivings, because enlargement to more diverse members called for more oversight and more support.

Together these dynamics produced the core EU features we have described in this paper: an international organization that constrains the major economic policies of its states more than national federations typically do. They also provoked the widespread calls for differentiation that we hear today. In order to find negotiated paths to workable and legitimate responses, Europeans must start by acknowledging more clearly the distinctively integrated institutions that they have built.

Notes

[1] Thus we do not disagree quite as fully as it may seem with Howarth and Sadeh (2010, 923) that there is "a surprising degree of flexibility, or differentiation" within the Single Market. They reach this conclusion by focusing substantially on transposition delays, implementation and transitional arrangements.
[2] The Court has often suggested that it also employs a "balancing" logic to evaluate whether a restriction on commerce is justified by its local benefits, but Donald Regan (1986) argues compellingly that this is very inconsistently applied and the effective logic focuses on purposeful protectionism.
[3] These criteria are known as a "Gebhard test" in services, and are similar in goods.
[4] See the Brookings Institution's "tracker" of deregulation under Trump at https://www.brookings.edu/interactives/tracking-deregulation-in-the-trump-era/.
[5] As of 2018, seven US states forego individual income taxes: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. New Hampshire and Tennessee only tax income on capital investments, including dividends.
[6] Greece's gross GDP at market prices decreased by 27% between 2008 and 2015: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_gdp&lang=en
[7] From May 2015 to November 2015, the Eurobarometer measured an *increase* in support for membership in the Economic and Monetary Union.

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