Market integration, democracy and development: lessons from the integration of Europe's Eastern and Southern peripheries

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Abstract

This paper offers a common analytical framework for a special issue that explores the economic and political crises of the EU from the perspective of the governance problems of deep integration among economies at different levels of development. Economic and political crises of the European Union today can all be linked to the deficiencies in the governance of market integration among economies at different levels of development. The deeper is economic integration and the more diverse are the capabilities of participating actors, the greater and less predictable are the vulnerabilities of peripheral economies, and the larger is the need for mechanisms that could help to deal with the negative developmental externalities of integration. This introduction and the following articles demonstrate such vulnerabilities in Europe's peripheries, and point to the limitations of both national and supranational agency for dealing with developmental problems in Europe. The lack of such agency can be attributed to the asymmetry of European polity, where policymakers whose primary accountability lies at the national level govern the transnational market. Contrary to the idea of international economic integration, nation-state and democracy as an impossible trinity, European experience shows that for deep economic integration to work, democratic institutions are needed at both national and supranational levels.

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Introduction

If the 2008 economic crisis was still followed by 'the strange non-death of neoliberalism' (Crouch, 2014), the year 2016 with Brexit and the elections in the United States led many commentators to proclaim that the era of global integration as we know it is over and we are witnessing 'globalization's last gasp' (Eichengreen, 2016). The dangers of market integration have gained center stage in political discourse and the threats of free trade, jobs relocation, migration and financial volatility are becoming a powerful source of political mobilization. While the famous Polanyian pendulum of market liberalization followed by movement towards protection seems to be in full swing at the global stage, nowhere has it been played out as dramatically as in the case of European Union. After all, Europe is the region that has experienced the deepest forms of supranational market integration, followed by equally deep divisions displayed in the bitter distributive conflicts between North and South in the Eurozone crisis, the rise of illiberal nationalism in the East, and culminating in the first case of a country voting itself out of the EU in the most Western part of the continent. Studying the crises of European integration thus promises to offer important insights for the study of market integration more generally, and it is the central idea of this special issue that the multiple and multiplying crises in Europe can all be linked to the problems of deepening market integration among economies at dramatically different levels of development.

States enter market integration in the expectation that by sharing growing part of rulemaking in the economy with other states, their gains will be larger than without such pooling of sovereignty (Baldwin et al. (2012);; Cooley and Spruyt, 2009;). However, the deeper is integration and the larger are developmental differences among participating states, the larger will be the range of uncertain and unpredictable consequences of putting more and more policy areas under uniform supranational rules. As the parties to integration cannot foresee all the uncertain consequences and longer-term distributive implications of sharing significant elements of economic sovereignty, they must defer the management of these problems to transnational governance institutions (Cooley and Spruyt, 2009). In principle, the goal of such transnational governance institutions is to help to make the common market a common good (Bruszt and McDermott, 2014). But the mode of governing market integration can also lead to limiting the capacity of the participating governments to be responsive to domestic constituencies, thus hollowing national democracies. The resistance to such consequences of market integration can take several forms including the spread of economic nationalism, populism or protectionism and can set in motion processes of disintegration (Rodrik, 2016; Mair, 2013; Offe, 2015). Our central claim is that the post 2008 crises display the failure of the EU as a polity and as a quasi-state to adequately manage the manifold political and developmental consequences of regional market making.

The literature dealing with the crises of the EU is rather fragmented. There are at best weak links between studies dealing with the crisis of the *monetary* integration and its effects on the economies in the Southern peripheries of Europe (Baldwin and Gavazzi, 2015; De Grauwe, 2015; Jones, 2015), and the research on the political and developmental consequences of participating in the Single Market in the Eastern peripheries (Jacoby, 2010; Sedelmeier, 2014;). A largely separate third literature deals with the factors and consequences of rising Euroscepticism in the core countries, with Brexit as its most drastic example (Vasilopolou, 2013; Menon and Salter, 2016).

In this special issue, we bring together studies that discuss in a comparative framework the problems of the management of deep integration among economies at different levels of development in both peripheries of Europe. We offer in our introduction a common framework to their analysis. Although briefly, we will also discuss the link between the problems of integrating the lesser developed parts of Europe and the factors that led to Brexit. We elaborate the mechanisms linked to the different stages of deepening integration that are responsible for the uneven distribution of economic vulnerabilities and discuss the role that was played by domestic and supranational actors and institutions in coping with these vulnerabilities.

While most of these vulnerabilities were widely discussed and debated throughout the history of European integration (see the analysis of Brigid Laffan in this issue), the EU is at present less and less able to deal with the developmental externalities of integration and to indeed make the common market a common good. While the EU has relatively strong capacities to create, and impose common regulations, it has very weak capacities to deal with the negative externalities that emerge once these common rules are implemented across a variety of very different contexts.

We argue that the mounting problems with the management of core-periphery relations are intimately interlinked with the governance features of the European polity: policymakers whose primary accountability lies at the national level govern the transnational market. More specifically, the emerging European federal regulatory state that can impose, monitor and sanction policies on 28 member states in nearly 40 different policy areas is controlled by a primarily intergovernmental (some would say, confederal) polity. This polity might have worked for extending transnational markets in times when mainly the gains of integration had to be redistributed. In times of crisis, when there would be a need for market correcting programs, the same polity has very weak capacity to produce policies that could represent the longer-term common interests of the member states. Instead, its decisions drastically restrict the sovereignty of the less fortunate member states, and further the spread of economic nationalism and populism (Mair, 2013; Hinarejos, 2013; Offe, 2015; Bruszt, 2015).

Based on the analysis of European market integration, we argue that, the “Rodrik trilemma” linked to transnational market making should be extended. Exposed in several essays, Rodrik’s trilemma states that democracy, national sovereignty and international economic integration are mutually incompatible: one can combine any two of the three, but never have all three simultaneously and in full (Rodrik, 2000). The lesson one can draw from the experiences of the post 2008 European crises is that having only two of the three in a regional integration regime can induce crises with the danger of leading to the collapse of the whole system. Whether one can combine all the three in Europe under the umbrella of a federal polity is a highly contested issue. While some suggest that such a combination could be the way out of the crises of the EU (Offe, 2014; Habermas, 2015), others argue that the only way out is via the downscaling of integration (Streeck and Elsasser, 2016; Scharpf, 2016).

The papers included in this special issue provide deeper analyses on the specific aspects of integration in Europe. Two of them, the paper by Nordlund and Vedres, and the paper by Bohle, deal with different aspects of the social and economic consequences of market integration in the two peripheries of Europe. A third paper by Dellepiane at al. focuses on the factors and effects of monetary integration. The last two papers, the one by Laffan and the other by Medve-Balint explore the dominating EU strategies to manage developmental disparities in Europe. The paper of Laffan provides a panoramic overview about the evolution of ideas linked to the problem of developmental disparities and about the emergence of the EU level policies designed to alleviate the potential negative developmental consequences of deep integration. The paper of Medve-Balint provides and analysis about the efficiency of these policies in the two peripheries of the EU.

These papers were first presented and then upgraded in two consecutive conferences in Florence. By inviting scholars of both the Southern and Eastern peripheries of Europe our goal was to encourage researching transnational market making in Europe from the perspective of the comparative study of core-periphery relations. By the later we refer to the management of the potentially uneven distribution of opportunities and vulnerabilities across the national economies of EU in the process of market integration. While stressing different aspects of core-periphery relations, the contributions in this special issue share the focus on the role of political agency, domestic and/or transnational, in shaping the distribution of these opportunities and vulnerabilities, rather than taking them as given by preexisting economic structures.

The rest of the introduction to the special issue is organized as follows. The next section introduces the notion of European integration as a mismanagement of an incomplete contract, arguing that the European Union never gained the capacities to deal with the unpredictable consequences and distributive implications of integration among countries at different levels of development. We then proceed to elaborate on the developmental consequences of such integration, including both the specific economic vulnerabilities of peripheral countries, as well as the impact of integration on national and supranational developmental agency for dealing with such vulnerabilities. The fourth and fifth sections discuss the different strategies the EU has used to manage core-periphery integration in Europe, demonstrating that both in the Southern and in the Eastern Europe such strategies failed to represent long-term solutions to the challenges of integration. The final section concludes.

EU Integration: Mismanagement of an incomplete contract

The emerging literature on the crises of the European integration project is rather fragmented: some focus on the Eurozone crisis and the increasing economic and political divide between

European North and South; others deal with Brexit, while the third strand tries to explain the democratic backsliding and the turn towards illiberal regimes in some of the East European countries. In this intro, we have no space to provide a broad overview about these literatures. From the perspective of this special issue those political economy approaches matter that focus on the broad governance problems of integration and the bulk of these studies has been focused on the monetary union. In common in these approaches is the stress of the misfit between economic and political integration. Some authors within this approach tend to focus on gaps in the institutional design of the monetary integration (De Grauwe, 2015). A similar approach is taken by constitutional lawyers and political scientists, who cite the attempt to depoliticize market integration in Europe as the source of present crises (Chalmers et al. 2016), or, on the failure to internalize the degree and democratic consequences of the interdependence generated by integration (Maduro et al, 2012).

The mainstream view emerging today is that the crisis appeared as the result of imbalances between surplus economies of the North and deficit economies of the South with excessive public and private debt creation in the periphery (Baldwin and Giavazzi, 2015, Baccaro and Pontusson, 2016). For the comparative capitalism literature, these imbalances and the resulting crisis stem primarily from divergence in institutions between coordinated market economies in the North and 'mixed' market economies in the South (Hancke, 2013; Hall, 2012; Iversen and Soskice, 2013; Hassel, 2014) which reinforced the divergence in competitiveness between the core and periphery, rendering their integration in a single monetary union non-viable in the long run. Others argue that the imbalances emerged primarily thanks to the financial integration, with the access to cheap credit increasing disposable income in demand-driven Southern periphery and driving the wage-inflation spirals, which contributed, to an increase in the real exchange rate (Jones, 2014; Johnston and Regan, 2015; Baldwin and Giavazzi, 2015). The emphasis on the financial integration and the features of this integration in the Eurozone puts into focus the problematic institutional architecture of the European Monetary Union, with monetary policy at the supranational level and fiscal policy at the national level and with no supranational fiscal transfers mitigating asymmetric economic shocks (Armingeon and Baccaro, 2012; De Grauwe, 2015, Johnston and Regan, 2015; Dellepiane et. al., this issue). Once such asymmetric shocks emerged, the only mechanism left to deal with the imbalances was 'internal devaluation' and austerity policies across the board, which only worsened the ratio of debt as a share of GDP and deepened economic recession in Europe (Blyth, 2011; De Grauwe, 2015; Johnston and Regan, 2015).

The debate on the sources of the Eurozone crisis has also yielded very different positions on the possible crisis solutions. Comparative political economists stress that both the socio-economic institutions as well as the associated political preferences of the Northern and Southern actors work against any attempts at making EMU closer to the optimal currency union (Iversen and Soskice, 2013). Drawing on the experience of fiscal transfers within Germany and Italy, Streeck and Elsäser (2016) conclude that the prospects for political support for such transfers, even in the event of the advent of the political union in Europe remain bleak. Thus, for many comparativists, as well as some economists, weakening the integration and allowing more flexibility for national political economies to adapt seems like the only way out of crisis (Streeck and Elsasser, 2016; Stiglitz, 2016). Others however argue that the only way to reduce disparities among European member states would be to engage in symmetric integration in the EU, marrying supranational monetary policy with supranational fiscal capacities, common economic and social policy as well as debt mutualisation (Sepos, 2016; Armingeon and Bacarro, 2012; De Grauwe, 2015; Tabellini, 2015). Such integration would however require the remaking of political governance mechanisms, making the Eurozone more like a federal state (Sepos, 2016; Armingeon and Bacarro, 2012; Piketty, 2016).

Our argument in this introductory paper draws on this later approach although we suggest applying its hindsight to the broader set of problems of market integration. While the above discussed more specific dilemmas of monetary integration differ from the dilemmas of the other stages of market integration, all of them have the same generic governance problems.

Market integration refers to the various steps of the multi-stage process leading to the removal of various forms of national level discriminations restricting the free movement of goods, services, capital and labour (Balassa, 1967). Integration starts with the removal of some or all of tariffs and it moves on with the reduction of non-tariff barriers and the harmonization of standards, regulations and policies in a growing number of policy fields. This process might arrive to monetary integration at a more advanced stage.

All stages of market integration entail two main governance problems. The first key governance challenge is the making and the implementation of common rules and policies. Integrated markets, from the perspective of economic actors, work to the degree that a growing number of rules become harmonized across the participating countries and these common rules are enforced everywhere.

The second key governance problem of integration is that integrated markets might distribute the costs and gains of implementing the common rules in a highly uneven way among the parties. The deeper integration becomes and the larger are the differences in the developmental endowments and institutional capacities of parties, the greater will be the need to correct outcomes generated by the integrated markets. The two dilemmas are interlinked: all parties to the integration should have both the capacity and the incentive to play by the common rules but, in the first place, all of them should be able to benefit from the common rules. Thus, the deeper integration gets and the more diverse are the capabilities of participating actors, the larger will be the need for mechanisms that could help to anticipate and alleviate in time the potential large scale negative developmental externalities of market integration. A common market works when its rules are harmonized, but that presupposes the working of mechanisms that can sustain the harmonization of the interests of the participating states.

One can put this dilemma also in the language of incomplete contracts. Nation states enter market integration and honour its rules with the expectation that by sharing growing part of rulemaking in the economy with other states, their gains will be larger than without such pooling of sovereignty (Baldwin et al. (2012); Cooley and Spruyt, 2009;). The problem of such contract is, however, that the parties to the integration cannot foresee all the uncertain consequences, longer-term distributive implications of sharing significant elements of economic sovereignty. Moreover, the unforeseen problems, the uneven distribution of gains and losses of integration do not only stay with the weaker economies but they might spill over to the stronger ones. Such spillovers appear in various forms: the loss of expected gains of enlarged markets; the need of fiscal transfers to worse performing economies or the unexpectedly high influx of migrant workers from the weaker member states creating political opposition to integration in the stronger ones (Bruszt and Langbein, 2015).

In brief, the deeper is market integration and the larger are developmental disparities among the participating countries, the bigger will be the need to defer the management of such problems to transnational governance institutions (Cooley and Spruyt, 2009). The primary goal of such transnational governance institutions would be to anticipate and alleviate at least those potential negative developmental externalities of integration that could endanger the reproduction of the common market. *In extremis* these governance institutions can also be expected to make common rules a common good (Bruszt and McDermott, 2014). The definition and representation of such common good at EU level is, however, made an uphill struggle by the asymmetries in the development of economic and political integration. The ever more transnationalized market is run by a primarily intergovernmental EU polity. The management of the developmental externalities of the pooling of economic sovereignty is in the hands of politicians whose political survival depends primarily on their capacity to present themselves as better representatives of *national* interests than their domestic competitors.

The European integration was never driven by the belief that market integration will on its own deliver common goods, and that all the parties can live by the common rules if they are ready to play by them (see also the paper of Brigid Laffan in this issue). The various mechanisms linked to integration that could yield large-scale negative developmental externalities and imperil integration have been discussed in several major EU policy documents (Werner Report, 1971; Delors Report, 1989; Agenda, 2000). Below we will elaborate these mechanisms and we will also provide a separate discussion of the dramatically different ways the EU tried to address the potential problems created by these mechanisms in its Southern and Eastern peripheries.

The common element in the diverging EU strategies was to try to remake and strengthen the developmental capacities of the member states themselves. Besides treating economic development as a primarily national business, only modest attempts were made within the EU to create supranational institutions to manage the externalities of the common market as a common problem of the member states. The European economic and social cohesion programs, as it will be argued in the paper of Medve Balint have weak capacity to get national developmental policies in synch either with domestic developmental needs or with the common interests of the member states. On the other hand, as we will elaborate below, despite the different EU strategies for reconfiguring economic state capacities in Southern and Eastern peripheries, none of these states appear capable of managing the multiple integration challenges of the single European market (see also in Bruszt and Vukov, 2017).

Because of the weaknesses of governing the developmental externalities of market integration, member states in both the Eastern and Southern peripheries of Europe face the dilemma that the requirements of playing by the uniform rules of the integrated market might conflict with their capacity to live by these rules. The later, living by the rules, refers both to the capacity of maintaining and increasing the competitiveness of their economies and, to the capacity to reply to domestic political pressure to preserve and increase the range of domestic winners of integration. In the South, member states try to cope with the dilemma that the implementation of the ever more elaborate and strict rules of the monetary union might undermine their attempt to slow down increase in the number of losers of deep integration and it might endanger the longer term competiveness of their economies.

As it will be discussed below, the Eastern member states face different developmental dilemma. They have greatly profited from the propitious coincidence of the EU induced transformation of their domestic state institutions and the interlinked influx of productive capital in their economies. Capitalizing on the availability of cheap and skilled labour and the upgrading of their domestic institutions, these economies became key platforms in the European production chains (see the paper of Nordlund and Vedres in this issue). However, as Nordlund and Vedres show in their paper, the domestic embedding of the multinational firms (MNC) is still feeble. Furthermore, only around a third of active labour benefits from employment in the better paying MNCs. As the competitiveness of their economies relies primarily on the abundance of cheap and skilled labour, the altering of their developmental model to improve positions in the EU markets and extend the range of beneficiaries of integration can easily be presented by competing political elites as national goals conflicting with the transnational rules. The spread of economic nationalism in the Eastern peripheries reflects these conditions.

Due to the increased interdependence among the economies of the member states, the more developed economies of the EU are increasingly pressed to share the consequences of the above-discussed developmental dilemmas of the peripheries. These pressures take various forms, ranging from the need for fiscal transfers to the taking in growing numbers of migrating labour from the peripheral economies, primarily from the East. Because core countries can use the continental free market less and less for free, incumbents in these countries are increasingly pressed by domestic political competitors to come up with programs that promise keeping the gains of the continental market without sharing the costs of its developmental externalities. The Brexit referendum in the UK was the first to prove that pains in the peripheries can generate political pains in the core countries and set in motion disintegrative processes.

All in all, the EU has inadequate capacities to manage the incomplete contract that allows for the pooling of sovereignty required for deeper market integration. The rather inefficient policies used by the EU to cope with the governance problems of market integration are produced by a transnational polity that has strong capacity to further market making but that has weak capacities to manage the challenges linked to correcting markets (Scharpf, 2010, Offe, 2015). As transnational market integration remains governed by a polity in which actors are accountable primarily to national constituencies, the management of the developmental externalities of the pooling of economic sovereignty is in the hands of politicians whose political survival depends primarily on their capacity to present themselves as better representatives of national interests than their domestic competitors. They have weak incentives to internalize the developmental externalities of the single market and they have high stakes in trying to externalize them. Transforming the patterns of political representation thus remains an important challenge for Europe if it wants to maintain deep market integration. We will get back to this question in the conluding section of this paper.

What are the more specific mechanisms responsible for the uneven distribution of the costs and gains of deepening market integration? How, with what effects can domestic and supranational developmental agency alter the effects of these mechanisms? We turn to these questions below.

Inequalities and developmental agency in the EU

Proceeding from the establishment of free trade area and customs union to single market and towards a monetary union (Balassa, 1967) one can encounter an ever longer list of mechanisms that could be responsible for the uneven distribution of costs and gains of integration.

Reflecting an era when more open trade was the major link among economies with self-contained national production structures, old dependency theories claimed that integration might actually lock less developed countries into a permanently peripheral status, due to the lower complexity of their exports (List, 1841; Prebisch, 1950).

More recently, in the era of the increased transnationalisation of production, attention shifted from the competitiveness of the final products for export, to the specific role a country plays in the production of final products in global value chains (GVC) (Gereffi, 1995). Challenging the initial claims of the founders of the GVC approach about the various venues of industrial upgrading, critical approaches argue that the lead firm in GVC may foster competition among its suppliers, pressuring them to deliver at lowest possible cost and with greatest flexibility. Consequently, this leaves suppliers with the low capacity to innovate and makes them resistant to improvements in wages or labor standards (Milberg and Winkler, 2013). Exploring the working of GVCs in the Eastern member states of the EU, others claim that due to the asymmetrical power relations within the GVCs, lead firms have the incentives and the capacity to reproduce dependency relations, leaving firms and states in the East basically no room to alter the distribution of the costs and gains of integration (Nolke and Vliegenhart, 2009).

Contrary to these claims on one-sided relations of dependency, our research on the evolution of the automotive sector in the Eastern and Southern peripheries of Europe finds that national governments can alter the conditions of inclusion in GVCs. At least as importantly, lead firms in the core countries might have stakes in local upgrading and they might get involved in transnational developmental alliances that could increase the range of beneficiaries of the participation in GVCs in the peripheries (Vukov, 2016; Bruszt et al, 2015; Karas, 2015).

A key aspect of these questions is explored in a deeper way in the paper of Nordlund and Vedres in this issue. Nordlund and Vedres ask whether increased openness of the economy fosters or hinders the increase in the density of domestic cross-sectoral linkages embedding export-oriented sectors into domestic upstream activities. Do firms in export oriented sectors pull larger parts of the economy into European and global value chains and with that, towards increased gains from trade openness? Or does increased openness lead to increasingly shallow domestic embedding of these firms. They find that core countries were more likely to combine increased integration with increased embeddedness of exporting sectors in domestic upstream activities, seemingly supporting general claims about the role of external factors in determining developmental inequalities in the regional market.

However, when going beyond regional averages they find significant differences within each of the economic regions of Europe. More specifically, the variation among countries of the Eastern periphery that they find nearly flawlessly corresponds to the variation in domestic developmental agency identified by the earlier study of Bohle and Greskovits in their book on capitalist diversity in Europe’s Eastern periphery (Bohle and Greskovits, 2012). Upgrading the capacities of domestic private and public actors can contribute to increased gains from the transnationalization of production.

At least as importantly, Nordlund and Vedres find strong indirect proofs for the weakness of supranational developmental agency. Even though Greece has been for more than a quarter century one of the biggest beneficiaries of the European developmental transfers, Nordlund and Vedres show that Greece went further and further away from a developmental path that could promise increasing domestic benefits from integration. Since gaining membership, Greece received more than 70 billion Euros in various EU transfers aiming at social and economic catch up growth with the core countries (Bruszt and Vukov, 2017). This amount is roughly two third of the total money spent in the whole of Europe in the framework of the Marshall Plan (See data on the Marshall Plan in Tony Judt, 2010). Thus, the continuously worsening position of Greece provides a further proof for the claims made in the paper of Medve-Balint in this issue about the inefficiency of the EU social and economic cohesion programs.

The next step on the ladder of market integration – the removal of non-tariff barriers to trade with the imposition of similar standards and regulations – implies yet other vulnerabilities for less developed countries. The implementation of common transnational rules might impose excessive costs on producers in less developed countries and might exclude many of them from the market. Domestic private and public actors might have weak capacity to implement these rules and, at least as importantly, they might have no or weak capacity to benefit from these rules (Stiglitz and Charlton 2006; Ismail 2007; Dunn 2003). Furthermore, institutional “mono-cropping”, the application of the same rules in big number of dramatically diverse local contexts, in economies at widely different levels of development and with domestic actors endowed with greatly different capacities can be the source of uncertain and unpredictable developmental problems (Evans, 2004; Bruszt, 2015). The more policy fields are included in the transfer of regulatory institutions, the bigger can be the mismatch between uniform regional rules and diverse domestic conditions. As Dorothee Bohle shows in her paper (in this issue) in the absence of domestic and transnational institutions with the capacity to manage the negative developmental externalities of institutional monocropping, its consequences can be especially harsh in the peripheral economies.

In her paper Bohle deals with the question why peripheral countries have been particularly vulnerable to housing and mortgage booms and busts. She shows how the combination of the peripheral super-homeownership regimes and European market integration created negative developmental externalities that neither domestic actors nor the EU were ready to manage. The integration into the European single market combined with EU-induced external liberalization and deregulation, and in the East Central European cases privatization of the banking sector, has washed these countries with excessive liquidity. It has dramatically decreased the costs of borrowing and allowed them to escape their narrow domestic deposit base. The bulk of international liquidity went into housing finance. Weakness of domestic agency, Bohle shows, have played a role in the negative developmental consequences transnational financialization: In three of the four countries, inexperienced banks were at the origin of the mortgage booms, and in all countries, governments and supervisory authorities were either unwilling or unable (and typically both) to rein in banks and the risky lending boom.

She argues that peripheral financialization differs from that of core in that it is ushered in by rules determined elsewhere, predominantly based on unsophisticated bank lending, relies on access to hard currency, and states lack the capacity the rein in the pressures for financialization. Also, while core countries can resort to autonomous monetary policies such as for instance quantitative easing to cushion the fallout from the crisis, peripheral countries cannot. They are dependent on more powerful actors to take these decisions for them. Bohle concludes with calling attention also to the weakness of transnational developmental agency: "while peripheral countries have more policy autonomy than commonly assumed, alternative policy responses all end up bringing back the old peripheral condition. To solve (not only) the peripheral housing question, transnational actors including the EU would have not only to rein in transnational finance, but also generously support public investment."

Proceeding toward monetary integration, the next element of Balassa's ladder, presents further source of increased vulnerability to less developed, less competitive countries. As discussed in Dellepiane et.al. (This issue), the vulnerabilities of the periphery in the monetary union resemble those already seen in the history of hard currency pegs in the emerging markets. Debt intolerance, the risk of sudden stops of capital inflows, or greater vulnerability due to the social construction of financial markets' confidence are only some of the mechanisms that make peripheral countries particularly vulnerable during monetary integration. A key aspects of this vulnerability is however their state capacity. As Dellepiane et. al. argue, peripheral countries need to be able to master several challenges: make credible commitments to sustainable financial management; have the domestic capacity to absorb shocks without rupturing these external commitments; and finally manage the above two without causing a political backlash that would undermine monetary and exchange rate commitments. The problem is however that very often it is precisely in the periphery that we find rather weak states, with limited capacity to either channel the resources into productive and growth-enhancing activities in good times, or manage their way out of the crisis in the hard times.

As Dellepiane et al. show, peripheries exposed to monetary integration in Europe suffered from similar challenges as the emerging markets, but were even more constrained in managing the crisis, limited not only by the common rules but also by the core countries' reactions to the crisis. Thus, while for many scholars the solutions to the problems of European monetary integration lie in strengthening the fiscal capacities of the EMU, including the establishment of the political union, Dellepiane et al. argue that it is domestic capacities and domestic policy options that should rather be increased. Drawing on the experience of global periphery, they argue that peripheral countries need to have space for innovative domestic solutions that suit their local conditions. Increasing such a space however cannot be achieved simply through deepening the political integration in Europe, but would rather require more flexibility in European policy making (Dellepiane et al.).

While deeper stages of integration thus imply a broader scope of vulnerabilities in the periphery, they also imply growth in the interdependence between the periphery and the core, increasing the probability that the negative externalities from the periphery will spill over to the core. Weak capacity of some of the member states to play by or live by the rules of the common markets might induce a spiral of non-compliance, undermining the common market. Economic and political troubles in the peripheries might necessitate large-scale transfers from the core countries. Absence of economic opportunities might force large-scale migration of labor from the weaker towards the stronger economies inducing political tensions in the host countries. Such developmental externalities of integration might in principle foster the emergence of new kind of developmental agency: the supranational one. The contributions in this issue, either explicitly or implicitly, all deal with the question of the emergence and the efficiency of transnational agency in the process of European integration.

As Brigid Laffan (this issue) shows, core countries and the EU actors were from the beginning of European integration aware of the possible negative developmental consequences of market integration among economies at different levels of development. They have devised several instruments to deal with its potential problems. Key of these devices were the EU cohesion policies that were based on the idea that market integration had to be accompanied by some market correction. Laffan argues that two key cleavages predominated the evolution of cohesion policies. The first was the cleavage between net contributors and recipients, the second was related to the management of cohesion policy, notably the role of the Commission in implementation and the degree of its intrusion into the member states and domestic autonomy. She traces the evolution of these cleavages across waves of enlargement and phases of market integration showing that nearly every major treaty change has involved a re-distributive bargain.

The only exception was the stage of the creation of the single currency. From the outset, EMU was accompanied by a discussion of the prospect of economic divergence within the Eurozone, but no policy instruments were established to assist countries to deal with asymmetric shocks or poor economic performance. Membership of the single currency was intended to be more limited and only when countries were strong enough or flexible enough to cope with the loss of the exchange rate mechanism. Laffan argues that the convergence criteria, the no bail-out clause and the Growth and Stability Pact were designed to avoid the moral hazard of weak domestic management but failed or were breached under pressure. To date the emphasis is on achieving convergence by structural reform and pressure on the poorly performing economies. The creation of a fiscal capacity is mooted but does not yet appear to have political traction. She concludes that it is too early to make longer-term predictions about the evolution of core periphery relations. The functional pressures to create a fiscal capacity in the Eurozone will persist and are likely to result in some strengthening of the role of public finance but just what form this will take, is yet unclear.

The paper of Gergo Medve-Balint (in this issue) continues the analysis of the Cohesion Funds with a focus on domestic spending strategies of EU transfers as a key factor that could account for the overall poor performance of EU policies to manage developmental disparities. Assessed on five expenditure categories, the paper reveals that physical infrastructure investments enjoyed priority over long-term growth-generating R&D and human capital projects and that the allocation of EU funds did not reflect domestic development needs. Furthermore, funds and GDP per capita were inversely related in the East but they show a positive association in the South. Medve-Balint argues that the dominance of physical infrastructure spending may be attributed to the fact that these investments are the most expensive ones. National governments thus prefer to dedicate the EU's resources to such projects instead of burdening the state budgets especially when fiscal discipline and tightening budgetary controls have become the dominant issues on the EU's current agenda. On the other hand, the completion of large infrastructural investments typically in the transport sector may yield immediate political gains for the governments because of their visibility and presumed popularity. However, these projects may not contribute to economic growth in the long run precisely because of their adverse effects discussed in detail by Medve-Balint.

Whereas the paper of Laffan explicitly shows that policy makers in Brussels have limited incentives to considerably increase the amount available for the management of developmental disparities, the paper of Medve-Balint can be read as an evidence for the weak capacity of the supranational institutions to control the spending strategies of the member states and guarantee that the EU transfers would contribute to correcting the transnational market.

While structural funds are by far the most visible aspect of EU developmental agency, they are but one aspect of broader EU attempts at addressing challenges of core-periphery integration. Below we will explore such EU strategies in greater detail, comparing the integration management in the Southern periphery with the one carried out during the Eastern enlargement.

Strategies of managing core-periphery relations

Southern enlargement presented the EEC actors and core countries with the challenge of increased structural and developmental disparities in the Community just at the time when the preparations for the Single European market were getting under way. The integration strategy reflected the self-assurance of more developed core countries and liberal reformers in the peripheries, their belief in the powers of market to set the incentives of domestic actors right and in the capacities of the EU hierarchy to enforce the rules of the transnational market. Market opening was expected to enable full exploitation of the economies of scale and provide incentives for private economic actors to improve and upgrade their products and processes in the face of larger competition. Another expectation was that market integration would also create incentives for state incumbents to bring about market friendly, supply-side policies conducive for increased competitiveness. As discussed in the papers of Laffan and Medve-

Balint, the transfers in the framework of the Structural and the Cohesion Funds were meant to be the only pro-active measures to manage developmental disparities.

The promise of EMU membership and the strict membership criteria was expected to provide further incentive for domestic public and private actors to strengthen their competitiveness in the common market. The criteria for EMU membership was seen to provide the external anchor, the *vincolo esterno,* enabling the domestic policy makers to introduce reforms aiming at macroeconomic stability and budget balance as the necessary condition for joining the common currency, thereby weakening domestic political opposition to such reforms (Torres, 1998; Rhodes, 2002; Crouch, 2000). By providing such *vincolo esterno* EMU was also expected to strengthen the infrastructural powers of the Southern states to coordinate the actions of the market actors with the view of ensuring increased competitiveness, macroeconomic stability and reduce inflationary pressures (Delors, 1989: 20).

The actual outcomes of these various elements of integration however turned out to be starkly different from the initial expectations. While the liberalization of goods and capital was supposed to force the Southern states to reorient towards increasing competitiveness, the membership in the EMU has in turn acted as the shield from these pressures by insulating the Southern economies from the pressures of the international financial markets (Vukov, 2016). The abundance of easily available cheap money, rather than fostering the implementation of reforms aimed at increasing competitiveness, has anaesthetized Southern states (Torres, 2009; Royo, 2009). And while before the EMU accession the principle of 'sound public finance' indeed did become priority for national governments, it turned out to be a short-lived phenomenon and once their borrowing costs converged with the rest of the Eurozone, the Southern governments (except for Spain) reduced fiscal discipline (Verney, 2009).

On the other hand, the EU efforts at fostering structural and technological change and increasing market power of local economic players proved to be far less efficient than expected (see the paper of Medve-Balint in this issue). As mentioned above, the weak efficiency had also to do with the weaknesses of transnational governance to ensure that the use of EU moneys will serve the goal of correcting the integrated market. The Structural Funds reforms of 1988 gave the Commission the latitude to set the framework goals and the principles for the spending of EU developmental moneys and monitoring their implementation (Hooghe, 1996; Ansell, 2000). At the same time, the reforms wanted to further the say of local governments and diverse types of domestic economic actors in developmental decision-making. By the turn of the century, however, largely as a result of the intergovernmental nature of decision-making in the EU, the Commission gave large part of the powers over distributing developmental moneys back to central governments (Keating, 2006; Bruszt, 2008). Left largely on their own, local and regional actors lacking subnational territorial organization could not translate territorial economic problems into effective political demands and could not prevent the recentralization of developmental decisions. In the new constellation of powers, central governments could use the EU moneys largely as free rents.

While Southern integration represented a case for arms-length management of developmental disparities based primarily on incentives, during the Eastern integration the EU relied on the combination of incentives, direct intervention in domestic institution-building and on setting broader economic policy goals for the would be member states. EU insiders were fearful that the Eastern applicant countries will not be able to play by and live by the rules of the integrated market, and that taking them might induce disintegrative processes in the EU, or might impose the need for increased transfers from the strongest economies (Bruszt and Langbein, 2015). The developmental goals of integration were defined in negative terms: preventing large-scale economic shocks that could potentially spill over to the core, as well as making sure that the integrity of the Single Market would not be undermined by the lax implementation of the EU standards in the periphery.

The above goals were explicitly framed as the criteria for accession. At around the Copenhagen summit of 1993, bureaucrats in Brussels were busy with defining and operationalizing things that were previously taken as granted: “functioning market economy” and “capacity to withstand competitive pressure within the EU market”. The third requirement was the capacity to implement the *acquis communautaire*. On the one hand, the Commission saw these requirements as non-negotiable preconditions of membership. On the other hand, it could not be sure whether states in these countries will be able to implement these requirements and, at least as important, whether their economies will be able to survive economically their implementation.

The governance of the economic integration of the Eastern periphery reflected these ambiguities and uncertainties. Instead of an arms-length checklist compliance, using solely the incentives linked to membership, the Commission involved the governments of the accession countries in several years long joint problem solving in more than thirty different policy areas ranging from the upgrading of the judiciary or civil service reform to such specific regulatory areas as environmental regulation, the regulation of competition or the implementation of the institutions that could guarantee the free movement of goods and prevent local private and public actors from discriminating non-domestic producers (Bruszt and McDermott, 2012). Usually, these processes started with the EU monitoring report that provided the opinion of the Commission on the distance between the EU demands and the situation on the ground. That was followed by the applicant state’s reply that already had to include a plan how these problems will be remedied, with the mobilization of what kinds of resources. While the monitoring of the progress in meeting the demands of the EU was repeated year by year, until the closing of the specific chapter, state restructuring in the East was growing embedded by the Commission in twinning programs, a transnational network of technical assistance mobilizing thousands of public and private actors in the old EU member states. These later actors not only helped the Commission to get intimate knowledge about the institutional change on the ground; they also directly participated in joint problem solving together with domestic actors (Bruszt and McDermott, 2012).

Thus, unlike in the South, in the case of the Eastern enlargement, the EU temporarily built up supranational capacities to foresee and manage negative developmental externalities of integration. Bureaucrats from DG Enlargement and the EC Delegation in the future member states, together with domestic actors, engaged in discussing opportunities, constraints and threats in the process of integration, as well as possible solutions for coping with these problems. EU pre-accession assistance programs that have transferred in the first wave of Eastern enlargement 28 billion Euros to the countries that have joined the EU in 2004 were linked to the problems detected in these reports, several times done in collaboration between domestic and external actors. Such supranational capacities were however quickly dissolved upon the accession of the East European countries, leaving the new member states with Structural Funds as the only EU instrument for helping their weaker regions adjust to the common market.

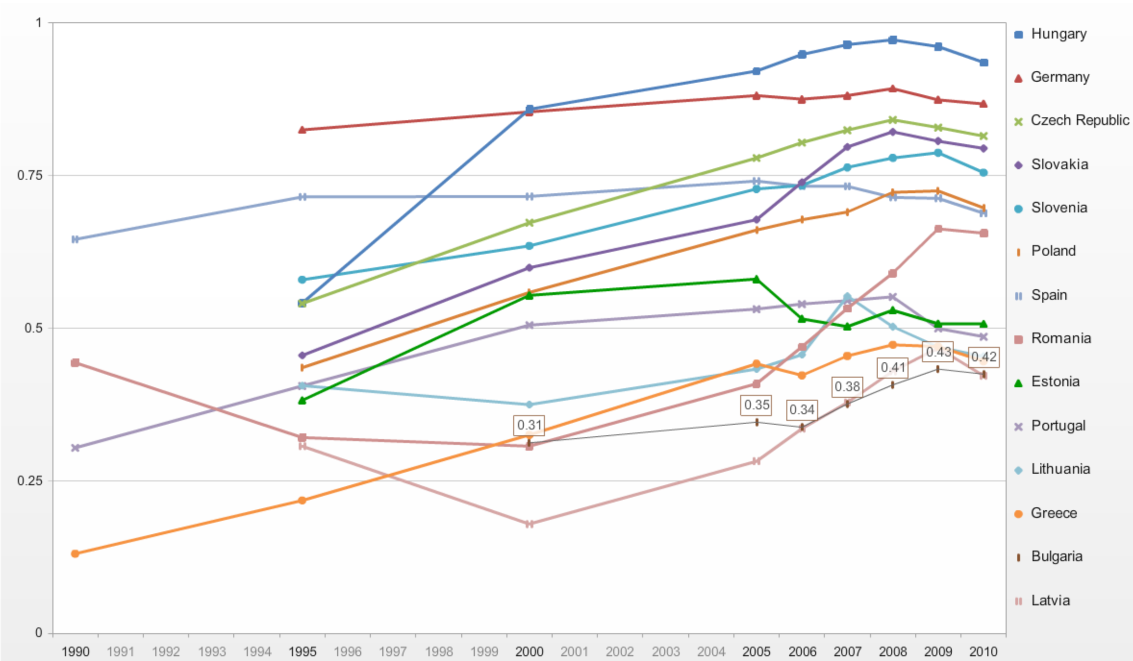
Measured by its own metric – to prevent the sinking of the Eastern economies in the process of integration – the EU efforts in the East have appeared somewhat more successful (see more on this in Bruszt and Vukov, 2017). Nevertheless, the developmental pathway of the Eastern periphery, while different from the Southern one, still retains problems that can not only have adverse effects on the periphery, but that also have the potential of spilling over to the core and contributing to the crises of the EU. We turn to these in the next section.

Pathways from the periphery: South and East contrasted

More than 10 years after the Eastern enlargement and 30 years after the Southern one, it is apparent that none of these peripheries has become the 'core'. Rather, the two peripheries have experienced different forms of patterned *partial* convergence with the core.

With regards to production profiles, the two peripheries record substantive differences in the structure of their manufacturing exports. Graph 1 shows the trends in the share of high and medium tech exports in total exports.

Graph 1. Share of Medium and High Tech Activities in Manufacturing Exports

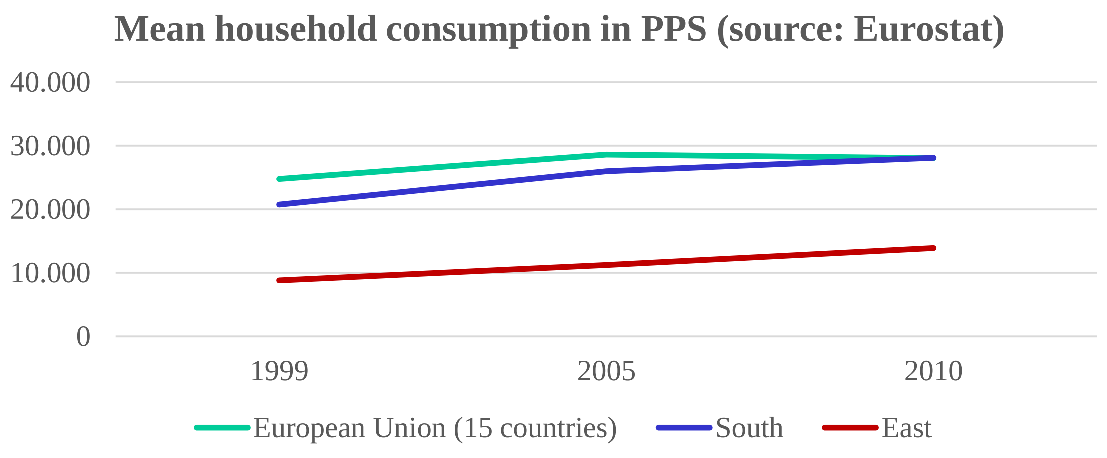


Source: UNIDO

In terms of export structure, the best performers in the East indeed seem to have converged with the core, with the technological intensity of Hungarian exports even surpassing that of Germany and the Czech, Slovak and Slovenian exports coming close to it, with more than 70% of medium and high-tech activity in their total exports. Such upgrading has been achieved primarily thanks to the large-scale foreign direct investment in the region (Bohle and Grekovits, 2012).

The situation is exactly the opposite when it comes to these countries' consumption levels, the proxy we use to measure the changes in the distribution of the benefits of convergence to the core. Here the Southern periphery has been doing much better than the Eastern one.

Graph 2. Mean household consumption in PPS



Both the South and the East thus experienced only partial convergence towards the core. While the South until the latest economic crisis managed to extend the range of domestic beneficiaries of integration and converged with the core in its levels of consumption, it remained peripheral in terms of its profile of production. Conversely, some of the East European peripheral countries record substantive improvement of their position in transnational markets, bringing their production profile closer to the core. Yet, neither of the Eastern new member states has come even close to catching up with the core in the levels of consumption and overall living standards.

Thus, both modes of managing core-periphery relations has left these two peripheries burdened with different developmental problems that not only affect the peripheries themselves but also have the potential to spill over to the core and jeopardize further economic integration. In the case of the Southern periphery, these problems and the associated financial vulnerability have come to the fore in the recent economic crisis, contributing to increasing political divides both in the Eurozone and beyond. The lagging behind of living standards in the East and the failure to increase the range of domestic beneficiaries of integration have the potential to create political problems for further integration by creating fertile ground for the resort to economic nationalism, as is already visible in some of the East European member states. As opposed to the pre-accession period, the post-accession institutional set up leaves much less opportunity for the EU actors to identify and manage developmental problems in the Eastern periphery, or to use conditionality to leverage their political developments.

Conclusions

In this paper we have argued, first, that the deeper the economic integration gets and the more diverse are the capabilities of participating actors, the larger will be the need for mechanisms that could help to anticipate and alleviate the potential large scale negative developmental externalities of market integration. A common market works when its rules are harmonized, but that presupposes the working of mechanisms that can sustain the harmonization of the interests of the participating states.

We have also argued that the disjuncture between economic and political integration is the common key factor behind the crises of market integration in Europe. The emerging European federal regulatory state that can impose, monitor and sanction policies on 28 member states in nearly 40 different policy areas is controlled by an intergovernmental polity. The management of the developmental externalities of the pooling of economic sovereignty is in the hands of politicians whose political survival depends primarily on their capacity to present themselves as better representatives of national interests than their domestic competitors in electoral competition.

This polity might have worked for extending transnational markets in times when mainly the gains of integration had to be redistributed. In times of crisis, when there is a growing need for market correcting programs, the same polity has very weak capacity to produce policies that could represent the longer-term common interests of the member states. Instead, its decisions decrease the room for democratic politics in member states (Mair, 2013) and drastically restrict the sovereignty of the less fortunate member states (Hinarejos, 2013). While the EU as an emerging quasi state has limited capacity to anticipate and alleviate the negative developmental externalities of market integration, the pressure of integrated markets combined with the growth of technocratic rule decreases the room for market correcting policies at the level of member states (Chalmers et al, 2016). The working of the integration regime, as a result, furthers growing distrust in national and EU level democracy (Armingeon et al, 2015), and boosts the spread of economic nationalism and populism (Bruszt, 2015). As a result of these pathologies, the polity created for furthering integration itself becomes a factor of disintegration (Offe, 2015).

Many in the debates about the various ways out of the present crises in Europe hold that the focus should be on changing *policies* and on redistributing competences between the national and supranational levels, suggesting either "more Europe" (e.g. Varoufakis, 2017) or "less Europe" (Scharpf, 2016). The problem with these proposals could be that moving either towards more or less Europe in an orderly way might already presuppose the existence of political mechanisms that could solve the distributive problems of change and manage interdependence among these economies and societies in the common interests of the member states. Thus, moving either forward or backward with integration might need political institutions that could prevent disintegration while advancing policy reforms in either of these directions.

Here we can cite Dani Rodrik's famous political trilemma of the world economy as he has applied it to the European Union. As he formulated it, one cannot have international economic integration, democracy, and national sovereignty simultaneously. One must choose two among the three. Applied to the EU Rodrik argued that "if European leaders want to maintain democracy, they must make a choice between political union and economic disintegration. They must either explicitly renounce economic sovereignty or actively put it to use for the benefit of their citizens. The first would entail coming clean with their own electorates and building democratic space above the level of the nation-state. The second would mean giving up on monetary union in order to be able to deploy national monetary and fiscal policies in the service of longer-term recovery." (Rodrik, 2012)

We tend to differ from these alternatives and from the way the trilemma is presented. First, from the dynamics of the European crises we can conclude that choosing two from among the three does not represent a stable equilibrium. As the unfolding drama of Brexit has shown, even for a country that has never joined the EMU, the alternative of choosing between national sovereignty and transnational market integration does not exist, except as the invention of populist politicians. The post-Brexit question is how and what part of national sovereignty will be allowed by national democratic process to be left in common transnational pool. Second, and at least as importantly, the question is whether and how the people of the UK will share with the peoples of other EU member states the democratic control over the pooled part of national sovereignty once they will be outside the decision-making bodies of the EU. Having only national sovereignty and democracy does not seem to be an alternative in the 21th Century.

The crises of the EU have also shown that leaving control over the rules of the integrated market to a supranational agency with questionable democratic credentials will not only limit national sovereignty. It might also hollow out national level democracy and it might create in member states agency for disintegration. Perhaps the solution to the trilemma is to institutionalize democracy at the supranational level *in addition* to the national one and leave it to the institutions representing the common interests of the peoples of the member states to decide which way to go with integration, how and what part of national sovereignty to pool at supranational level. Federalism, as a polity, was not invented to create some stable equilibrium between national and supranational sovereignty. It was meant to serve as a mechanism to manage in orderly way conflicts linked to multi-level sovereignty, allowing also for moving back and forth between centralization and decentralization.

Finally, if the goal is to change the political institutions of the EU, perhaps the key question is what institutional setup can sustain at the same time unity and diversity while managing the single market. What institutional setup can defend better the interests of the diverse *peoples* of Europe and increase at the same time the probability that the common interests of the *Europeans* will get a better representation in the policies of the EU? Is it possible to give institutionalized form of the common interests of Europeans without political parties formed and competing at the European level? Are there other ways of institutionalizing solidarity among the member states than by using the self-interests and the imagination of political parties formed at the European level to represent encompassing programs for th*e peoples* of Europe that are more competitive than their alternatives? These are questions that we think must be included in debates about European integration's future. Otherwise, it may not have one.

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