Background paper for the worshop “Reforming the EU: Central European Perspectives”

Market integration, sovereignty and democracy[1]

Rodrik’s trilemma in the light of the integration of Europe’s Eastern and Southern peripheries

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Abstract

This introduction offers a common analytical framework for the papers in the special issue that explore the economic and political crises of the EU from the perspective of the governance problems of market integration. These crises, we argue, 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 strengths and w 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, more democratic institutions are needed at both national and supranational levels.

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Introduction

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 integrated market a common good (Bruszt and McDermott, 2014). Our central claim in this special issue is that the post 2008 crises in Europe display the weaknesses of the European Union (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. 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, the EU has at present weak capacity 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 weaker capacities to deal with the negative developmental consequences that emerge once these common rules are implemented across a variety of very different national 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 smoothly 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 EU displays the weaknesses of a confederal polity in which policy makers are accountable primarily to member state level constituencies. The actors that are responsible to produce EU level policies representing the longer-term common interests of the member states, must compete for office in national political arenas only and have therefore limited incentives to consider the longer term common interests of the Europeans.

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 disintegration of the whole system. Whether one can combine all the three in Europe under the umbrella of a federal polity, that would give representation also to the Europeans, besides the peoples of the member states is a contested issue (Fabbrini, S. 20xx). 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. Finally, the paper by Medve-Balint explores the dominating EU strategies to manage developmental disparities in Europe.

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.

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 has weak capacities to deal with the unforeseen 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

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 the unification of monetary, fiscal, social and countercyclical policies governed by a supranational entity (Balassa, 1961).

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 for 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 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. Several major EU policy documents have discussed the various mechanisms linked to the extension of the regional market that could yield large-scale negative developmental externalities and imperil integration (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 potential negative externalities of the common market. 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, these states have highly uneven domestic capacities to manage the multiple integration challenges of the single European market (see also in Bruszt and Vukov, 2017).

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 at a low fee, 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 proved that pains in the peripheries can generate pains in the core countries and set in motion disintegrative processes.

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.

Traditional dependency theories claimed that liberalization of trade might lock less developed countries into a permanently peripheral status and prevent development due to the lower complexity of their exports (List, 1841; Prebisch, 1950). Newer versions of dependency theory focus on the role lesser developed countries can play in the production of final products in global value chains (GVC). They 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 while there is a room for industrial upgrading, public and private actors in member states differ dramatically in their capacities to exploit such opportunities. At least as importantly, the EU has limited capacity to either help to upgrade domestic capacities, or coordinate the development policies of the member states (Vukov, 2016; Bruszt et al, 2015; Karas, 2015; Bruszt and Vukov, 2017; Scepanovic, 2017; Medve-Balint in this issue). Depending on the policies of member states and the EU, we found, 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 GVCs in the peripheries).

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 in their own home countries, 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 weakness 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.

Core countries and EU actors were from the beginning of European integration aware of the possible negative developmental consequences of market integration and they have devised several instruments to deal with its potential problems. Key of these devices were the EU cohesion policies discussed in the paper of Medve-Balint (in this issue).

His paper focuses 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.

The paper of Medve-Balint provides an indirect evidence for the weak capacity of the supranational EU institutions to control the spending strategies of the member states and guarantee that the EU transfers would contribute to correcting the transnational market or that the use of EU moneys would further common developmental goals among the EU member states .

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. Two of them merit mentioning here: nurturing of domestic institution-building and direct intervention in domestic economic policies. As it will be discussed below, both of these policies were solely of ad-hoc nature, they were apllied solely in the Eastern and Central European countries and only for the period leading to accession to EU membership.

Since the starting of the deepening of market integration in the late 1980s and its extension to the Eastern peripheries, EU policy makers were concerned by the weak institutional capacities of less developed (would be) member states (Werner Report, 1976; Delors Report, 1989; Agenda, 2000). However, at the time of the creation of the single currency,the dominating belief was that the incentives of the extended market, together with the enhanced sanctioning powers of the Commission will be enough to induce the Southern members with weaker states to upgrade their domestic institutions on their own. No policy instruments were established to assist countries to deal with asymmetric shocks or poor economic performance. 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.

Dramatically different were the policies of the EU during the Eastern enlargement. Fearful of the weakness of the capacities of the aspiring member states, and the low level of competitiveness of their fledling market economies, the Commission has designed innovative policies to upgrade states and introduce remedial economic measures in order to assist these countries to play by and live by the rules of the common market (Bruszt and Vukov, 2016; Bruszt and Campos, 2017).

Below we will explore these 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. 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. By design, these later policies saw the sub-national state as the primary unit of market correction, the expectation was that at the national levels the incentives of the extended market will induce the necessary changes without greater EU interventions.

The promise of EMU membership and the strict membership criteria was expected to provide the key 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: "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.

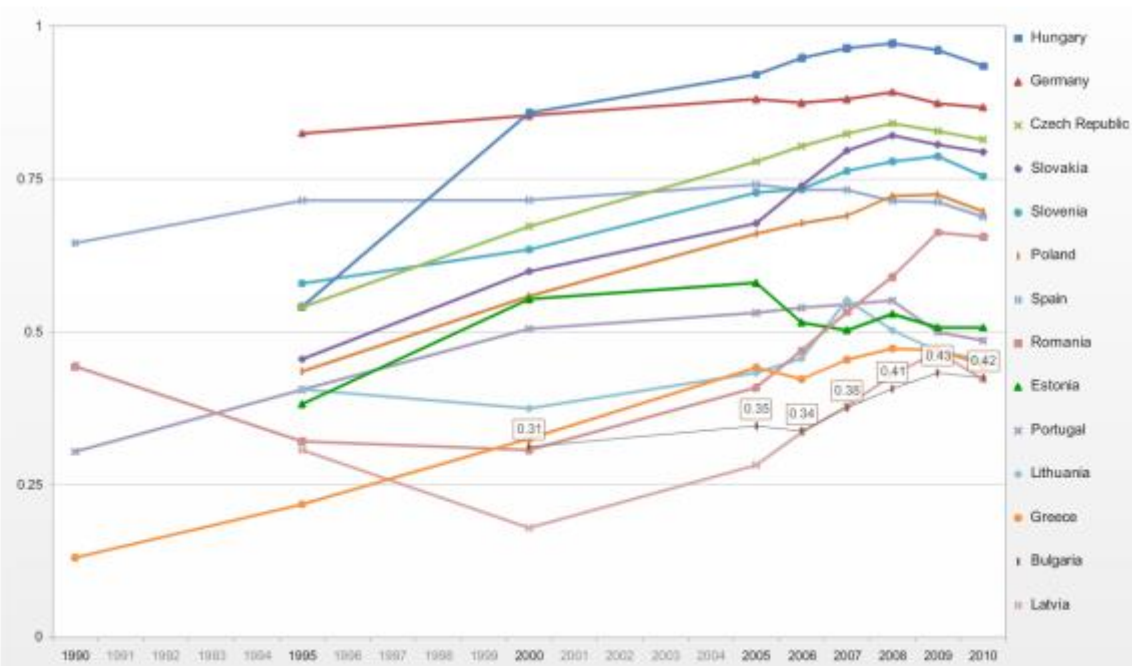
Measured by its own metric – to prevent the sinking of the Eastern economies in the process of integration – the EU efforts in the East have appeared somewhat more successful (see more on this in Bruszt and Vukov, 2017). Nevertheless, the developmental pathway of the Eastern periphery, while different 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

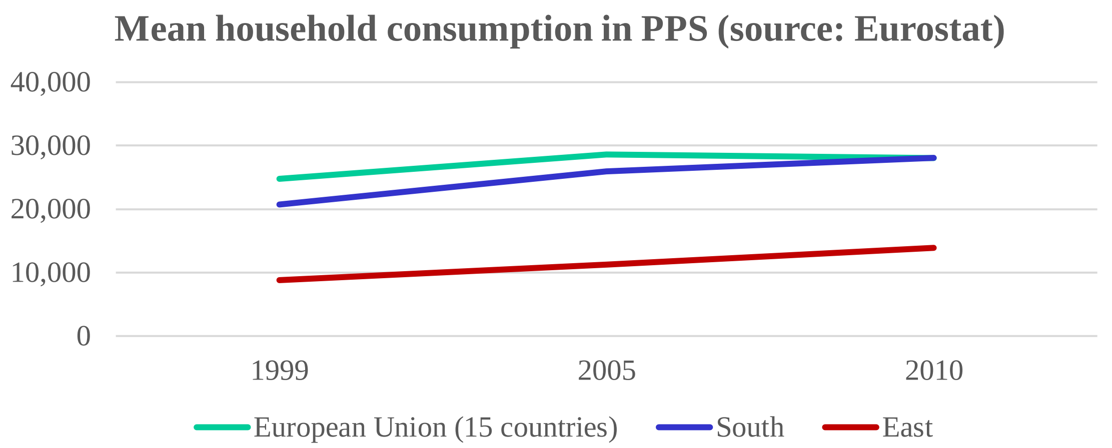


Source: UNIDO

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).

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 what part of national sovereignty will be allowed by national democratic process to be left in common transnational pool, shared by transnational and national institutions or, remain at member states' level. 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 that is accountable solely to member states with widely differing powers to impose their will in Brussels can result in limiting the national sovereignty of weaker member states (Fabbrini, F., 2017). 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 the representation of the Europeans at the EU level *in addition* to the national representation of the peoples of Europe in Brussels and leave it to the outcomes of the conflicts and compromises among these representative institutions 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.

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