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Transnationalizing States in Europe's Peripheries: European Integration and the Evolution of Economic State Capacities in the Southern and Eastern Peripheries of Europe

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Abstract: The paper examines the evolution of economic state capacities in the Southern and Eastern peripheries of Europe induced by the European integration. European market-making has implied conscious EU efforts to induce institutional change in the peripheries, by cutting off state capacities for promoting and protecting domestic actors, while strengthening capacities for preserving market order, implementing transnational regulations and increasing competitiveness in a market-friendly way. However, the EU strategies of backyard management were dramatically different in the Eastern and the Southern periphery of Europe. In the South the main strategy was to 'get the incentives right': market integration would prompt public and private actors to build institutions for increasing competitiveness. In the East, the strategy was 'getting the institutions right': the EU engaged in direct institution building, monitoring and assisting institutional change. These external strategies resulted in starkly different patterns of economic state restructuring and different developmental pathways. The leading countries of the East increased their competitiveness and converged with the core in their production profiles, but remained peripheral in their consumption patterns, while exactly the opposite is the case in the Southern periphery.

Keywords: development, economic integration, EU, periphery, state

JEL Classification Numbers: F15, F55, O19

1. Introduction

There is by now an established body of scholarship dealing with the issue of how European integration has in the past decades effected state restructuring in member states. With regards to economic state capacities in particular a prominent view is that domestic state capacities to govern the economy are getting weaker and that the economy is becoming increasingly ungovernable due to the embedding of national governments in transnational markets and in a set of supranational rules (Stopford and Strange, 1990, Streeck and Mertens, 2013). Others argue that rather than declining state capacity, in reality we are witnessing the process of state transformation from Keynesian Welfare State to Schumpeterian Workfare state or Competition state and that Europeanization or the process of European market making has underlined precisely such competitiveness-oriented restructuring of the state

(Scharpf, 2002, Jessop, 2002).

While fully agreeing that European market making induces state transformation, in this paper we focus on the integration of the Southern and Eastern peripheries of Europe and argue that there are important variations in state restructuring in Europe that can not be attributed simply to the different domestic responses to the same pressures emanating from the European integration. There is no such thing as a unitary 'EU effect': the EU uses different sets of strategies of integration outside of its core shaping state restructuring in various parts of Europe in different ways.

We make two key arguments. First, we argue that European market making has from its inception been intimately linked with the conscious attempts to restructure states in the European peripheries, both in the South and the East and via this shape their developmental pathways within the common market. Second, the means used by the EU for inducing and helping state restructuring in the East and South were markedly different yielding substantive divergence in the evolution of economic state capacities in EU's two peripheries and contributing to developmental outcomes that represent dramatically different dilemmas for further integration.

First, state restructuring has been the key part of the goals of the integration of the less developed peripheral countries of Europe from the time of the restarting of the European regional market making project in the late 1980s (Dyson, 2002; Radaelli, 2002; Jones, Frieden and Torres, 1998, Featherstone, 1998; Royo, 2013). These goals have included both the weakening and cutting off of some state capacities and also the strengthening of some others. As to the first, the EU took away traditional developmental state capacities relying on direct interventions in the economy and on shielding of specific sectors from international market competition - capacities which formed the basis of development strategies both in the global South and also in the core countries of Western Europe until the 1980s (Shonfield, 1967 Amsden 2001). Such strategies were in conflict with the EU goal of creating a 'level playing field' via imposing the same economic rules within the regional market independently of differences in levels of development and endowments in economic capacities.

The economic state promoted by the EU in its peripheries that we will call "liberal developmental state" differed from the old developmental states by not having hands to micro-manage, promote or protect firms. Instead, it had (or, in several cases: it was expected to have) upgraded capacities to generate and sustain a market-friendly environment that could lure FDI, further economic upgrading and increased competitiveness, and nurture in market-friendly ways the competitive power of more backward regions, firms or different categories of economic actors.

Second, as we will show below, there is striking divergence in the evolution of Southern and East European states. Exactly in those dimensions of the economic state that were seen as key by the EU, the new Eastern member states show substantively better performance than the older members in the South. Solely domestic political and economic features cannot explain such systemic regional variation. Here we argue that differences in the means used by the EU to further state restructuring played a key role in the divergence of economic state capacities in these two peripheries.

In the case of the South, the EU has refrained from major direct interventions in domestic institutional change and has expected state restructuring primarily from getting the incentives right. The extension of supranational sanctioning of the rules of the common market via the European Commission and the ECJ; the increased competition brought about by the free movement of capital, goods and services, as well as the conditionality linked to participation in the EMU were expected to force actors in the Southern member states to adjust their institutions and economic policies in the right direction (Dyson, 2002; Radaelli, 2002; Jones, Frieden and Torress, 1998). The only 'intrusive' intervention of the EU in the South with the goal of upgrading states' developmental capacities was linked to a scheme that also aimed at 'getting incentives right'': forcing central governments to set developmental goals in an institutional setup that extended their accountability downwards to subnational actors and upwards, to EU level actors (Keating, 2006; Bruszt, 2008).

In the East, on the other hand, the main strategy of the EU was to get the institutions right and the EU engaged in direct monitoring and assistance of the process of institutional change, establishing benchmarks and institutional conditionality, and regularly reporting on the progress achieved and goals yet to be met (Vachudova, 2005). Moreover, instead of a simple enforcement based on checklist-compliance, the EU invested in twinning programs that have embedded domestic state building in a transnational network of technical assistance and joint problem solving (Bruszt and McDermott, 2012).

The different strategies described above also contributed to diverging outcomes. While the East European states managed to converge with the Southern ones in administrative state capacities, their scores are significantly higher in state capacities to preserve and regulate markets. Furthermore, in the East the pressures induced by liberalization of capital and goods markets indeed prompted the states to develop policies aimed at increasing their competitiveness in transnational markets. In the case of the South, however, these pressures were weakened by the participation in the monetary union that effectively shielded the Southern states from the pressures of the international financial markets and reduced the incentives for competitiveness-oriented reforms (Vukov, 2013). Partly as a result of these differences, the developmental pathways of the South and the East were also starkly different as the two peripheries experienced two very different patterns of economic transnationalisation.

Ten years after the biggest European enlargement and 30 years after the accession of the Mediterranean states to the EU (at the time the EC), the leading economies in the Eastern periphery have arrived close to the core, if not at the level of consumption but at least at the level of structure of their production. At the same time, the economies of the South have reached the consumption levels of the core countries while basically staying closer to the periphery from the perspective of their positioning in the European markets. Such differences pose variation in developmental dilemmas and call attention to the weakness or absence of different types of economic state capacities in the two peripheries of the EU.

The literature on the Europeanization of the Southern states has already drawn attention to the EU-induced economic state restructuring in the periphery (Royo, 2013; Crouch, 2000; Radaelli, 2002;

Rhodes, 2002). However, the focus of this literature has been primarily on the state capacity to preserve macroeconomic stability and further competitiveness, while the evolution of other economic state capacities such as the regulatory, the developmental or the general bureaucratic and market preserving capacities was left in the dark. Furthermore, for the studies of Southern integration, the particular mechanisms of promoting state restructuring via incentives are simply described and taken for granted, rather than problematized as only one of the possible alternatives the EU could have used.

The literature on the Europeanization of Eastern Europe for its part has provided many insights on the institution-building efforts of the EU in the East and in particular the strengthening of the bureaucratic and regulatory state capacities in the region (Schimmelfening and Sedelmeier, 2005; Dimitrova, 2005; Vachudova, 2005). Nevertheless, this institution building has typically been analyzed in the framework of compliance studies and much less as part of the EU management of the economic integration of its periphery. On the other hand, the few studies that do explicitly frame EU strategies in a developmental framework (Jacoby, 2010; Bruszt and Greskovits, 2009) still do not analyze this backyard management in comparative perspective. Consequently, the literature on the European integration of the East has so far provided no metric for assessing the relative success or failure of such backyard management. By comparing EU-induced economic state restructuring in the East with the one in the South we take the first step in that direction by providing tools for analyzing and assessing different strategies of backyard management in the EU.

The rest of the paper is organized as follows. The second section elaborates on the contested notion of economic state capacities, identifying the key dimensions of economic state capacities entailed in the EU policy goals as well as demonstrating substantive divergence between the Southern and Eastern states with regards to these state capacities. The third section analyses EU strategies in the South and in the East respectively, focusing both on the expectations about state restructuring linked with different aspects of the integration of the periphery as well as their actual, intended or unintended, consequences while the fourth section concludes.

2. Promoting the liberal developmental state: Economic state capacities on Europe's peripheries

The goals

It has always been a contested issue what capacities states were supposed to have to help economic development. In the scholarly literature, what was usually meant by state capacity was the variable and changeable probability that specific states will provide diverse types of public goods related to the maintenance and development of (social, economic, political) order (O'Donnell 1994; Linz and Stepan 1996; Gereffi 1995; Evans 1995; Woodruff 1999). Definitions usually included the probability that states will be able to get the resources (e.g., in the form of taxes, political support) necessary for supplying these public goods. What these public goods were, or what they were supposed to be, was contested and varied in time and space. Students of the political and economic transformations in the global East and the South have listed and studied several relevant state capacities, ranging from the capacity to maintain the rule of law and enforce citizenship rights (O'Donnell 1994; Linz and Stepan 1996), uphold economic freedoms and create a predictable policy environment (North and Weingast 1989), collect taxes and impose enforceable rules in the economy (Woodruff 1999; Bruszt 2002), and resist corruption or state capture (Hellman 1998) to such capacities as implementing unpopular restructuring policies (Haggard and Kaufman 1995) or formulating and implementing coherent policies that reflect wider developmental considerations (Evans 1995).

The role states were expected to play in socioeconomic development, and the list of capacities states were supposed to have has changed several times during the past three decades, and it still differs dramatically across the world's regions. Until the early eighties, in most of the developing countries in the South and the East, states were seen to be the prime movers of development (Gereffi 1995; Evans 1995; Stepan 1978). Even in the most developed economies, until the 1980s the mainstream view was that the capitalism of the developed global North also moved toward a "mixed economy" characterized by significant state management of the economy (Shonfield, 1967). The reviving interest in the study of the developmental state capacities has induced innovative research on the bases of states' capacity to design and implement coherent developmental programs (Evans 1995; Stepan 1978; Skocpol, Evans, and Rueschemeyer 1985).

During the eighties, partly as a result of the failure of the state-based developmental models in several Latin American countries and in Eastern and Central Europe, states began to be perceived in mainstream approaches more as part of the problem itself than as part of the solution. For some time the capacity to "introduce and sustain the right policies" of liberalization, privatization, and stabilization — the mantra of the international financial institutions (IFIs) —was the sole cited challenge on the pathway of economic transformation and development. In that context, social and political regulations were pictured as key potential sources for corrupting markets (and states) and state capacity to liberate the economy from the state, the so called 'orthodox paradox' was pictured as the metric of success in economic state action (Haggard and Kaufman 1995).

The first positive state capacities that were mentioned in the 1990s were linked to the capacity to enforce and uphold the freedom of property and contracting, and the capacity to maintain the rule of law in the governance of economic transactions – the capacities of the so-called **market preserving state** (North and Weingast, 1989). Very soon, however, the developing of **regulatory state** capacities became seen as one of the crucial aspects of state capacity to ensure the functioning of markets (Majone, 1994).

In the world of increasingly transnational regulations, a key challenge for the developing countries became also their capacity to implement the transnational rules and have institutional capacities that could prevent the use of different non-tariff barriers to the free flow of the diverse factors of production (Stiglitz and Charlton, 2006). Given that developing countries of the global East and South are typically 'rule takers' in transnational integration regimes, their effective participation in transnational markets became dependent on developing state capacities to contribute to making transnational markets.

In the context of the European market making and the integration of European peripheries, the idea that the state is 'part of the problem' and should simply give way to free and unfettered markets never gained much ground. Instead, the EU approach to market making has from its inception relied on the idea that strong markets require strong states. The precise ideas of what constitutes this state strength represented a mixture of several of the above-mentioned capacities. To begin with, **market-preserving state** has most certainly been seen as one of the key preconditions of the well-functioning markets; however, the EU, led by ordo-liberal ideas, went beyond this, and saw regulations as the key element of market building. By the time of the fall of Berlin Wall the EU already had a rapidly growing corpus of regional market regulations and it made the condition of membership in the regional free trade regime for the countries in its Eastern peripheries to adopt and to build institutional capacities to implement 80,000 pages of EU institutional standards and regulations. The countries in the Southern peripheries of the EU were already member states at the time of the building up of the EU regulatory regime. While Brussels could not use in their case the robust conditionality, it has enforced the regulatory requirements relying primarily on the sanctioning powers of the EU judiciary and executive. Large part of these regulations aimed at imposing competition on domestic markets, preventing the misuse of asymmetries in economic and informational power (Bruszt, 2002). The main state structures required to create the **EU conform regulatory state** capacities were extensive: just their brief descriptions prepared for experts working for the European Commission takes more than 100 pages single spaced.

A third group of non-negotiable domestic state capacities that were demanded and enforced in both peripheries were linked to the goal of the EU to impose a level playing field in the regional markets and prevent domestic states to promote or protect domestic economic actors. The EU did not only demand the removal of tariffs and did not only monitor and sanction member states for the use of non-tariff barriers. Member states and aspiring members on the peripheries were obliged to build up encompassing domestic institutional capacities to monitor domestic state and non-state actors in the economy and prevent them from discriminatory practices that could constrain the free movement of goods, capital and services. Such **transnational market making state** capacities have required the creation of state units that could act as local guardians of the EU within the nation states. In the field of the free movements of goods this included the creation of autonomous institutions for standardization, accreditation, conformity assessment, metrology and market surveillance. In the field of the free movement of services actual and aspiring member states were obliged to build up administrative capacity to continuously screen administrative or legal rules existing or under preparation as to their compatibility with market freedoms as interpreted by the European Court of Justice. In the field of the free movement of capital the EU demanded the setup of new legal and administrative infrastructure in all areas, where previously practices or sectoral policies have relied on capital movement restrictions. Such institutional demands were minimalist only in the field of the free movement of labor.

By cutting off the (discriminatory) helping hand of the state and instituting domestic guardians to hinder the rebirth of old developmental state practices the EU foreclosed the path to the independent and traditional integrationist developmental strategy characterizing states of Western Europe before the 1980s, as well as the states of the global East and South. Whereas the 'independent' model, exemplified by the developmental pathway of Taiwan, South Korea and several of the EU15 core economies, has nurtured primarily the global market power of domestic firms, the 'integrationist' model that has evolved in the Latin American countries relied much more on FDI. In the latter, the state tried to manipulate actively the relationships between MNCs and domestic firms with the goal to improve via such an alliance the overall economic position of the country in global markets (Amsden 2001). Both of these strategies were based on state capacities to micro-manage the economy and selectively promote and protect specific sectors from the competition in international markets and were hence incompatible with the EU market making efforts. While the EU was thus taking away from the peripheral countries the old developmental state capacities, the 1988 reform of the Structural Funds (SF) tried to introduce and further a **market friendly developmental state** capacity specifically in the old and new peripheries of Europe. Closely linked to the efforts of deepening European market making, the goal of the SF reforms was to create domestic capacities to increase the market power of weaker economic actors and reduce territorial disparities among economic actors in the capacity to profit from the enlarged European market. Unlike the old developmental state that tried to shield economic actors from market competition or compensate them for the vagaries of markets, the developmental state promoted in Europe's two peripheries was a liberal one that tried to increase the market power of economic actors to withstand competitive pressure and eventually benefit from it.

The fifth state capacity promoted by the EU, closely interlinked with the promotion of the regulatory state, was general **administrative state** capacity referring to the creation of the institutional conditions of the coming about of an impartial, trustworthy and efficient public bureaucracy. Whereas the market-friendly developmental state capacities were first designed specifically for the Southern peripheries, general administrative state capacities became part of the conditionality during the Eastern enlargement. The requirements for such administrative state capacities included civil service reforms in conformity with EU rules and well staffed, budgeted state bureaucracies with civil servants selected and promoted in a depoliticized and on meritocratic basis.

The above listed five areas of the EU promoted economic state, the capacity of maintaining the rule of law and uphold economic freedoms; the capacity to safeguard competition and impose EU conform regulations; the capacity to contribute actively to the prevention of old developmental practices that could hinder regional market freedoms; the capacity to further competitiveness and reduce disparities in market power, and finally, the general administrative capacity to implement the rules and policies of the state in an impartial, trustworthy and efficient way make up a new type of economic state that is absent in the global East and South. We call this new type of state the **liberal developmental state** as it combines capacities for increasing the role of transnational markets in shaping developmental outcomes with the capacities to maintain and increase the market power of various categories of domestic actors.

As it will be discussed below, the EU has used different means to promote the economic state capacities that could help the coming about of liberal development state. As for the enforcement of the requirements of the promoted state capacities, the EU has means of widely different efficiency varying in their sanctioning powers both across these five dimensions of the liberal developmental state and also before and after accession. The EU had the strongest sanctioning powers in its Eastern peripheries; as for those countries meeting the demands of Brussels was the condition of membership. Countries in the Southern periphery were already member states at the time of the new wave of European market making and in their case the lesser powerful means of intra-EU sanctioning were used namely relying on the sanctioning powers of the EU judiciary and the executive. Out of the above-described five areas those that are linked to domestic regulatory state and the preservation of transnational markets have the strongest legal basis for sanctioning. Member states have bigger freedoms in shaping the judiciary, the key institution of the market preserving state and the also in the formation of the corps of civil servants, the key actors of the administrative state. Finally, in the case of the developmental state, the EU only has indirect means to shape domestic institution building.

Outcomes

There is a profound divergence between East and South, with different types of their state capacities being strengthened or weakened in the process of European integration.

As for the state capacity to impose EU conform regulations in the economy and ensure the four freedoms of the common market, the evidence available through the data on the number of infringement procedures suggest that in the two core dimensions of the liberal developmental state that are sanctioned with the strongest means changes went further in the East than in the South, with Eastern states recording the lowest and Southern states the highest number of infringement procedures within the EU (Sedelmeier, 2008).

The data on the administrative capacity and the quality of government in the East and in the South suggest that in this respect the East has converged with the South. Charron et. al. (2010) perform cluster analysis of the EU states based on the quality of governance data collected by the World Bank and show that there are three groups of countries in Europe, with none of the Eastern or Southern states being in the best performing group. Rather, Estonia and Slovenia show similar capacity as Spain and Portugal, while the rest of the NMS is in the worst performing group, together with Greece and Italy. Moreover, the data on subnational bureaucratic capacity show that most of the East European regions have converged with the level of regional capacity prevalent in Portugal, while the worst performers are Bulgaria and Greece recording very similar low levels of regional state capacities. To be sure, neither the East nor the South would count as the best performers or could match the national and subnational bureaucratic capacities of the core European states (with the exception of some of the Spanish regions). Nevertheless, we find it telling that after 30 years of membership in the EU and in particular 30 years of intensive strengthening of regional policies and regional capacities in the South, all of the Greek and some of the Italian regions are still at the level of capacity of regions in Bulgaria.

While in terms of general bureaucratic capacities, the East has thus by and large converged with the South, the capacity of the judiciary to uphold functioning market order, secure property rights and ensure the respect of contractual relations has been markedly strengthened in the former socialist states of the East and has even surpassed the similar capacities of the Southern states. In terms of the evaluations of the effectiveness of judiciary, the key institution of the market preserving state, East European states actually score higher than the Southern ones when it comes to measures such as disposition time of civil litigious cases as well as the clearance rates (the ratio of incoming and settled cases). Furthermore, in the composite measure of overall business friendliness of the judiciary measured as the combination of data on disposition time for litigious non-criminal and commercial cases, the number of procedures and the costs involved in processes such as setting up a business, filing for bankruptcy, registering land property etc. East European judiciaries again appear much more business friendly than those of the Southern states.

Table 1. Effectiveness of judiciary

Countries	Disposition time of civil litigious cases at 1st instance courts (in days)	Clearance rate for civil litigious cases	Business friendliness of the judiciary
Baltic and Balkan	187	91	0.64
Visegrad	209	102	0.57
South	305	87	0.36

Source: CEPEJ (2013), data for 2008

Furthermore, not only judiciaries, but also the executives of the East European states turn out to be much more business friendly than those of the Southern states. As a result of their reorientation towards attracting FDI, state restructuring in the East of Europe (with the exception of Slovenia) is in comparative terms indeed much closer to the ideal-typical transformation into liberal or liberal developmental states than the restructuring of the states in the European Monetary Union. Moreover, among the EMU members, Southern states again stand out as those that over time actually implement reforms that decrease competitiveness, cutting the finances for non-discriminative horizontal state aid supporting employment, research and development or regional development, while simultaneously increasing social expenditure (Vukov, 2013). The divergence in the outcome of state restructuring is apparent from Table 2.

Table 2. State restructuring – supply side policies in the East and South, 2007

2007	Corporate tax	VAT in total revenue (in %)	Horizontal aid in % of GDP	Labour rigidity	Education in % of public spending	Welfare in % of GDP	Government R & D spending in % of GDP
Visegrad	18.68	21.45	0.83	1.74	10.62	18.79	0.23
Baltic & Balkan	14.08	27.44	0.21	2.44	12.61	13.15	0.17
South	26.6	19.3	0.24	3.06	10.61	21.32	0.15
EU Average	22.18	21.08	0.38	2.2	11.5	20.98	0.2

Source: Eurostat

The East European states via reforming their tax system and by making their labor markets more flexible restructured into radically business-friendly states, with important differentiation between the Baltic and Balkan that represents a low road of the liberal developmental model and the Visegrad states that took the high road with their much stronger emphasis on state aid and R&D. At the same time, the restructuring of states of the European South certainly resembled nothing of a kind. While allowing for trade and investment liberalization, Southern states as a matter of fact experienced very little restructuring to begin with, and to the extent that some policy reforms were apparent they went in the direction of decreasing competitiveness while simultaneously increasing social expenditure and compensating for the potential adverse effects of market integration.

The above divergence has been shaped by a number of different factors, among which domestic economic structures, historical legacies and political systems certainly play an important role. Such systemic regional differences however cannot solely be explained with reference to domestic factors and they have been shaped by the very different means used by the EU to promote institutional capacities linked to the liberal developmental state. We turn to these strategies in the next section.

3. The means of integrating peripheries: Varieties of EU backyard management

The concept of backyard management here denotes different strategies and actions exercised by the core countries and EU actors in order to manage the integration of the peripheral, economically less competitive countries in the common market. We take the concept of backyard management from Wade Jacoby (Jacoby, 2010) who was among the first to argue that the EU was trying to manage globalization by managing its East European 'backyard'. Focusing on the Eastern peripheries, Jacoby provided an innovative analytical framework for the study of EU strategies to integrate countries in its peripheries. His key argument was that the EU-15 actors acted as rational calculative actors and saw the integration of the Eastern backyard as an opportunity to exploit its proximity and lower costs. We take the starting assumption of Jacoby that rational calculative considerations can be a good starting point to understand the behavior of core countries and the Commission. We depart however from a second assumption, implicit in his thesis that the core countries or the Commission could act as if they were independent from the peripheries. Because of complex interdependences, we argue, the EU core could not completely disregard the interests of the peripheral countries and externalize the costs of integration (Bruszt and Langbein, 2013). Persistent economic disparities could impose costs on core countries, or prevent them from furthering integration and/or gain more from better-integrated markets. Once acquiring the member state status, peripheral countries could also use their political powers to slow down or block further integration. As we will illustrate it below, the EU core had to consider at least part of the developmental consequences of enlargement in the peripheral countries. Backyard management in that sense represented attempts at coping with economic and political interdependence by way of trying to anticipate and manage the potential negative externalities of integration in the periphery and thereby also prevent costs that could eventually spill over to the core countries.

From the perspective of backyard management one of the key developmental problem perceived by the EU actors both in regard to the East and the South, was lack of competitiveness understood in terms of the ability to increase their export market shares and improve their trade balance with the EU. Both the Southern and the Eastern periphery were assumed to suffer from inadequate or obsolete economic structures and weaker capacity to compete with the firms from the core countries in the single European market. Furthermore, they were both seen as having economies characterized by large-scale rent seeking, with domestic markets being distorted by vested interests in the forms of monopolies, or subsidized enterprises. As elaborated above the key goals of this backyard management were hence to ensure that besides imposing EU conform institutions to implement the rules of the regional market, steps will be taken to upgrade the market power of weaker categories of economic actors and subnational units, and increase the competitiveness of domestic economy. The EU has however used dramatically different strategies to further these goals, using primarily on indirect means relying primarily on incentives in the case of the Southern periphery while engaging in direct institution building in the case of the Eastern periphery.

3.1. Getting the incentives wrong – backyard management in the South

The problems of the integration of the European South were widely debated and discussed both in the academic and in the policy circles during the intensification of European economic integration via the Single European Act and the preparations for the European Monetary Union (Laffan, 1984; Delors, 1989). Economic considerations were not at the forefront of the negotiations for the actual accession of these countries to the EC simply because at the time there was no single European market to begin with. Rather the problems of their peripheral economic position became salient only with the deepening of economic integration from the late 1980s onwards. From the perspective of the less developed parts of Europe, the strategy of integration had two key components. On the one hand, the creation of the single European market presupposed the imposition of the same market rules on all the member states and the creation of a 'level playing field' that included the abolition of all national obstacles standing in the way of the free movement of the factors of production. On the other hand, disparities in economic power and economic divergence were seen as factors that could endanger the creation and consolidation of such a 'level playing field'. Therefore, besides the imposition of the rules of the level playing field, the EU also had to find a way to care about leveling the market power of various members, increasing the competitiveness. A Community level economic policy was considered (and rejected) at a very early stage and it was the SF reforms of 1988 that had made a less ambitious first effort to cope with the problem of asymmetries in economic power.

For the leaders of the European integration the fact that Southern economies were at a much lower level of economic development represented a challenge both from the perspective of the potential economic costs, as well as from the perspective of the future of European integration since the reactions to economic difficulties arising in the process of integration could stall the further implementation of the reforms and jeopardize the entire process. Concerns about the problems of economic disparities as an obstacle to further economic integration are already high on the agenda in the late 1970s and with the accession of the countries from the South these concerns just grow further (Laffan, 1984). Mentioning of disparities as potential constrains on further market integration can be found already in the Werner Report of 1970 (Council-Commission of the European Communities, 1970) or in the Marjolin Report of 1974 and they are reiterated also in the Delors Report nearly two decades later. (Delors, 1989: 18) Besides the fear that without EU level interventions, the peripheries would be among the losers of monetary integration, some economists added their suspicions that the monetarist model could not work in a Eurozone comprising extremely heterogeneous national economies (Eichengreen 1990; Feldstein 1997). However, the majoritarian view was that more intense interaction in the Monetary Union and the incentives linked to the Maastricht criteria would set the incentives of the Southern private and public actors right, force them to care better about competitiveness and ensure the convergence of economic conditions (Dyson and Featherstone 1999; Heipertz and Verdun 2010).

The EU has used a mixture of incentives to alter the structure of constraints and opportunities of domestic public and private actors and advance the desired state reorientation. Much like the rest of the EU, the Southern states were obliged to liberalize the flow of capital, goods, services and labor across their borders, create the domestic state institutions that could implement the EU regulations and bring about also within their states the institutions that could guard the freedoms of the regional market. Building of such state capacities was a member state business, not helped by EU level institution building programs. They were supposed to emerge thanks to the sanctioning powers of the European Commission and the European Court of Justice who could react only ex post.

Furthermore, trade liberalization and the liberalization of capital markets, together with the participation in the monetary union were expected to increase push for reforming state capacities to help increase in competitiveness, both in terms of supply-side policies as well as in terms of the capacity for macroeconomic coordination. By taking away exchange rate setting as one of the shields of the protectionist nation-state, EMU was supposed to prompt both public and private actors to adjust to the competitive demands of the integrated market (Torres, 1998; Rhodes, 2002; Crouch, 2002; Boyer, 2000). Weakness of the infrastructural powers of the Southern states to coordinate the actions of the market actors in order to ensure increased competitiveness, macroeconomic stability and reduce inflationary pressures at the same time was seen as one of the key problems (Delors, 1989: 20). The rise of competitive corporatism in a number of Southern countries prior to the EMU entry has indeed given rise to the hope that with the help of the EMU conditionality, the Southern states are finally gaining the capacity for macroeconomic coordination (Rhodes, 2002; Radaelli, 2002), although already at the time there were voices warning that such a capacity may not persist in the course of the euro-membership (Crouch, 2002). In addition to fostering coordination and concertation of social interests, joining the EMU and committing to the Maastricht criteria was seen as an important element in creating the incentives for the 'modernization' of the Southern welfare state (Rhodes, 2002), while it was also supposed to foster tax competition and competitiveness-enhancing reforms, especially in small countries where domestic demand is less relevant for their economic growth (La Cacheux, 2007). Overall, thus, the main expectation from the EMU was that it will prompt stronger reorientation towards increasing competitiveness, while the Maastricht criteria for its part, as well as the Stability and Growth Pact were supposed to help bring about the culture of stability and 'sound public finance'.

The other aspect of the liberal developmental state – namely, the developmental capacity to reduce territorial differences in the ability to profit from the European market – was at the focus of the 1988 reform of the Structural Funds (SF). This reform was based on the rejection of the older 'territorial Keynesianism' that gave the central state the task of governing territorial development and it instead included subnational state and non-state actors in the design of national-level programs affecting the regions. Furthermore, as a key innovation, the SF reforms also involved the Commission in setting the framework goals and the principles for the spending of EU developmental moneys and monitoring their implementation (Hooghe, 1996; Ansell, 2000). This institutional setup was expected to get the incentives of national governments right: alter their developmental capacities partly by depriving them from the capacity to directly redistribute resources and partly by forcing them to follow strict rules and principles in setting framework developmental goals in an institutional setup that extended central government actors' accountability downwards to subnational actors and upwards, to EU level actors (Keating, 2006 Hooghe and Mark, 2004 Bruszt, 2008). Caught in this pincer, central governments were expected to act in principled way and care about reducing developmental disparities, instead of using EU moneys for the nurturing of their local clientele as they did in many cases in the old centralized model.

All in all EU relied primarily on incentives to further state restructuring in the South trying to strengthen their regulatory, transnational market making and developmental state capacities, without much concern about the market preserving or the general administrative capacities of these states.

As already shown, the actual outcomes of these different elements of integration however turned out to be starkly different from the initial expectations. While the liberalization of the flows 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 all of these pressures by insulating the Southern economies from the pressures of the international financial markets (Vukov, 2013). The creation of the common currency in Europe resulted in the convergence in the yields on government bonds, while also making the pricing of corporate bonds almost completely dependent on the sectoral and credit-risk characteristic of issuers with country factors playing only a very small role (Lane, 2006). In other words, up until the 2008 financial crisis, all of the Eurozone countries appeared equal in the eyes of the international financial markets. Hence, rather than fostering the implementation of reforms aimed at increasing competitiveness, EMU actually anaesthetized the capacity of Southern states to implement reforms (Torres, 2009; Royo, 2009). And while before the EMU accession the stabilization efforts and the principle of 'sound public finance' indeed did become priority for national governments, they turned out to be a short-lived phenomenon and once their borrowing costs converged with the rest of the Eurozone, the Southern governments (with the exception of Spain) reduced fiscal discipline (Verney, 2009).

On the other hand, the EU efforts aiming at fostering structural and technological change (infrastructure, R & D and SME support, etc.) and increasing market power of local economic players by increasing positive externalities of integration were relegated to the sub-national, regional level. However, the EU efforts at creating and consolidating a 'networked governance' that could steer the desire and the capacity of central governments to reduce territorial disparities were weakened by the resistance of central governments that wanted to have freer hand in distributing the EU moneys. In the early 1990s, the Commission still stressed the need for creating subnational "endogenous problem-solving capacity" by empowering sub-national public and private actors. By the turn of the century the Commission gave large part of the powers back to central governments (Keating, 2004; Bruszt 2008). Left largely on their own, regional actors lacking subnational territorial organization could not politicize and translate territorial problems of economic transformation into effective political demands and could not prevent the recentralization of developmental decisions. In the new constellation of powers states could use the EU moneys largely as free rents with weak incentives to care about reducing developmental disparities. Consequently, after the SF reforms, Structural Funds failed to significantly reduce territorial disparities in the member states (Boldrin and Canova, 2001). Furthermore, given the low economic openness and lower institutional quality, as well as higher corruption, the Funds actually had negative effect on growth in Portugal, Spain and Greece (Ederveen et. al, 2006: 17).

3.2. Getting the institutions right: backyard management in the East

In the case of the Eastern peripheries the EU could not even take for granted that the economies of the East were 'functioning market economies' to begin with. At around the time of the Copenhagen summit of 1993, when the EU had to formulate the criteria of membership for the countries in its Eastern periphery, bureaucrats in Brussels were busy with defining and operationalizing things that were previously taken as granted and never defined by the core countries: "functioning market economy" and "capacity to withstand competitive pressure within the EU market". The problem of lower competitiveness was framed primarily in the form of the fears that the "not yet market economies" of the East with their underdeveloped states, obsolete industries and dysfunctional institutions will collapse like house of cards if they will have to play by EU market rules exposed to competition with some of the strongest economies on Earth. The Copenhagen summit had to define the criteria of membership for these economies in the shadow of the near complete collapse of the East German economy after the hastily undertaken economic integration of the former GDR economy with the strongest economy of Europe. While the core countries of the EU 15 wanted to keep the costs Eastern enlargement under control, the Southern member states of the EU have also made clear that they will support the Eastern enlargement only under the condition that their shares from the EU developmental moneys will not decline.

Hence, there was never the expectation that European integration should bring about rapid income convergence between the East and the West and the developmental goals of accession were defined primarily in negative terms: these countries have to get the capacity to withstand competitive pressure within the European markets. The emphasis in the Eastern backyard management was on state capacities linked to creating 'functioning market economies' in the first place – including the market preserving capacities, regulatory state, transnational market making state and general administrative capacities. Developmental state capacities were partly the same as for the Southern member states, however the EU has also pressed governments in these countries to create elementary planning capacities to foresee and manage potential negative externalities of integration, and prevent large-scale economic shocks.

The Commission was ambiguous about the imposition of the policies linked to market liberalization and the too hasty implementation of the EU rules in the fledgling Eastern market economies. 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, their economies will be able to survive economically their implementation. Also, the Commission, unlike the IMF or the World Bank of the 1980s, did not think to possess the ultimate knowledge about what actually a functioning market economy was or what actually would make these economies capable "to cope with competitive pressure and market forces within the Union".

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. Usually, these processes started with the EU monitoring report that provided the opinion of the Commission on the distance between 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. The Commission often discussed these materials with diverse international organizations, ministers from the old member states and Commission experts. Joint problems solving and state restructuring went hand in hand in these processes. The Commission created detailed guidelines about specific state capacities that were required for each single policy field and it had regularly monitored their implementation.

While these steps were repeated year by year, until the Commission could close 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 did not only help the Commission to get intimate knowledge in monitoring progress on institutional change. They also directly participated in joint problem solving together with domestic actors (Bruszt and McDermott, 2012).

The most important parts of EU requirements were all linked to state restructuring. Clearly, market making in the East, from the perspective of the EU was primarily about state making. The listing of the specific state capacities required for the implementation of the acquis was more than 100 pages long (Commission Guidelines xxx) and they tackled all the five dimensions of liberal developmental state identified above: capacity to create and maintain market order, capacity to regulate the economy by the rules of the EU, capacity to promote transnational market making and prevent any protectionist measures, building up the EU conform state institutions to manage SF moneys and via civil service reforms improve the general administrative capacities of these states.

The first group of institutional requirements, capacity to create and maintain market order was absent in the South as the existence of these capacities in their cases were taken as granted. The operationalization of the state capacities required for a functioning market economy could have easily be written by Max Weber. Reflecting the fears of the Commission that without rational law and rational bureaucracy such an economy will not come about, the Commission has created elaborate demands about the institutional requirements for creating an independent judiciary, the key element of the market preserving state (Weingast, 1994) steeled with a cohesive and capable state bureaucracy, a requirement also missing from the integration of the South (Meyer-Sahlings, 2009). Besides institutional guarantees for the independence of the judiciary and its extended powers to supervise the other branches of government, the Commission regularly checked whether the courts are well staffed with well trained and well paid judges who handle the cases in a fair way.[1]

Originally the second group of EU institutional demands, the capacity to regulate the economy according to EU rules and the creation of the institutional guarantees for the free flow of goods, services, and capital were the most important and most elaborate parts of the state restructuring in the East. The EU regularly controlled progress in the implementation on the EU standards and regulations sector by sector and policy field by policy field. Large part of the EU assistance programs was spent on training the necessary staff for the specialized regulatory institutions and to endow these state units with the right infrastructure.

However, when facing the more complex problems with elementary state capacities in the Balkans, the EU put a much stronger emphasis on the previous groups of requirements trying to strengthen the judiciary, to bring about elementary administrative capacities and, in the first place, to create the elementary state capacities to resist corruption. (Vachudova and Spendzharova, 2012; Dimitrova, 2005)

Whereas in the Visegrad countries the EU could focus on upgrading already existing sectoral state institutions, in the Balkans in many cases these state units either did not exist, or still worse, they have existed but they were corrupted and the EU had to deal with restructuring states that were weak in their administrative structures, were built on patrimonial principles in their selection and promotion procedures and were wide open for corruption (Meyer Sahlings, 2009, Vachudova and Spendzharova2012).

Besides imposing its policies and rules, the Commission also had to deal in these countries with the strengthening (or in many cases, the creating) of state capacity to foresee and manage the negative developmental externalities of integration. Just few years after being liberated from a 'planned economy', these countries had to learn planning, now the EU way. Bureaucrats working in various sectors and policy areas, or, responsible for the general development of the state or the economy were trained to do the Commission style reporting of problems on the ground and the discussion of opportunities, constraints and threats in the process of coping with these problems. EU 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. Assistance programs in the countries of the Balkans were much more intensive, they were directed much more to the creating of elementary economic state capacities and have included special projects to help the strengthening of domestic demand side for state upgrading.

Measured by its own metric, to prevent the sinking of the Eastern economies in the process of their integration, the EU state building efforts were successful. Corruption is still high in Bulgaria, Romania or the Czech Republic, in some areas of state reform there are reversals (Meyer Sahlings, 2009) but according to all measures, state capacities in these countries have converged to the level of the Southern peripheries of Europe and have in many respects even surpassed them. Moreover, the simultaneous liberalization of the capital markets and the imposition of the EU rules that prevented in key areas of the economy the discriminatory treatment of non-domestic firms dramatically altered the composition of players in the domestic economies. In the most developed new member states 60 to 80 percent of productive assets is in the hands of non-domestic actors, mainly MNCs. The rapid transnationalization of these economies transformed the domestic demand-side for state restructuring. MNCs that have to compete with other Europe wide value chains became robust actors in these countries of the faster adoption and implementation of EU standards to prevent unfair competition.

4. Conclusions

In the course of their European integration, the Southern and the Eastern periphery of Europe have taken radically different roads, characterized with different forms of state restructuring and dissimilar developmental strategies and resulting in diverging patterns of insertion in the European and global markets. While the East has witnessed the emergence of liberal developmental states with varied properties, the South has witnessed much less of state restructuring to begin with. At the same time, the East has embarked on developmental paths marked by deep FDI-based transnationalization and export-led growth, with the leading economies getting close to the core in the structure of their exports, while nevertheless remaining in the periphery at the levels of per capita GDP and consumption. Nearly the opposite is the case in the Southern periphery with transnationalization based primarily on foreign borrowing and investment in non-tradable sectors, and with levels of consumption reaching the core countries while lagging way behind them in their peripheral patterns of production.

To be sure, a large part of this variation is also due to the differences in domestic factors and while we do not intend to deny their importance in the process of state restructuring and the emergence of divergent developmental pathways, our argument is nevertheless that differences in the strategies of backyard management exercised by the EU played an important role by shaping in divergent ways the structure of incentives, constraints and opportunities for domestic agency in the two peripheries of Europe. Rather than assessing these strategies and their divergent outcomes simply as a success or failure we suggest that each of these pathways thus far represents different developmental dilemmas and poses different challenges to further state restructuring in the Europe's peripheries.

Starting with the latter, while direct institution building and better compliance with the EU rules have certainly contributed to the upgrading of elementary state capacities even in the worst performing new member states in the East, it remains an open question whether the faithful implementation of transnational rules is indeed a blessing for the 'rule takers' or it may also represent a policy straightjacket precluding domestic experimentation with different developmental strategies. As for the Southern states, until the recent Eurozone crisis the room for such experimentation might have been more open for them, but with their less coherent and cohesive bureaucracies these states seem not to have used this space well for improving their position in the transnational markets.

While the EU has relatively strong tools to sanction the implementation of its own regulations before and after accession, once a country became a member, the EU has very weak tools to influence in it the building or even the maintaining of usable state bureaucracies. The EU has only slightly stronger powers to control the institutional parameters of the judiciary. It is not by chance that 'experimentation' in some of the new member states started with these two state institutions with the danger that these countries might in the end converge to the South while further diverging from the Western part of Europe.

As for the developmental challenges, in the South, the most immediate dilemma is how to slow down the increase in the number of losers of the developmental crisis while at the same time finding ways to put their economies in a sustainable pathway that could improve their position in the European market. From the perspective of state restructuring the key issue is thus how to (re) create coordination capacity and elementary developmental capacities. The biggest challenge for the South however comes from the fact that the current EU crisis management does not leave much space to even start such a restructuring, with the current reforms of the Eurozone based primarily on tying the hands of the national governments, narrowing the space for autonomous policy making, and increasing their responsibility towards supranational institutions while decreasing their responsiveness to national actors (Laffan, 2014).

The dilemma for the leading Eastern countries is seemingly the opposite of the Southern ones. The task for these states is to widen the circle of beneficiaries of their FDI-led growth and increase the benefits of domestic actors while maintaining and increasing the competitiveness of their economies. Even though MNCs in the Visegrad countries control up to 80% of productive assets, they still employ no more than 30% of the labor force and it is far from certain that the segments of society not directly employed by the MNCs actually directly benefit from this economic model. And if Albert Hirschman's ideas about the tunnel effect hold also for countries in the Eastern peripheries (in brief: optimism about being on the cusp of progress will turn into the anger of being left behind as an unavoidable part of uneven development), than the failure to broaden this circle of beneficiaries is likely to bring about politicization of anti-European resentment and a turn to a nationalist model, as is already happening in some of the new member states.

All in all, while the Eastern economic states seem to be better equipped to maneuver in the transnational economy than their Southern counterparts, it is doubtful that they could be capable of solving these dilemmas on their own. While the liberal elements of their state capacities might allow them to remain attractive for FDI, the developmental part of their states is clearly too weak to either reduce developmental disparities within these economies or to cope adequately with the distributive issues of transnational integration. Developmental problems for both peripheries thus appear to call not only for strong domestic institutions and national economic capacities, but also for the regional, EU level capacities for dealing with externalities of integration in a way that would go beyond relying simply on domestic state restructuring. Such regional capacities however for the time being are in short supply. In the absence of regional-level economic and fiscal policies the means for such developmental agency at the EU level remain scarce and the same is true for the motivation of policy-makers to engage with such initiatives. Despite substantive economic transnationalisation in Europe, political accountability of policy makers still remains firmly with the national polities rather than with a transnational polity. Given the current institutional set-up of the EU, the management of developmental interdependence and with it, the integration of Europe's peripheries is thus likely to remain mired in persistent economic and political challenges.

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Notes

[1] The regular monitoring reports of the Commission carefully evaluated such aspects of the judiciary as 1/progress in building up a well staffed, well trained judiciary with continuously upgraded knowledge about domestic and European legal change; 2/ factors shaping the independence of the judiciary, including procedures appointment, promotion and distribution of cases to judges 3/balanced workload, length of handling the cases 4/ fairness of legal procedure 5/capacity of the judiciary to control the executive and the legislative.

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