

# Deep Economic Integration and State Capacity: The Case of the Eastern Enlargement of the European Union\*

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**Abstract:** It remains under-appreciated that deep economic integration (which goes beyond free trade agreements) can induce powerful actors to support increasing general state capacities in less-developed countries. In this paper we ask: under what conditions can deep economic integration yield increases in state capacity? We measure institutional change in 17 Eastern and Central European countries (EU membership candidates) exposed to similar challenges of deep integration and find large variation in the evolution of state capacities. To understand this variation, we put forward a conceptual framework stressing three main areas (judiciary, bureaucracy, and competition policy) and supporting a set of hypotheses based on the ideas of Montesquieu, Weber and Smith, respectively. From testing these hypotheses, we empirically identify key relationships and specific reform implementation sequences. Our main result is the centrality of an intricate relationship between bureaucratic independence and judiciary capacity as a main driver of institutional change.

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## INTRODUCTION

Institutions are long-run root causes of economic prosperity. But which institutions matter the most, why, and what role can policy play? One answer to such questions centres on the notion of “state capacity,” that is, on the capacity of the State to uphold political and economic freedoms, enforce law and order, regulate economic activity, and provide public goods<sup>1</sup>.

Countries invest in attempts to further economic integration because the benefits of doing so are almost always larger than the costs. Yet there are multiple ways integration takes place. One simple dichotomy contrasts shallow with deep, with the former restricted to trade liberalization and the latter encompassing the creation of the conditions for freer movement of capital and services on the basis of joint economic and political integration.<sup>2</sup> Free trade area agreements are a form of shallow integration while custom unions with encompassing regulatory harmonization and the construction of common institutions are a form of deep integration<sup>3</sup>.

This paper bridges the literatures on institutions and integration and investigates an unexplored question: under what conditions can deep economic integration yield increases in state capacity? One can find several strong arguments why one should expect deep integration to increase state capacities. Shallow integration in most of the cases requires limited change in state capacities. Large parts of economy remain untouched and powerful economic actors interested in the status quo can maintain their dominating economic positions. The more encompassing integration gets, the more sectors and policy fields get involved in rule harmonization, the more public

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<sup>1</sup> State capacity has always enjoyed a stable centrality in the political science scholarship. Key references are Evans et al. (1985); Geddes (1994) Weiss (1998). Economists have recently started working on the issue: see Acemoglu et al. (2015), Besley and Persson (2009, 2010), and Dinsecco and Katz (2016). Savoia and Ken (2015) provide an excellent survey.

<sup>2</sup> See, among others, Baldwin et al. (2012), Beeson (2014), Brou and Ruta (2011), Mattli (1999), Robson (2012) and Hoekman (2016).

<sup>3</sup> Tinbergen famously contrasted positive and negative integration. Positive referring to the creation of common institutions, and negative to the destruction of tariff walls. Balassa suggests there are various stages of integration and places customs unions one step above free trade areas.

institutions have to acquire the capacity to implement common transnational rules ranging from the capacity to uphold economic freedoms, to the capacity of administering and regulating markets in various policy fields (Bruszt and McDermott, 2014).

A robust coalition of domestic and external actors might have common stakes in supporting encompassing institutional change necessary for participation in deep integration. Domestic economic actors who could gain from accessing much larger markets might be strong supporters of upgrading state institutions. Domestic state elites might be enthusiastic supporters of state reform in the expectation of increases in tax revenues and lesser pressure on public expenditures due to weakening of domestic rent-seeking alliances exposed to external competition. Powerful external private actors might have strong interests in fighting for a ‘race to the top’ at the level of state institutions that could guarantee even-handed enforcement of the rules of the integrated markets (Vogel and Kagan, 2008). Similarly, external public actors might have strong incentives to press for domestic institutional change necessary to defend the integrity of the common markets (Bruszt and Langbein, 2016).

Using the annual monitoring reports produced by expert teams for the European Commission, we quantify changes over time in state capacity in 17 Central and Eastern European (CEE) countries (candidates for EU membership).<sup>4</sup> We find large variation in the evolution of these capabilities. In exchange for access to a 500 million large market, these countries were exposed to the same set of requirements in domestic institutional change encompassing more than thirty policy fields ranging from environmental regulation to transportation. More importantly, the CEE countries were supposed to make considerable upgrading in three key groups of state institutions that determine the possible scope of change in all the other institutional arenas: the judiciary, the

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<sup>4</sup> Progress reports in our sample: Albania 2005-2013; Bosnia 2005-2013; Bulgaria 1997-2006; Croatia 2005-2013; Czech Rep 1997-2003; Estonia 1997-2003; Hungary 1997-2003; Kosovo 2005-2013; Latvia 1997-2003; Lithuania 1997-2003; Macedonia 2007-2013; Montenegro 2007-2013; Poland 1997-2003; Romania 1997-2006; Serbia 2005-2013; Slovakia 1997-2003; Slovenia 1997-2003; Turkey 1998-2013.

bureaucracy, and competition policy. Eleven of these countries have already joined the EU; another six are still in the process of meeting the requirements of membership. In our research we found large variation both in the sequencing and the outcomes of domestic institutional change. While several of the countries have succeeded to achieve considerable change across a wide range of state institutions, some have made only modest changes in few institutional arenas. Clearly, the effects of deep integration on domestic change vary with some sequences of institutional change being more effective than others. Our task in this paper is to explore the question what could be the best sequencing of the changes in institutions and policies that yield progress in economic integration and simultaneous improvements in state capacities.

We first put together a conceptual framework to guide our empirical analysis that features key ideas from political economy, the separation of powers and the benefits of enforcing economic competition. The three main strands that support our framework are ideas from Baron de Montesquieu, Max Weber and Adam Smith as this paper attempts to identify empirically key relationships between institutional and regulatory reforms in three above mentioned core areas, namely, the judiciary, bureaucracy, and competition policy (or anti-trust policy, as it is more often called in the U.S.). All three of these classics have provided strong arguments for why their preferred institution was necessary for the extension of markets and their ideas provide a robust basis for exploring various present day theories about the right sequencing of change among these institutions.

The political economy problems of transforming the institutions that govern the economy are widely discussed in the literature (Hellman et al. 2000, Evans 1995, Haggard and Kaufman, 1992). Changes in any of these three key institutional arenas might redistribute wealth and opportunities among domestic economic actors (Buccirossi et al 2013). They might reduce the room for the misuse of asymmetries in

economic power and decrease dramatically the economic and political powers of various rent-seeking groups in the domestic economy and within the state. The reform of the bureaucracy can stabilize the expectations of economic actors that they can safely profit from rational calculative enterprise and it can increase state capacity to resist capture (Evans, 1990,1992;). Capable regulatory agencies enforcing the rules of competition might stabilize the expectation of economic actors that as a rule they can only profit from rational enterprise and they can alter the composition of economic players and change the balance of power among them.

The problem in many lesser-developed economies is that either a small group of stronger economic actors, beneficiaries of the status quo, controls the state, or even if the domestic state has some autonomy, the potential beneficiaries of integration are not strong enough to push for the changes leading to deeper integration. Also, in many cases, the domestic state has no resources or capacity to implement the necessary changes that could allow economic actors to play by and live by the common rules.

What are the ways to depart from such a status quo? A key debate in the scholarship on the politics of the extension of markets is about the right sequencing of change in institutions that can lead to a sustainable institutional change.<sup>5</sup> Based on ideas that have their roots in the works of Adam Smith, some hold that economic liberalization should be given priority: Reforms that open up markets and increase competition could bring in the economy new players and alter this way the demand side for institutional change.

Others, based on ideas that have their roots in the works of Max Weber and Baron de Montesquieu suggest to start with transformations on the supply side of reforms, with the transformation of the state institution, with an increase of the

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<sup>5</sup> For excellent summaries of the debate see Haggard and Kaufman (1992) and Roland (1994.)

autonomy of the state, its capacity to design and implement public regarding policies and uphold even-handedly the rights of economic actors.

Similar dilemmas of sequencing one also finds inside of the specific institutional arenas, like the judiciary or the state bureaucracy. Should the depoliticizing of the civil service precede its professionalization or is the right sequencing the other way around? Can the separation of the judiciary from the other branches of the state create an effective judiciary on its own or one has first to introduce measures that allow for the judiciary oversight of the two other branches of the state?

The unique process of accession of the CEE economies to the European Union (EU) and the European Single Market (ESM) offers a laboratory to explore these questions and test a variety of theoretical propositions from the political economy of market integration (Campos and Coricelli 2002).

The EU, eager to defend the integrity of its internal market uses regular standardized monitoring of progress in institutional change in all the institutional arenas that could affect the capacity of the applicant countries to implement on the ground the rules of the Single market. These roughly correspond to the various individual chapters of the *acquis* that need to be successfully negotiated before accession. The yearly monitoring reports of the European Commission offer an exceptional basis for the analysis of the single largest natural experiment in simultaneous deep integration of a large number of countries.

We have a unique database that allows us to explore these questions. Relying on the coding of the yearly monitoring reports of the European Commission in all the 17 accession candidate countries since 1997, we have a longitudinal and comparative database on the dynamics of change in the various policy areas and institutional arenas in the political process of integration. In each of these institutional arenas we have data on the national paths of meeting the institutional requirements of EU membership

starting with the transposition of EU regulations to the creation of EU conform regulatory organizations endowed with the right types of powers, resources and personnel.

Based on our exploration of this data set we find a small number of key implementation sequences, chiefly among them the independence of the bureaucracy, which seems driven by judiciary capacity, competition policy and administrative capacity. Our results help to identify which policy implementation sequences were the most important: they highlight the central and indeed intricate relationship between bureaucratic independence and judiciary capacity that seem to play the role of main driver of institutional convergence.

This paper is organised as follows. In the next section we present the various theoretical perspectives we draw from and use them to formulate our key hypotheses. Section 3 describes the data construction and collection procedures we followed as well as the variables we use in our analysis with emphasis on the institutions of the judiciary, bureaucracy and competition authority. Section 4 briefly discusses key methodological issues. Section 5 presents our empirical results examining the cross-determination of the three individual institutional reforms in the judiciary, public administration and competition. Section 6 concludes.

## **THEORETICAL FRAMEWORK**

Market integration, the removal of national discriminations among producers, goods, services and people in the realm of the economy has progressed very slowly across the globe. Most of the attempts at furthering market integration stop at a very shallow level, involving at most a Free Trade Agreement with limited common regulations in very few areas (Balassa, 1967). The integration by the EU of the Central and Eastern European (CEE) economies, from this perspective seems to be a unique experience as it

has involved the rapid abolition of all tariffs and the transfer of around 80 thousand pages of common regulations covering more than 30 policy fields. Besides the restructuring of key economic institutions, deep integration extended to the remaking of the two central institutional arenas of the state, the judiciary and the state bureaucracy.

The stress on state reform by the EU was strongly linked to a key dilemma of deep economic integration. The creation and the extension of a common market presuppose the capacity of all members to play by the common rules. Implementation of these rules might be costly and, at least as importantly, it might require considerable administrative and judicial capacities that could conceivably be in short supply in the less-developed countries (Bruszt and McDermott, 2014). An eventual large-scale non-compliance in the countries with weaker states could undermine the integrity of the regional market. Such vulnerability of the regional integration grows with the number of policy areas that are included in institutional harmonization and with the potential importance of the lesser-developed economies as trading partners or production sites.

The simultaneous initiation of accession negotiations with, first ten and then another seven, Central and Eastern European countries represented exactly such a challenge. Key EU actors perceived the Eastern enlargement as a factor potentially endangering the results of the previous waves of economic integration (European Commission, 1997). The first monitoring reports of the Commission published in 1997 painted a rather bleak picture of the institutional capacities of the applicant countries. These reports saw the need for major changes in public administration and judiciary in all these countries. At least as importantly, in most of the more than thirty policy fields of market regulation, the reports found that the institutional status quo in the applicant countries was far away from the institutional requirements for participating in the common market.

In our research we found that even after the EU has invested seven to ten years'

effort in furthering institutional upgrading in the CEE countries, the outcomes are highly diverging across and within these countries. In some of the accession countries the paths of institutional change converged towards EU norms, in others institutional convergence got stuck way below the norms of the regional market.

How were these paths of institutional change interlinked? Was there a right sequencing of change within and across the key institutional areas that has allowed for progress in transforming key state institutions? What role did the sequencing of institutional change play in the dramatic divergence of outcomes?

We seek theoretical guidance for alternative potential answers to these questions in the classics of political thought. Our background assumptions rely on the ideas of those political scientists, economists and sociologists who have stressed the dynamics of self-reinforcing or positive-feedback processes instead of timeless relations among diverse variables (Pierson 2000; Tilly 1984; Artur 1994; North 1990). We look at institutional transformation as a complex set of interlinked changes in multiple arenas whereby the timing of a change within a sequence effects how change happens and also what effects it has on change in other institutional arenas. In this approach early events can trigger self-perpetuating processes or they can set in motion a backlash that hinders further institutional change (Stinchcombe, 1968; Pierson, 2000). To increase the portability of our hypotheses, we add to each of our assumptions a mechanism that could account for setting in motions either blockage or positive feedback. We start with the ideas on the right sequencing of change within the judiciary and the state bureaucracy and proceed to conflicting ideas about the right sequencing of change across the three key institutional fields.

### ***Judiciary (Montesquieu)***

The reforming of the judiciary was one of the key institutional arenas of state reform

that the EU deemed equally crucial for the upholding of democratic political rights and economic freedoms.

From a theoretical perspective, the reform of judiciary had to create a key institutional condition of credibly committing the aspiring member states to sanction the rules of the EU. Also, putting in place an independent judiciary with the capacity to efficiently and evenhandedly enforce economic freedoms and the rules of the Common Market could, in principle, set in motion at least two interlinked mechanisms that would reinforce institutional change in other institutional arenas. The stabilization of the expectation of economic players that they can safely invest and contract - because the judiciary predictably enforces their rights independently of their differences in economic and/or political power - can increase the number and alter the composition of economic players. This way judiciary reform can change the balance of power on the demand side of state reform. The increasing returns of judiciary autonomy and efficiency can also alter the incentives of state incumbents to supply improved institutional conditions in more specific policy areas in order to further improve the revenue basis of the state.

But what are the institutional conditions of judiciary independence? In defining these conditions, we can rely on the ideas of Montesquieu.

*“... there is no liberty if the judiciary power be not separated from the legislative and executive. Were it joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control; for the judge would be then the legislator. Were it joined to the executive power, the judge might behave with violence and oppression.”*  
(Montesquieu, 1777 pp. 221-237)

To put this in a positive way, the institutional sources of judiciary independence have to do with the separation of powers. The judiciary should be independent of both the legislature and the executive, and should restrict itself to applying the rules of the Common Market to particular cases in a fixed, transparent and consistent manner.

In formulating our first hypothesis, we rely on the late 18<sup>th</sup> Century upgrading of the ideas of Montesquieu by the founding fathers of American Constitution (Manin 1994.) Their starting point was the same as that of Montesquieu: key to the stabilization

of the common market of the thirteen North American states lies with the creation of independent judiciary. But, learning from the weaknesses of previous constitutional solutions, the American founding fathers were not satisfied with the notional separation of the different branches of the state. They thought that solely the constitutional declaration of the independence of judiciary would not do. Among the three branches of governments there was a hierarchy in the degree of legitimacy. Branches of government with stronger legitimacy, the executive and the legislative, they argued, could encroach on the autonomy of the branch with weaker legitimacy, like the judiciary. Their conclusion therefore was that mechanical separation of powers will on their own not do and each branch should be empowered with the necessary powers to defend its boundaries from encroachment. In the case of the judiciary, these were the powers given to the judiciary to oversee the constitutionality of the legislative and the executive.

Based on the above discussion we can formulate the following hypothesis:

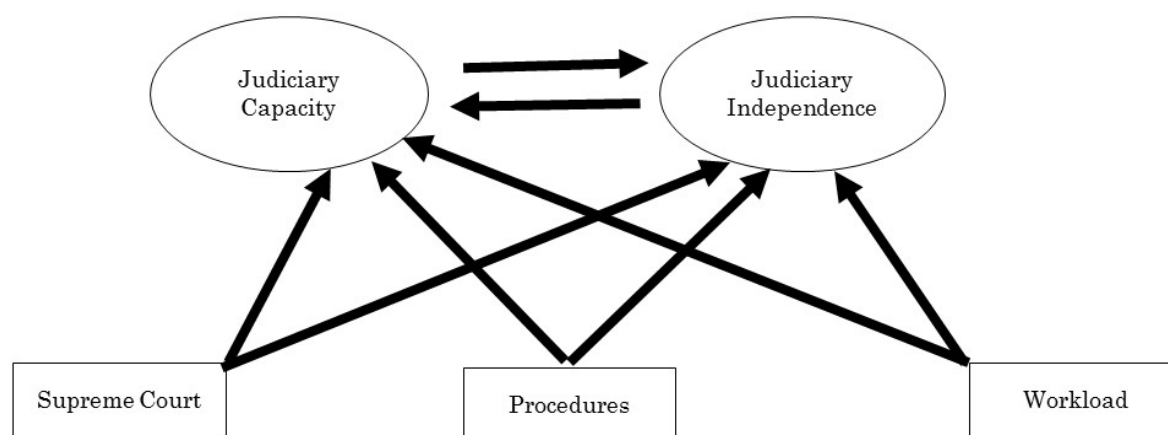
*H1 The sooner there will be progress in terms of establishing an independent constitutional court, the faster can countries create an independent judiciary.*

While making no reference either to Montesquieu or the American founding fathers, the institutional requirements of EU membership clearly reflected the above concerns. These requirements included the professionalization of the judiciary, and the endowing of it with skilled staff and resources to process cases efficiently and in a timely manner. These factors were seen as necessary aspects of judiciary capacities, all evaluated separately in EU progress reports. Similarly, an important role was played in EU evaluations by the separation of judiciary from political control and the steeling of judiciary independence by the creation of an autonomous constitutional court.

In Figure 1 we provide a schematic presentation of EU requirements in this field. As it can be seen, judiciary capacity and independence can be viewed as ultimate outcomes of institutional development in this area. The EU progress reports allow us to

distinguish three inputs into this process: the workload, the procedures and the relative strength of the Supreme Court. We define in an operational manner each one of these five aspects in detail below.

*Figure 1. Building Judiciary Capacity and Independence (Montesquieu)*



### ***State bureaucracy (Weber)***

The other institutional arena that was seen by the EU as crucial for integrating the CEE economies was public administration. The concerns of the EU in this field were similar to the one described above with reference to the judiciary. Only a depoliticized, professional bureaucracy can efficiently implement, administer and enforce the rules of the common market. The expected self-reinforcing benefits of state reforms were the same as in the case of judiciary (European Commission, 1997).

But, what could be the right sequence of reforms within the public administration? What should come first, the professionalization of the bureaucracy implying the meritocratic selection and promotion together with employment protection, or the establishment of the legal defences from politicization of the state bureaucracy?

In formulating this hypothesis, we rely on the work of Max Weber who was the first to stress the intimate relationship between the spread of large-scale capitalist enterprise and modern bureaucratic state .

*<Compared to the Chinese state> "...very different is the rational state in which alone modern capitalism can flourish. Its basis is an expert officialdom and a rational law. The*

*Chinese state changed over to administration through trained officials in the place of humanistically cultured persons as early as the 7<sup>th</sup> and 11<sup>th</sup> centuries but the change could be only temporarily maintained.” (Weber, 1924, p. 339)*

He also stressed the strong association between the emergence of rational law and well-functioning bureaucracy:

*“The rational law of the modern occidental state, on the basis of which the trained official renders his decisions, arose on its formal side, though not as to its content out of Roman Law.” “Capitalism... requires a law which can be counted upon like a machine. The creation of such a body of law was achieved through the alliance of modern state and the jurists.” (Weber, 1924, p. 342-3)*

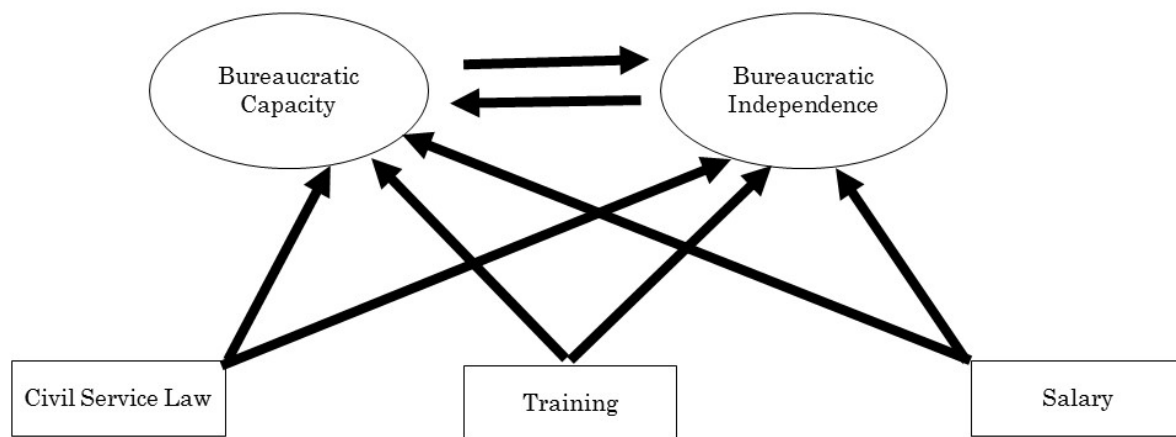
In the work of Weber, the state’s ability to support the market depended on the bureaucracy being a corporately coherent entity with its own independent selective criteria. That goal could be attained by “conferring a distinctive and rewarding status on bureaucrats... the concentration of expertise...through meritocratic recruitment and the opportunities for long-term career rewards” (Evans, 1992 p.146). Peter Evans, who did perhaps the most to translate and apply the Weberian ideas to the comparative study of evolving market economies (Evans, 1992, 1995) argued that key factor explaining variation in state capacities was the corporate coherence of the autonomous state: the existence of defences for the civil service from short-term political or economic interests. Highly selective meritocratic recruitment and promotion, and, in general professionalization of the bureaucracy were the key to create a cohesive bureaucracy with an *esprit de corps*, with its own professional criteria of success. Such a cohesive bureaucracy had, Evans argued, stronger defences against re-politicizing and against capture by private interests.

Based on the above discussion we can formulate the following hypothesis:

*H2 The sooner there will be progress in the implementation of reforms that strengthen the professionalization of the civil service, the faster will be progress in the implementation of measures that increase the independence of state bureaucracy.*

In Figure 2 we provide a schematic presentation of EU requirements in this field. These variables are defined in detail below.

Figure 2. Building Bureaucratic Capacity and Independence (Weber)



***Start with the demand side for institutional change: Competition policy (Smith)***

Above we have discussed two propositions about sequences of change *within* specific institutional arenas. We continue with three further propositions that are linked to the question about the ‘right’ sequencing of change *across* these institutional arenas.

According to the first, institutional change should start with the institutions that could induce and maintain competition; according to the second approach change should start with the reform of state institutions. Finally, according to the third approach a critical mass of change in both institutional arenas is the way to start.

The underlying idea is that the major hindrance before institutional change is in the wrong constellation of economic interests that hold the state captive in a bad *status quo*. Key economic and social actors have vested interests in maintaining the *status quo*; they paralyze the state and prevent any change. Change should start within the economy, by measures that are introduced fast and alter the composition and the preferences of the players. The structural changes in the economy are assumed to result in the liberation of the state from the hold of vested interests and allow for progressing with institutional change in other institutional arenas, including the sphere of civil service. The key is the speed of changes (Åslund et al, 1996 p. 217), not allowing time to react and resist the implementation of the right measures.

Translated to the level of institutional change, from this perspective the implementation of the institutional conditions of competition policy and the free movement of goods and capital is the way to start (Motta, 2014). The implementation of EU conform rules of competition allows new entrants to the domestic market; they will weaken the powers of the dominating economic groups and alter the demand side for implementing the necessary steps for integration. The state will be liberated to introduce the reform of the state bureaucracy and the judiciary.

The literature on the ‘race to the top’ can also be used to make this argument (Vogel and Kagan, 2008). Accordingly, business firms coming from effectively regulated markets will be agents of institutional change, demanding higher regulatory standards in their host countries if that improves their competitive position; if it helps them to exclude from the host market weaker actors, and/or, if it helps them to prevent unfair competition by non-compliant domestic firms.

We here call this the Adam Smith channel. In the *Wealth of the Nations*, Adam Smith highlighted the dangers of the presence of monopolies on the state:

*“The interest of the dealer, however, in any particular branch of trade or manufacture, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition is always the interest of the dealers.” (Smith, 1776, pp. 219-220)*

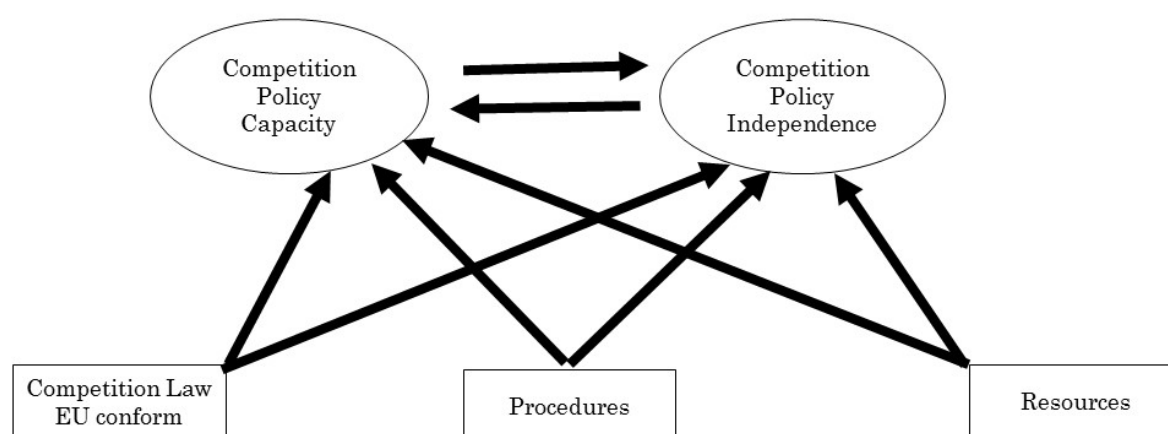
*“This monopoly has so much increased the number of some particular tribes of them that, like an overgrown standing army, they have become formidable to the government, and upon many occasions intimidate the legislature.” ...The legislature, were it possible that its deliberations could be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good, ought upon this very account, perhaps, to be particularly careful neither to establish any new monopolies of this kind, nor to extend further those which are already established. Every such regulation introduces some degree of real disorder into the constitution of the state, which it will be difficult afterwards to cure without occasioning another disorder.” (Smith, 1776, p. 368)*

Based on the above discussion we formulate the following hypothesis:

*H3 The sooner there will be progress in implementing EU conform institutional change in the field of competition policy and free movement of goods, the faster there will be progress in civil service reform and the reform of the judiciary.*

In Figure 3 we provide a schematic presentation of EU requirements in this field.

*Figure 3. Building Competition Policy Capacity and Independence (Adam Smith)*



### **Change the supply side of institutional change first (Montesquieu & Weber)**

A different view from the above is to have as first step in the complex processes of economic transformation is to build up the defenses of the state. Opening up the markets without first strengthening general state capacities could get to stalemate at the best, or it could lead to state capture at the worse (see e.g. Dewatripont and Roland, 1992; 1995). The new entrants might not change the nature of the demand side for state reform; they might just exploit the weaknesses of the state. The implication of these arguments is that the better way is to start with the measures of state strengthening suggested on the basis of Montesquieu and Weber and create first the institutional conditions of functioning judiciary and bureaucracy.

Based on this discussion we can formulate the following hypothesis that is the opposite of the preceding one:

*H 4 The sooner there will be progress in implementing EU conform civil service reform and the reform of the judiciary, the faster will be progress in the field of competition and free movement of goods.*

Reforms creating a judiciary endowed with institutional guarantees of independence, and a depoliticized civil service are expected to bring about two veto-points within the state and increase its capacity to resist capture. Such a state then is expected to have the capacity to induce positive feedback loops by undertaking sustainable institutional changes in the more specific regulatory fields, including those that could alter the demand side of integration.

### ***Induction of virtuous circles (Montesquieu or Weber, and Smith)***

Based on the critique of the above two general approaches one can generate a third hypothesis. In itself neither the changing of the demand side or of the supply side might be sufficient to set institutional change in the economy in a sustainable new path. Some simultaneity of change in the demand and supply sides are needed that could together help to consolidate control over institutional change by an emerging pro-reform alliance of actors within and outside of the state (Forslid et al 2011).

Two interlinked arguments can be made in support of such an approach. One could argue, first, that reforms might not generate enough defences for the autonomy of the state without some change in the demand side of the reform. Even multiple veto points within the state, meaning the existence of the institutional guarantees of the independence of the judiciary and the bureaucracy, might not provide a sufficient defence for the state if all the veto points could be controlled by status quo oriented economic and political groups (Stasavage, 2002). It is hard to lock in externally supported state reforms if the factors that have created the intertwining between public and private actors prior to the reform are not broken with the help of new pro-reform alliances in the economy.

On the other hand, except for the sweeping transformation of the demand side in the economy, the emerging alliances for institutional change need at least one defense,

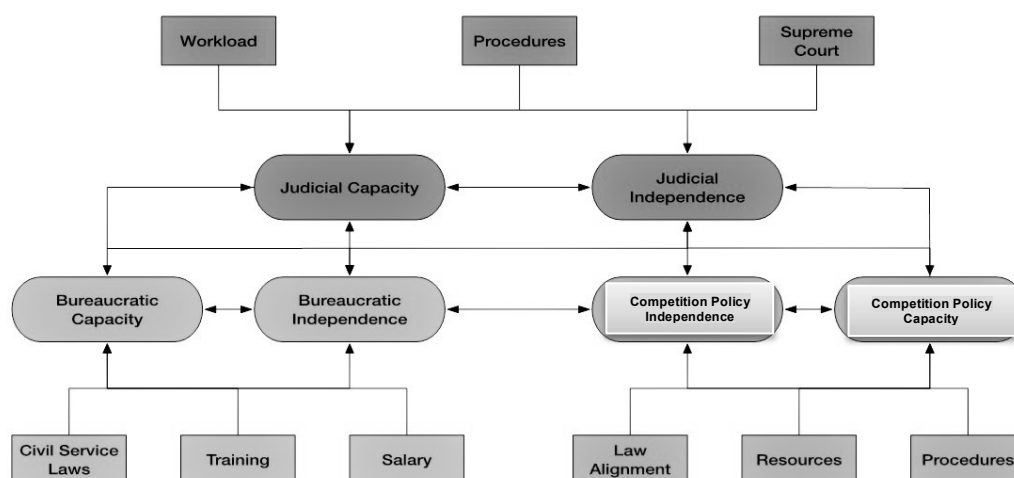
at least one veto point within the state in order to lock in reform. Change in the demand side for reform, on its own might not generate sufficient enough support for institutional change in the economy if there is not some simultaneous progress in reform within at least one branch of the state.

To set in motion institutional change one should expect a combination of supply and demand side reforms to generate progress in deep integration.

*H5 The sooner there will be simultaneous change in regulatory institutions responsible for competition and the free movement of goods on the one hand, and in some aspects of implementing EU conform civil service reform or the reform of the judiciary on the other hand, the more likely it is to have cumulative progress in other general state institutions.*

Based on the above discussion we can now summarise the key institutional requirements of deep integration as they were seen from Brussels. Notice that Figure 4 represents only the core of EU mandated institutional changes in the applicant countries. A fuller picture would include the institutional requirements in more than 30 specific policy fields from environmental regulation to food safety regulation. Note also that Figure 4 does not represent any EU expectations about sequencing of change. During the first wave of Eastern enlargement Brussels left it to the aspiring member state to choose their own sequencing strategy.

*Figure 4. Institutional Conditions of Joining the Single European Market*



## MEASUREMENT

This paper focuses on three key regulatory areas, namely the judiciary, public administration (the bureaucracy) and competition policy. For each one of these areas we quantify the various aspects that the European Commission judged to be crucial. It is important to notice that the Commission never differentiates between inputs and outcomes in the Progress Reports. It evaluates individually each of the aspects without taking into account the potential relationships among them. This call is entirely ours: based on our understanding of each regulatory area, we decided which variables are deemed inputs and which are deemed to be outcomes. For each of the three areas, we are able to identify two main outcomes (capacity and independence, which are similar across the three areas) as well as the various inputs into the delivery of these outcomes (which are not similar across the three areas.)<sup>6</sup>

For the data collection a codebook has been prepared that aimed to capture wherever possible the institutional dimensions discussed above. For each dimension a scale has been created that ranges from “severe deficiencies in the conformity with EU requirements” to “full conformity with EU requirements,” the grading of the scale differs depending on the chapter and dimension but is usually organized along a four-grade scale. Grades 1 to 2 capture situations in which the accession country’s reforms is not in line with EU requirements, whereas grades 3 and 4 captures situations in which the country is in full compliance or nearly in full compliance with EU requirements.<sup>7</sup>

Coders, all of them doctoral students dealing with European integration, used the *Atlas.ti* dedicated software to create a high degree of inter-coder reliability. Two

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<sup>6</sup> For further details see data codebook (Bruszt and Lundstedt 2016).

<sup>7</sup> For example, in 1999 Poland was graded 2 in the legislative state aid dimension, which is part of the Unions competition policy. The European Commission writes “[i]n the area of State aid, Poland has undertaken to align its State aid award provisions with the *acquis* by way of adopting a comprehensive law on State aid. However, the adoption of this law is still pending which gives rise to concerns” (Poland Progress Report 1999:33). In 2003, for the same dimensions, the Commission concludes that the recent amendments to the state aid legislation have brought the rules into closer conformity with the EU requirements, and that the country now satisfies the basic requirements of EU norms (Poland Progress Report 2003:27); an evaluation gave Poland a score of 3 for that dimension.

coders independently from each other coded each chapter simultaneously. In cases of disagreements between coders a third coder has been brought in to make the final judgment. The use of the *Atlas.ti* software has the advantage of increasing the transparency of the coding process since it allows researcher to go over the coding and see on what basis a country has received a certain score, something that increases the inter-subjectivity of the data.

The objective of this section is to discuss how each of these inputs and outcomes of the three regulatory areas was operationalized and measured.

### ***Judiciary (Montesquieu)***

Let us start with the judiciary. Outcomes are measured in terms of both judiciary capacity and judiciary independence. Capacity refers to access to necessary resources, expertise and training. EU norms establish basic parameters for the functioning of the judiciary. Conformity with these norms basically speaks to the workload and to delays in the workings of the judicial system. The expert teams responsible for the Progress Reports evaluate judiciary capacity and our coding of their assessment range from 1 to 4 as detailed in Table 1. A similar scale is used throughout and thus regarding judicial independence which refers to judicial independence in terms of appointment, promotion and remuneration. Thus, corruption of the judicial system (which also affects the independence of the judiciary) is not dealt with in this dimension, but in the input “Legal Procedural Dimension” discussed below.

Regarding the judiciary, we focus on three main inputs that we theorise can potentially contribute to the “production” of capacity and of independence as defined above. One regards the constitutional dimension (existence and strength of a Supreme Court), the second centres on the workload (“behavioural dimension” in the codebook)

and the third focuses on the “legal procedures dimension” of the judicial system.<sup>8</sup> It is also important to note that when corruption happens to be an issue identified with respect to the judiciary it is always reflected in the coding of this last particular item.<sup>9</sup>

Let us now turn to each of the three inputs for the Montesquielian channel. The constitutional dimension of the Judiciary centres on the existence and functioning of the Supreme (or Constitutional) Court. Constitutional control is sometimes referred to as the Supreme Court’s ability to safeguard citizens’ rights. Important features of a Supreme Court endowed with the necessary powers are: (a) the possibility of citizens to refer complaints to the Court; and (b) the parliament and/or the executive is not able to overturn decisions made by the Supreme Court.

The workload is key to the behavioural dimension of judiciary reform. EU norms establish basic parameters for the functioning of the judiciary. Conformity with these norms speaks to workload and delays (See Table 1).

The third and last “input” into judiciary capacity and independence refers to existence and effectiveness of legal procedures. This dimension reflects ease of access to courts and the expected certainty of judicial decisions both in terms of their content and of their enforcement. As EU norms are quite developed in this regard, the scale used reflects the degree of conformity.

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<sup>8</sup> This dimension covers three different aspects: (1) access to courts (e.g. the right to appeal); (2) the court procedure (e.g. legal certainty, which in turn includes a unified interpretation of the law by the courts, the requirement of justification for judicial decisions, and an evenly handled procedure); and (3) the enforcement of judicial decisions.

<sup>9</sup> If corruption is mentioned as a problem for the judiciary in a Progress Report the report should be coded 1 or 2 depending on if efforts to remedy the problem with corruption have been taken.

Table 1. Measuring progress to EU institutional requirements

	Grade 1	Grade 2	Grade 3	Grade 4
Judiciary capacity	Severe deficiencies	Unsatisfactory convergence to EU norms	Some more efforts are necessary to comply with EU requirements	Comparable to other EU member states
Judicial independence	Severe political pressure on the courts	Unsatisfactory convergence to EU norms	Minor strengthening of needed to comply with EU requirements	Comparable to other EU member states
Existence and functioning of Supreme Court	No Supreme Court or severe deficiencies in its power	Unsatisfactory convergence to EU norms	Generally satisfactory powers but further strengthening is needed	Fully endowed with powers to monitor and exercise constitutional control
Workload of the Judiciary	Courts are severely overloaded, unjustified delays	Unsatisfactory convergence	Workload of the courts close to satisfactory, but minor backlogs	Workload of the courts satisfactory
Legal Procedures	Severe deficiencies in legal procedures	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Independence of the bureaucracy	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Public administration fully independent
Administrative capacity	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Extent and quality of the training	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
The structure of the salaries of public administrators	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory

Civil service law	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Quality of the enforcement of anti-trust and merger legislation	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Independence of the competition authority	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Anti-trust and merger legislation	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Resources	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory
Procedural structures for market surveillance	Severe deficiencies	Unsatisfactory convergence	Generally satisfactory, some improvements are needed	Satisfactory

### ***State bureaucracy (Weber)***

Let us now turn to the bureaucracy or the quality of public administration. The evaluation on the public administration is based on the European Principles of Administration elaborated by SIGMA and the European Commission. Here we look at two key outcome dimensions of the quality of public administration: independence of the bureaucracy and administrative capacity.

The notion of administrative capacity in this context means that there is sufficient professionalism in the civil service and that a coherent institutional or organizational set of administrative structures exists to that the bureaucracy has capacity to deliver. This aspect is thought of by the EU as centred on the career structure of the civil service, but it includes dimensions such as performance evaluation,

recruitment, promotion, and employment security (See Table 1).

We consider three key inputs into this Weberian channel, namely (1) the extent and quality of the training and (2) the structure of the salaries of public administrators as well as (3) whether the civil service law in place is appropriate and effective (“legislative dimension” in the codebook) (See Table 1).

### ***Competition policy (Smith)***

The third dimension we consider is competition policy. The national state-aid authority often go under the name of Competition Office, Competition Council or Division of Competition and State-aid. Some countries divide the responsibilities between several bodies while others only have one responsible authority. The authority/authorities are in some cases responsible for both anti-trust and merger, and state-aid.

We evaluate three key inputs into the Smith channel: alignment of anti-trust and merger legislation with EU requirements; the resources available for the enforcement of anti-trust and merger legislation; and procedural structures for market surveillance (with reference to free movement of goods.)<sup>10</sup> These refer to agencies responsible to the enactment, alignment and enforcement of competition policy.

Legislation on anti-trust and mergers includes legislation on competition, cartels, plus abuse of dominant market position, market concentration and restrictive practices (See Table 1). The resource input into competition policy refers to the number and quality of staff, physical resources (ICT and buildings), and general financial/budgetary resources. The third inputs into competition policy we consider are the procedural structures for market surveillance. Procedural structures consist of the ability of the agency to operate independently, its competences, and its powers. Competences refer to the areas the national anti-trust and merger authority has the

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<sup>10</sup> In the codebook, these variables appear under “Competition Policy” and as indicated all refer to anti-trust and merger policy.

competence to make decisions. The powers refer to the strength of, for example, sanctions that the national anti-trust and merger authority can impose. Procedural structures in line with EU requirements mean responsible authorities are in place; they are independent and impartial; and they respect the principle of proportionality.

Outcomes from the Adam Smith channel are again measured in terms of capacity and independence. In the case of competition policy, we define capacity as the quality of the enforcement of anti-trust and merger legislation and we define independence in terms of the freedom from interference enjoyed by the competition authority. The independence aspect of the outcomes from competition policy comes from a different chapter in our data set and refers to the capacity to deliver market surveillance (See Table 1).<sup>11</sup>

## **METHODOLOGICAL ISSUES**

The objective of this section is to discuss three main methodological issues and clarify the choices we make in this paper. One issue refers to our focus on implementation sequences, another to the overall modelling strategy and the third to the implications for estimation of the fact that most of our variables of interest are categorical.

Regarding the first issue, we decided that all right-handed variables will always enter in one-period lags (one-year lag in this case). This choice ameliorates endogeneity concerns and, more importantly, lends itself quite naturally to a discussion of temporal implementation sequences. A finding that one reform last year is statistically associated with a change in another reform this year can be interpreted as a temporal sequence.

Given that institutions change notoriously slowly, one must account for the potential inertia that one may think characterizes the behavior of institutional changes and hence

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<sup>11</sup> While all the three inputs and the capacity outcome for competition policy can be found under the chapter 2 entry in the codebook (“competition policy”), the independence measure originates from chapter 7 (“free movement of goods”) and refers to the extent to which the required procedures to deliver market surveillance are in place.

in all specifications we include the lagged dependent variable in the right-hand side.

The second important methodological issue refers to the structure of the conceptual framework we put forward above and how we go about testing it. Recall it centers on three pillars, namely the Montesquieu, Weber and Smith channels. We empirically implement this framework using a two-stage scheme: first we estimate the effects within each channel and then we estimate the effects between channels. In the first stage, we estimate whether and how each of the two outcome measures can be explained by the three inputs, while in the second we estimate (in addition) the effects of the other two channels. For example, let us take the Weberian channel. First we explore whether and how administrative capacity and administrative independence were explained by (one-year lagged) civil service law, by the training of public servants and by their salaries. In the second stage we assess whether, after accounting for these inputs, there are specific effects from the other two channels. For example, whether administrative independence was affected by (one-year lagged) judiciary independence or by the quality of the enforcement of anti-trust and merger legislation.

The third issue we need to discuss is how we deal with the implications for the choice of estimation method of the fact that most of our variables are categorical. There are three obvious estimator choices. One is the fixed-effects panel estimator which main advantage is that it is simple and quite standard. The use of country and year fixed-effects would be helpful to ameliorate criticisms of omitted variable biases, which may be important in this context. The second choice is the System GMM (Arellano-Bover/Blundell-Bond linear dynamic panel-data) estimator, which has as its main advantage that it handles the presence of the lagged depended variable, hence is the natural choice for the estimation problem at hand. One issue these two options do not address is that most of our variables of interest are categorical and thus an estimator like the Ordered Probit would be a more satisfactory way of handling this.

We observe that the use of these three estimators delivers qualitatively similar results. Table 2 shows one example for the case of administrative capacity. Note that the key result (regarding the role of civil service law) is robust across the three estimators. Also note that measures of goodness of fit in both the fixed-effects and ordered probit cases is quite satisfactory and, more importantly, that for the System GMM estimator in column 2 the AR(1) and AR(2) tests suggest that the instruments we use are valid and that the model is correctly specified. Given institutions change slowly, we decided to report and focus our analysis on the System GMM results.

The System GMM estimator is designed for situations like ours, in which we have an unbalanced panel with a “small T and large N” (for the countries that joined the EU in 2004 our data only covers six years) and the left-hand side variable is defined as dynamic in that it depends on its own past realisations (Plümper et al 2005). Moreover, the System GMM handles well right-hand side variables that are not strictly exogenous and may be correlated with past and current realisations of the error term, (country-level) unobserved heterogeneity, measurement error and omitted variables, as well as potential heteroscedasticity and autocorrelation within or across individual units’ errors. Our estimation was implemented using Stata’s `xtdpvars` facility.

**Table 2.**  
**Determinants of Administrative Capacity**  
**A Comparison of Fixed-Effects, System GMM and Ordered Probit Estimators**

	(1) <b>Fixed Effects</b>	(2) <b>System GMM</b>	(3) <b>Ordered Probit</b>
One-year Lag Administrative Capacity	0.434*** [0.0670]	0.741*** [0.138]	6.597*** [1.639]
One-year Lag Civil Service Law	0.198** [0.0775]	0.152** [0.0626]	0.891* [0.537]
One-year Lag Civil Servant Training	0.0584 [0.0478]	0.110** [0.0486]	0.781 [0.492]
One-year Lag Civil Servant Salary	-0.190 [0.128]	-0.244** [0.114]	-1.412* [0.724]
One-year Lag Judiciary Capacity	-0.00754 [0.0798]	0.00614 [0.0687]	0.466 [0.615]
One-year Lag Judiciary Independence	0.117 [0.116]	0.0557 [0.144]	0.366 [0.394]
One-year Lag Competition Policy Quality	0.111** [0.0505]	0.0122 [0.0426]	0.626 [0.572]
Constant	0.383 [0.319]	0.301 [0.368]	
Observations	104 16	104 16	104 16
Number of countries			
R-squared	0.527		0.655 (pseudo)
AB test AR(1)		0.0046	
AB test AR(2)		0.6141	

Notes: Robust standard errors in brackets. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## EMPIRICAL RESULTS

The aim of this paper is to empirically identify implementation sequences of changes in three key regulatory areas. We study how a set of countries embark on deliberate changes in rule of law, public administration and competition policy aiming towards reaching European Union standards so that they can be deemed fit for membership.<sup>12</sup> Above we explained the theoretical framework guiding this exercise, the data collection and measurement efforts, and discussed methodological options on how to proceed. We argue that the System GMM approach is the best option and this is in light of the fact that results do not differ qualitatively following radical changes in method. We consider the following dynamic panel data model:

$$y_{it} = \sum_{j=1}^p \alpha_j y_{i,t-j} + x_{it} \beta_1 + w_{it} \beta_2 + v_i + \epsilon_{it} \quad i = 1, \dots, N \quad t = 1, \dots, T_i \quad (1)$$

Where  $y_{it}$  can be one of six options as it represents one of our measures of judiciary independence or capacity, bureaucracy independence or capacity, and competition policy independence or capacity. With  $\alpha_j$  and  $p$  as parameters to be estimated,  $v_i$  and  $\epsilon_{it}$  as vectors of parameters to be estimated and the panel effects ( $v_i$ ) and  $\epsilon_{it}$  assumed to be independent for each country  $i$  and across all years  $t$ . Importantly,  $x_{it}$  is a vector of exogenous covariates that includes within reform area variables (or inputs), while  $w_{it}$  is a vector of exogenous covariates that includes the remaining five reform area outcomes.

Here we first focus our presentation on the set of results for the Weberian channel (public administration or bureaucracy) and then use the diagrammatic scheme presented above to put these results in overall context and contrast them with those we obtain for the judiciary and competition channels.

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<sup>12</sup> We have preliminarily explored the economic effects of our inputs and output measures and find that they are positively correlated with international trade (export levels), economic growth and income inequality. These will be studied in detail in a companion paper.

Table 3 presents our System GMM estimates for the independence of the bureaucracy focusing on inputs from within the Weberian channel.

One first noteworthy finding is that none of the three “inputs” into bureaucratic independence enjoys much empirical support. Civil service law, salaries or training in previous periods do not seem to be empirically associated with current level of bureaucratic independent.<sup>13</sup> Instead, this is better explained by other outcome variables such as bureaucratic capacity, judiciary capacity and competition policy capacity.

**Table 3.**  
**Determinants of Independence of the Bureaucracy with Emphasis on Inputs**  
**System GMM Estimator**

	(1)	(2)	(3)	(4)
One-year Lag Bureaucratic Independence	0.175 [0.229]	0.534*** [0.136]	0.832*** [0.280]	0.672*** [0.153]
One-year Lag Bureaucratic Capacity	0.206* [0.118]	0.217** [0.101]	0.339** [0.160]	0.316 [0.224]
One-year Lag Civil Service Law	-0.0878 [0.0585]	0.0245 [0.0394]	-0.0840 [0.0613]	0.0543 [0.0575]
One-year Lag Civil Servant Training	-0.0205 [0.0262]	0.0185 [0.0202]	0.193 [0.138]	0.0190 [0.0494]
One-year Lag Civil Servant Salary	0.0424 [0.121]	-0.0689 [0.103]	-0.268*** [0.0971]	-0.437 [0.329]
One-year Lag Judiciary Capacity	0.334*** [0.125]			
One-year Lag Judiciary Independence		0.177** [0.0802]		
One-year Lag Competition Policy Independence			-0.0268 [0.0394]	
One-year Lag Competition Policy Capacity				0.214*** [0.0691]
Constant	1.017*** [0.356]	0.250 [0.315]	0.316 [0.261]	0.609*** [0.233]
AB test AR(1)	0.2246	0.0309	0.0405	0.0463
AB test AR(2)	0.83	0.6546	0.2663	0.6925
Observations	104	104	104	104
Number of id	16	16	16	16

Standard errors in brackets \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

<sup>13</sup> This is confirmed by the results from the AR(1) and AR(2) tests that suggest the model in column 1 is not correctly specified (the other columns suggest this is because it excludes the other outcome variables as the results from these tests become supportive).

It should also be noted that these overall pattern of results (bureaucratic independence being better explained by other outcomes than by its own inputs) do not change if we split the sample between the countries that succeeded in becoming members of the European Union and those that did not (so far). Moreover, the model seems to be picking up well the fixed-effects characterizing individual county features because these results are also not affected by the addition of various other controls such as their initial level of development (proxied by per capita income in 1990), their economic growth rates, their shares of population living in urban areas, and the evolution of their overall political institutions (as proxied by the widely used Witold Henisz's index of political constraints.)<sup>14</sup>

Table 4 shows the results of the compounded effects of the other five outcome variables on the evolution across countries and over time of our quantification of the Commission's assessment of the level of bureaucratic independence. It shows the dominant role played by competition and judiciary capacity in this case.

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<sup>14</sup> These are available from the authors upon request.

**Table 4.**  
**Determinants of Independence of the Bureaucracy with Emphasis on Outcomes**  
**System GMM Estimator**

	(1)	(2)	(3)
One-year Lag Bureaucratic Independence	0.401** [0.198]	0.600*** [0.167]	0.354 [0.253]
One-year Lag Bureaucratic Capacity	0.191** [0.0934]	0.293 [0.220]	0.329** [0.164]
One-year Lag Civil Service Law	-0.0793 [0.0560]	0.0237 [0.0660]	0.0369 [0.0648]
One-year Lag Civil Servant Training	-0.00943 [0.0230]	0.0201 [0.0572]	0.0586 [0.0571]
One-year Lag Civil Servant Salary	-0.0328 [0.0942]	-0.284 [0.353]	-0.366 [0.348]
One-year Lag Judiciary Capacity	0.325** [0.126]		0.208* [0.125]
One-year Lag Judiciary Independence	0.179** [0.0839]		0.104 [0.116]
One-year Lag Competition Policy Independence		-0.0736* [0.0441]	-0.0807** [0.0383]
One-year Lag Competition Policy Capacity		0.375*** [0.122]	0.318*** [0.0797]
Constant	0.207 [0.363]	0.479* [0.277]	0.383 [0.404]
AB test AR(1)	0.0417	0.0328	0.0655
AB test AR(2)	0.544	0.8966	0.8022
Observations	104	104	104
Number of id	16	16	16

Standard errors in brackets \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Now we turn our attention to the other outcome variable in the Weberian channel. Table 5 shows System GMM estimates for equations in which the dependent variable is bureaucratic quality. First we examine the relative importance of its own inputs and the main findings here are quite different than those for bureaucratic independence: inputs seem to be more important than the other outcomes. Civil service law and civil servant training in the previous year are show to be positively correlated (while salaries are negatively correlated) with the current level of bureaucratic quality. Another noteworthy difference is that in this case inertia is much stronger than for the other outcome: previous realizations of bureaucratic quality are strongly related to

current levels of it while the same cannot be said for bureaucratic independence. Last, but not least, it is important to note that we find previous levels of quality are positive related to current levels of independence so one can argue that the effects of the three inputs on independence is indirect, that is, it takes place through capacity. This is an example of a sequence uncovered by our results: training increases capacity, which, by its turn, leads to increases in bureaucratic independence.

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**Table 5.**  
**Determinants of Capacity of the Bureaucracy with Emphasis on Inputs**  
**System GMM Estimator**

	(1)	(2)	(3)	(4)
One-year Lag Bureaucratic Capacity	0.721*** [0.114]	0.725*** [0.133]	0.772*** [0.133]	0.762*** [0.125]
One-year Lag Bureaucratic Independence	0.0530 [0.0817]	0.0530 [0.0873]	0.0861 [0.0762]	0.0534 [0.0850]
One-year Lag Civil Service Law	0.126** [0.0615]	0.128* [0.0709]	0.0890 [0.0627]	0.0935 [0.0733]
One-year Lag Civil Servant Training	0.127*** [0.0440]	0.143*** [0.0338]	0.149*** [0.0441]	0.181*** [0.0480]
One-year Lag Civil Servant Salary	-0.231* [0.118]	-0.244*** [0.0798]	-0.226** [0.0957]	-0.180 [0.136]
One-year Lag Judiciary Capacity	0.00824 [0.0560]			
One-year Lag Judiciary Independence		-0.0432 [0.103]		
One-year Lag Competition Policy Independence			0.0669 [0.0554]	
One-year Lag Competition Policy Capacity				-0.132* [0.0787]
Constant	0.372** [0.168]	0.475* [0.258]	0.148 [0.235]	0.426*** [0.151]
AB test AR(1)	0.0022	0.0025	0.0024	0.0036
AB test AR(2)	0.6189	0.7069	0.6999	0.9772
Observations	104	104	104	104
Number of id	16	16	16	16

Standard errors in brackets \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table 6 shows the results of the compounded effects of the other five outcome variables on the evolution across countries and over time of our quantification of the Commission's assessment of the level of bureaucratic quality. It shows that differently from the results we obtain for independence, here the dominant role is not played by

competition and judiciary capacities, but instead by inputs, in particular by the alignment of the domestic civil service law with EU standards and by civil servant's training. Notice that accounting for the other outcomes makes the coefficient on salary, which was negative and statistically significant above into, statistically insignificantly different from zero. The level of inertia we observe for bureaucratic capacity or quality is much stronger than the one we estimate for independence. This seems intuitive to us because one can conjecture that bureaucratic independence better reflects balance of powers considerations and as such may vary more easily over time if either the judiciary or the executive become relatively more assertive.

Table 6.  
Determinants of Capacity of the Bureaucracy with Emphasis on Outcomes  
System GMM Estimator

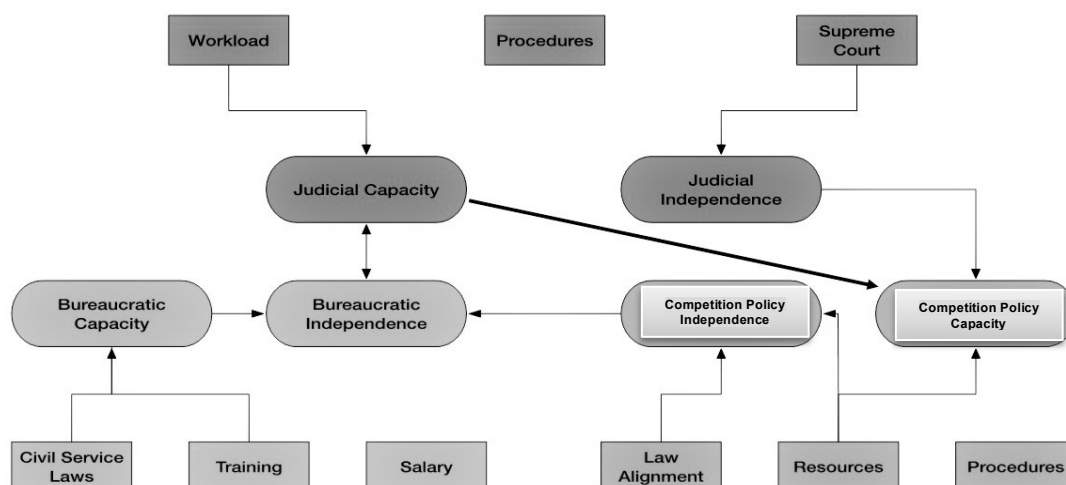
	(1)	(2)	(3)
One-year Lag Bureaucratic Capacity	0.741*** [0.125]	0.593*** [0.189]	0.450* [0.245]
One-year Lag Bureaucratic Independence	0.0623 [0.0878]	0.0623 [0.0731]	0.0415 [0.0995]
One-year Lag Civil Service Law	0.125* [0.0705]	0.110 [0.0755]	0.137* [0.0819]
One-year Lag Civil Servant Training	0.129*** [0.0433]	0.120*** [0.0417]	0.114** [0.0507]
One-year Lag Civil Servant Salary	-0.236*** [0.0819]	-0.191 [0.137]	-0.0812 [0.206]
One-year Lag Judiciary Capacity	-0.0257 [0.0523]		0.0157 [0.0982]
One-year Lag Judiciary Independence	0.0901 [0.134]		0.116 [0.170]
One-year Lag Competition Policy Independence		0.0422 [0.0542]	0.0323 [0.0497]
One-year Lag Competition Policy Capacity		-0.0840 [0.100]	-0.0573 [0.177]
Constant	0.182 [0.319]	0.617** [0.247]	0.318 [0.574]
AB test AR(1)	0.0034	0.0166	0.0417
AB test AR(2)	0.6456	0.8264	0.9496
Observations	104	104	104
Number of id	16	16	16

Standard errors in brackets \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

We repeated the same estimation exercise above for both the judiciary and competition (Montesquieu and Smith channels) but devised a more economical way to report and discuss our results than in the more standard tabular format. As a departure point, we use Figure 1 above which shows all three channels, their inter-relationships and all inputs we assess in each one of the three channels to construct Figure 5 below which instead of showing all links, only shows those links (represented by arrows) for which we find robust econometric support.

Starting from the Weberian channel, the first observation is that civil servant salary in the previous period does not seem to be related to either bureaucratic capacity or independence in the current period. On the other hand, training and civil service law both positively affect future bureaucratic capacity, which by its turn positively affects one-year ahead bureaucratic independence. We just described referring to Figure 5 what we reported and discussed above in Tables of System GMM estimates so it should be easier to follow from this point onwards. These results are then not reported here but available in an on-line Appendix.

**Figure 5. Diagrammatic representation of main econometric results**



Turning to the Montesquieu channel, our results indicate that the only input driving judiciary capacity is workload, while the only input driving judiciary independence is the effectiveness of the Supreme Court. Neither procedures nor the Supreme Court affects judiciary capacity in a sequential manner. By the same token, neither procedures nor the workload affects judiciary independence in a temporal manner. Yet, we find a link between judiciary capacity towards the Smith channel, more specifically with the quality of competition policy's antitrust enforcement.

However, the most important result from the Montesquieu channel is the intricate, self-reinforcing, bi-directional relationship between judiciary capacity and bureaucratic independence. Judiciary capacity in the previous year is positively related to bureaucratic independence in the current year. And uniquely among our results (as it can be seen in the Figure below this is the only case in which arrows go both ways), bureaucratic independence in the last period is positively related to judiciary capacity in the current year. It can be said that this "BI-JC node" is the fulcral relationship because it is the end-point for all robust sequences we uncover from our estimation results.

There are other important sequences we identify with the Smith channel. In particular, we find that alignment with EU law and adequate resources in previous periods are associated with increases in the current period in the independence of the Competition Authority. This last factor, by its turn, is shown to increase bureaucratic independence. On the Montesquieu channel, we should also mention a sequence from Supreme Court in previous period towards improvements in current levels of judiciary independence that, by its turn, is related to improvements in the quality of the enforcement of competition policy in future periods.

In summary, using the measures and methods discussed above we were able to document that deep integration indeed contributes to increases in key state capacities. Moreover, our analysis throws some light on how it does so. We identify various

implementation sequences that depict the evolution of three important institutional areas across countries and over time, explicitly driven by the objective of becoming a full-fledged member of the European Union.

There are various caveats and limitation one should bear in mind. One is that our results focus on temporal sequences, which obviously leave aside interesting possibilities of contemporaneous relationships that are not analyzed above. There are other ways of carrying out this exercise (network analysis comes to mind) but we believe the step-by-step approach we favor above is more transparent and easier to communicate. Last, but not least, it is likely that other institutional reforms may be important and their omission biases our results in important ways.

## CONCLUSIONS

The aim of this paper was to explore variation in the effects of deep integration on the development of state capacities from the perspective of strategies for sequencing institutional change. In order to do so, we made use of a new panel data set on the accession process to the European Union of Central and Eastern European countries.

Regarding our first hypothesis, we find it has strong support from our results: The sooner there is progress in establishing an independent constitutional court, the faster countries put in place an independent judiciary. The experience of institutional transformations in Central and Eastern Europe proved the authors of the Federalist Papers right: independent constitutional courts are functional for the progress of judiciary independence suggested by Montesquieu. Our findings also support the shared expectation of Montesquieu and the authors of the Federalist Papers: progress in judiciary independence increases the capacity of the state to uphold the freedoms of market, in our case, from the misuse of asymmetries in economic power. This it does by way of strengthening the enforcement of anti-trust regulations.

We also find support for our second hypothesis: Early reforms that strengthen the professionalization of the civil service contribute to increasing the independence of state bureaucracy. The implementation of civil service law and progress in the training of civil servants increases bureaucratic capacity. The later contributes to increasing bureaucratic independence. We did not find support for the proposition about the link between salaries and increasing bureaucratic capacity.

We find limited or partial support for our third hypothesis: On the one hand, improving the quality of competition policy has a positive effect on the autonomy of state bureaucracy. Thus, changes in the demand side of state reform can contribute to the transformation of the properties of the state in a key dimension. But the enforcement of antitrust regulation does not have the expected effect on other key aspects of the state reform, namely the transformation of the judiciary. Just to the contrary, it is the increase in judiciary capacity that results in the increased enforcement of antitrust regulation and to the opening of the possibility for new players to enter in the market. Thus we find no support to the notion that market reforms will further state reform on their own.

Similarly, our empirical results do not support the hypothesis that supply side reforms, the encompassing change of the judiciary and the bureaucracy will on their own improve the institutions regulating market competition. State reforms, we found, have a direct effect on the anti-trust institutions via the increasing capacity and independence of the judiciary. The effect of increase in bureaucratic capacity and autonomy is mediated via the Montesquieu channel. In turn, progress in bureaucratic independence is reinforced by a key element of the Smith channel.

Finally, we find strong support for our fifth hypothesis: a simultaneous change in some aspects of implementing competition policy and achieving progress in civil service reform or the reform of the judiciary will most likely yield progress in other general

state institutions and in regulatory institutions. We found an intricate and bi-directional relationship between judiciary capacity and bureaucratic independence. Judiciary capacity in the previous year is positively related to bureaucratic independence in the current year and bureaucratic independence in the last period is positively related to judiciary capacity in the current year. This crucial relationship is the only case for which we find evidence of a self-reinforcing, bi-directional relationship. Further, the independence of the Competition Authority was shown to increase bureaucratic independence, a nucleus of the sequences of institutional reforms we uncover.

Our findings about the complex interplay between reforming the institutions of the state and the market have broader relevance for market integration attempts in other parts of the globe. Extension of transnational markets goes slowly in several parts of the world because there are no states in place that are capable of implementing sustainable institutional change. Such change presupposes increase in the capacities of the private and public actors both to play by and live by the rules of transnational markets. External assistance or pressure to change the institutions of the market might increase the opportunities of many, or they might dramatically deteriorate the positions of large segments of the society (Bruszt and McDermott, 2014). What makes the difference is whether or not there is a state in place that is not the hostage of short-term interests, which has the capacity and autonomy to manage the developmental externalities of reforms, besides enforcing the transnational rules. Shallow integration attempts that focus solely on changing market institutions, as we saw it, cannot induce self-sustaining change. Liberation of markets, we found, will not liberate the state on its own. But we also found that deep integration can increase both state capacity and state autonomy and can set in motion self-reinforcing sequences of institutional change.

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## **Online Appendix (Not for publication)**

### **Background information on the Monitoring Reports of EU Accession Progress**

EU membership conditionality has changed several times dramatically since the first enlargement in 1973 and it became increasingly more complex. In the case of the Eastern enlargement, besides taking over more than 80 thousand pages of regulations in 31 chapters (and for Croatia and the countries of Western Balkans, for 35 chapters), the EU requirements have included also institutional conditions that were seen to be necessary for the implementation of EU regulations on the ground.

As we have mentioned above, fearful of the potential negative consequences of large-scale non-compliance on the integrity of the common market, in 1997 the European Council gave the Commission the task to monitor the CEE countries' progress towards accession. The outcome of this exercise was synthesised in the annual Progress Reports, which were intended to work as a mechanism to help the accession countries align their legislation with the *acquis* (European Council, 1997, p. 3). Legislative alignment was defined as the extent and quality of transposition of EU legislation into national law. However, alignment also included the creation of the institutional conditions for the implementation of the EU conform regulations on the ground (European Commission, 1998, p. 1). The reporting exercise by the Commission started with the analysis of the institutional status quo and the level of distance from EU institutional requirements, and then registering year-by-year and chapter-by-chapter convergence, or the absence thereof to EU standards.

The EU Commission was agnostic in the issue of sequencing of institutional change across the different chapters during the first wave of Eastern enlargement between 1997 and 2004. While it has used various mechanisms to assist domestic institutional change, the EU has left basically to state incumbents in these countries to decide about the pace and the sequencing of reform. When the process of enlargement has reached the Western Balkans, the approach of EU has changed. Facing sustained resistance to regulatory change, the EU has decided that applicant countries have first make progress in the judiciary and the civil service reforms<sup>15</sup>. Progress in these two areas was made the condition to open any of the more specific chapters on narrower issues of market regulation.

Our data is based on the coding of these yearly reports for all the 17 countries and for all the years until the accession of the eleven new member states, and until 2013 in the case of the countries that still have the applicant status.

To assess institution building, the Commission worked out several indicators to measure different aspects of institutional change (cf. European Commission, 2005). Although the exact requirements for the different chapters varied, it was possible to identify four categories that were of special concern for the Commission. The first category concerns the transposition of the substantial legislation. For each chapter, the monitors had to report the degree to which the laws and regulations in the given countries were aligned to EU regulations. These evaluations ranged from registering the absence of any law in the specific policy field that would reflect the norms of the EU, or that would partly or completely conflict with EU norms, to the registering of the passing of new laws that fully meet EU requirements (see Bruszt and Lundsted 2016.)

The second dimension of monitoring reflected the presence or absence of organizations, regulatory agencies that could enforce on the ground the EU rules. The exact ramification of these organizations differed across the *acquis* chapters, but they usually implied the creation of an enforcement agency that was independent from

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<sup>15</sup> Authors' interview in the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR)

political and private influence endowed with sufficient enforcement power to properly execute its duties.

The third dimension of monitoring have registered whether and to what degree is the given enforcement organization endowed with the necessary resources, meaning usually human, budgetary and physical resources. Last but not least, the Commission was concerned with the actual performance of the supervisory authority in specific regulatory fields. To evaluate this the Commission developed criteria for assessing progress to EU requirements that could include also indicators of the frequency of inspections, the number of fines imposed, and in general, the overall quality and predictability of rule enforcement.

A possible critique directed against the Progress Reports is a potential political bias, i.e., that the reports would tend to shy away from criticising countries because of political or other reasons. Albeit a possibility, it is difficult to find anything in the data that points in the direction of a systematic under- or overvaluation of one or more of the candidate countries. The final political decision whether to take a given country or not as member was just partly dependent on the evaluations by the Commission of progress towards meeting all the EU requirements. One of the interesting finding of our coding was that at the time of the final decision to take specific countries, the reports done by the desk-officers of the Commission had still lots negative evaluations (meaning still below EU standards) in several of the chapters. Furthermore, the Progress Reports are vulnerable to much of the same critique that has been directed to many of the other operationalization of institutional capacity, namely that the measure is based on subjective assessments rather than objective criteria. However, this is only partly true, the evaluations made by the country experts are based on criteria worked out by the Commission. The country experts had to evaluate each sector within a country in accordance with the standards laid down in the *Guide to Main Administrative Criteria* (European Commission, 2005). Although this does not go all the way to meeting the requirement of objective indicators, it at least provides a systematic assessment, which enables cross-country and cross-sector comparisons.