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Economic integration and state capacity

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Abstract

We investigate whether and how economic integration increases state capacity. This important relationship has not been studied in detail so far. We put together a conceptual framework that highlights what we call the Montesquieu, Weber and Smith channels to guide our analysis. Each of these corresponds to a series of mechanisms in three distinct institutional arenas: judiciary, bureaucracy and competition policy. To test our framework, we introduce a new panel of institutional reform measures that allow us to investigate how changes in these three arenas interact with each other and what sequence of changes yields increases in state capacity. The yearly data set covers all the 17 candidate countries to join the European Union (EU) after the 1995 enlargement. Deep integration, we find, can induce broad institutional change by providing incentives for simultaneous change in core state institutions. Bureaucratic independence and judicial capacity seem to be the key engine of the process engendered by the prospect of EU membership. Yet early and abrupt removal of external anchors might generate significant backsliding, or reversals, in domestic institutional change.

Keywords: deep integration; state capacity; European Union accession; judiciary; bureaucracy; competition policy

1. Introduction

The Great Recession and the Eurozone crisis dented the consensus about the economic benefits of EU membership. Economic research has strived to quantify these benefits but some of them have proven notoriously difficult to pinpoint (Crafts, 2018; Campos et al., forthcoming).[1]

This paper argues that one of these potential yet broadly understudied benefits is the increase in state capacity. We investigate the role that economic integration, specifically the prospect of EU membership, plays in building up the capacity of the state to uphold political and economic freedoms, enforce law and order, regulate economic activity and provide public goods.[2]

One can enlist several arguments why deepening of integration among countries endowed with states at different levels of development may necessitate an increase in state capacities. The more encompassing integration gets, the more sectors and policy fields are involved in rule harmonization

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[1]On the benefits of economic integration, see, among others, Beeson (2014), Brou and Ruta (2011), Mattli (1999), Robson (2012) and Hoekman (2016).

[2]According to Besley and Persson, '[T]he lack of attention to the role of state capacity by economists contrasts with other social scientists' (2014: 930). The scholarship on state capacity has a long tradition in social sciences (Evans *et al.*, 1985; Tilly, 1975). Besley and Persson (2010) focus on fiscal capacity. Dincecco and Katz (2016) and Chuaire *et al.* (2017) provide supporting econometric evidence. Besley and Persson (2014) investigate complementarities among different state capacities (fiscal, legal and collective) as well as positive feedbacks between state capacity and income. |Acemoglu *et al.* (2015, 2016) use case studies (Colombian intergovernmental relations and the diffusion of US post offices) of state capacity building. Bardhan (2016), Savoia and Sen (2015), and Koyama and Johnson (2017) survey this nascent literature drawing on works from economic development and history.

allowing for the freer movement of goods, services, capital and labour. Integrating markets implies that the institutions of the member states should acquire the capacity to implement common transnational rules. These rules range from the capacity to uphold economic freedoms, to the capacity to implement harmonized regulations and policies in dozens of policy fields (Bruszt and McDermott, 2014). Public and private actors in countries with more capable states might have high stakes in caring about institutional capabilities in countries with weaker states. The deeper the integration, the more the benefits of the players in the stronger economies will depend on the capacity of states in weaker economies. Weak state capacities to implement the common rules might deprive economic actors in the stronger economies from the potential gains of more integrated markets. It might also induce a race to the bottom by allowing competitive advantage to firms in the weaker economies and reducing the incentives of economic players in the stronger economies to play by the common rules. The deeper economic integration is, the more policy fields are regulated by common rules, the higher might be the incentives of actors in the stronger economies to care about states' capacity in the weaker economies.

The dilemma of such externally induced institutional change is, however, that powerful domestic actors in countries with weak states might benefit enormously from the conservation of the institutional status quo and the potential domestic beneficiaries of state reform might be too weak to make a difference. State reform might deprive economic elites of stable flows of rents. Patrimonial political elites might see the economic bases of their political power undermined by the reforms of core state institutions like the judiciary or the bureaucracy. Even if domestic elites might grudgingly introduce some of the externally demanded institutional changes, once external monitoring or sanctioning power declines they might revert to the old practices. The transition from a state manipulated by a rent-seeking elite to an organization providing the framework for an efficient and integrated market economy remains a puzzle (Brousseau et al., 2010).

So how can deep economic integration further state reform and yield major changes in state capacities? To answer this question, we put together a conceptual framework that highlights what we call the Montesquieu, Max Weber and Adam Smith channels to guide our analysis. Each of these channels corresponds to a series of mechanisms in three distinct institutional arenas, namely, the judiciary, bureaucracy, and competition (or anti-trust) policy. All present-day theories on the interplay between state making and market making draw on one or the other of these classics and all share similar diagnoses: the development of states and markets is prevented either by the dominance of rent-seeking groups that might control the state and corrupt the market, or, even if states are not captured, their weakness prevents attempts to overcome the resistance of economic insiders, who are the beneficiaries of the status quo (Åslund et al., 1996; Brousseau et al., 2010; Dewatripont and Roland, 1992; Evans, 1992; North et al., 2009; Rajan and Zingales, 2003).

Based on the ideas of Adam Smith some authors hold that economic liberalization should be given priority (Åslund et al., 1996). Reforms that open markets and increase competition could thus bring in new players and foster the demand for institutional reform and state capacity building. State agencies shielded from the tainted parts of the state should open up the market and enforce competition, and thus serve as an Archimedean point from where the liberation of the state could start (Rajan and Zingales, 2003). Other authors suggest starting with transformations on the supply side of institutional reforms, with more autonomy for the state, either through its capacity to design and implement public policies ('Weber channel') or to uphold economic and political rights ('Montesquieu channel' (Brousseau et al., 2010; Dewatripont and Roland, 1992; Evans, 1992).[3]

The Eastern enlargement of the EU provides a unique opportunity to investigate these issues. After the 1995 enlargement (in which Austria, Finland and Sweden joined), the EU created a system of

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[3]Similar sequencing dilemmas are found within 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 must one first introduce measures that allow oversight of the two other branches of the state to the judiciary?

regular standardized monitoring of progress in institutional change in all the arenas that could affect the capacity of candidate countries to implement the rules of the Single Market. These correspond roughly to the individual chapters of the *acquis*, which of course need to be satisfactorily implemented before accession from the transplantation of regulations (Berkowitz *et al.*, 2003) to the creation of regulatory organizations endowed with the necessary powers, resources and personnel. Quantifying these yearly reports on progress towards accession of the European Commission (2017) generates a longitudinal database that reflects changes in key institutional areas.

Our data set is the result of the quantification of these annual progress reports, encompassing *de jure* (independence) and *de facto* (capacity) institutional measures for 17 EU candidate countries yearly since 1997.

This unique data set allows us to investigate how state capacity responds to changes in the relationship *between* these three arenas and to changes *within* each individual arena. We understand these as reform implementation sequences.

Our main findings are as follows. First, we find no support for the 'demand side' approach: institutional change that increases space for market competition will not yield sufficient support for state reform on its own. Just to the contrary, it is the reform of core state institutions, the judiciary and the bureaucracy that can yield institutional change in the institutions that can liberate entry to the market.

Our most important finding rests upon the relationship between judicial capacity and bureaucratic independence. We estimate that capable, independent courts are prime movers behind the development of a professional state bureaucracy, and *vice versa*. The reforming of these two core state institutions together can generate a political basis for advancing institutional change.

This paper is organized as follows. The next section presents the conceptual framework. Section 3 describes the data construction and collection procedures. Section 4 discusses identification and methodology issues. Section 5 presents our econometric results on the build-up of state capacity in three key areas, namely the judiciary, public administration and competition policy. Section 6 concludes.

2. A political economy framework of institutional change

How are paths of institutional change interlinked? Is there a right sequencing of change within and across key institutional areas that allows for progress in transforming key state institutions? What role does the sequencing of institutional change play?

In seeking theoretical guidance for these questions we rely on the ideas of those scholars who have stressed the dynamics of self-reinforcing or positive feedback processes instead of timeless relations among diverse variables (North, 1990; Pierson, 2000; Tilly, 1984). In this approach, institutional transformations are described as a complex set of interlinked changes in multiple arenas whereby the timing of a change within a sequence effects how change happens and what effects it has on change in other institutional arenas. Early events can trigger self-perpetuating processes, or they can set in motion a backlash that hinders further institutional change (Pierson, 2000; Stinchcombe, 1968). The notion of sequencing institutional change is strongly interlinked with various conceptualizations of institutional complementarity (Amable, 2016; Aoki, 2007) and clusters (Jellema and Roland, 2011; Saleth and Dinar, 2008). The common idea in these various approaches to institutional change is that it is not a specific institution that matters but the way it is combined and interacts with institutional change in other fields. Institutional change in specific organizational fields might set in motion virtuous or vicious circles, a series of interlinked institutional changes leading either to a new stable equilibrium providing benefits to a broader set of actors, or to stasis and a low equilibrium trap blocking the possibilities for change. The dynamic notion of institutional complementarity (Amable, 2016) might be helpful to grasp the difference between these two outcomes. For a social group, two or more institutions are complementary when their joint presence reinforces the group or protects their interests (Amable, 2016). For political actors, complementarity can be defined with reference to the support they can obtain from a sufficiently large set of social groups (Amable, 2016). We

can speak of a self-reinforcing virtuous circle if changes in one institutional arena can empower actors with stakes in institutional change in another institutional arena. If successful, the joint working of these institutions yields a new equilibrium that provides benefits to diverse groups, sufficient to sustain institutional change in the affected organizational fields. In a vicious circle, institutional change in one arena empowers actors to fight to prevent institutional change in other institutional arenas and set in motion a backlash that hinders further institutional change.

In this paper we ask which of the sequencing of externally induced institutional change can lead into a new self-sustaining equilibrium of more autonomous and capable states.

We start with ideas on the right sequencing of change *within* the judiciary and the state bureaucracy and proceed to competition policy and then to conflicting ideas about the right sequencing of change *across* the three key institutional fields.

Judiciary: the Montesquieu channel

From a theoretical perspective, the reform of the judiciary represents a key institutional condition of credibly committing the aspiring member states to sanction the rules of the transnational market. But what are the institutional conditions of judicial independence? In defining these conditions, we start with 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: 221–237)

The institutional sources of judicial independence have to do with the separation of powers.

In formulating our first hypothesis, we rely on the late 18th-century reading of the ideas of Montesquieu by the founding fathers of the American Constitution (Manin, 1994.) Their starting point was the same as that of Montesquieu: the key to the stabilization of the common market of the 13 North American states lies with the creation of an 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 branches of government with stronger legitimacy, the executive and the legislative, could encroach on the autonomy of the branch with weaker legitimacy, i.e. the judiciary. Their conclusion therefore was that mechanical separation of powers on their own will not do, and that 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.

On this basis we can formulate as a guiding hypothesis that the sooner there is progress in terms of establishing an independent constitutional court, the faster countries will be able to create an independent judiciary.

We can add to these late 18th-century conditions two further ones: the professionalization of the judiciary and the endowing of the courts with sufficient resources to enable them to carry out efficiently and promptly. Professionalization refers to the selection and promotion of judges on the basis of professional qualifications and performance, an added factor that is supposed to strengthen both the autonomy and the capacity of the judiciary. On the other hand, endowing the judiciary with the necessary resources, skilled staff and financial and physical assets helps to process cases efficiently and in a timely manner.

Figure 1 shows how the ideas above guide our data collection and organize our thinking about the Montesquieu channel and the other two areas. We consider judicial capacity and independence as ultimate outcomes of institutional development in this area. The EU progress reports allow us to distinguish three inputs into this process: the relative strength of the Supreme Court, the availability of
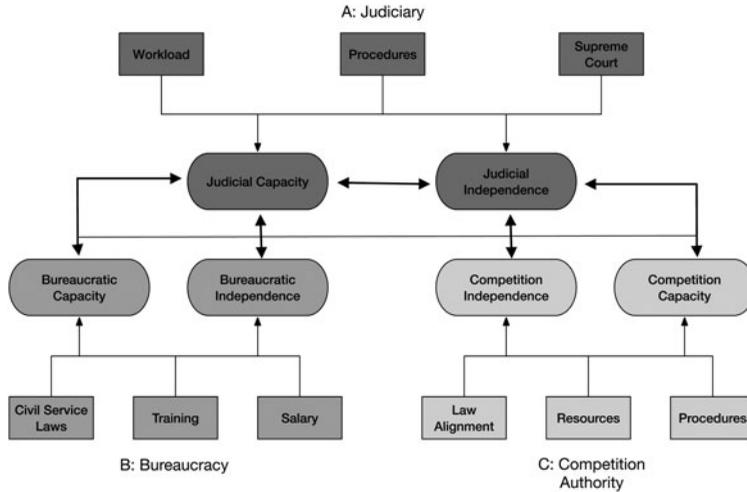
Figure 1. Intra- and inter-channel relationships in three key institutional arenas (bureaucracy/Weber, judiciary/Montesquieu, competition/Smith)

necessary resources and the professionalization of judges.[4] We define in an operational manner each one of these five aspects in detail below.

State bureaucracy: the Weber channel

The other institutional arena that is crucial for integrating markets is public administration. Only a depoliticized, professional bureaucracy can efficiently implement, administer and enforce the rules of the common market. The impersonal rule that establishes integrated markets requires an unbiased bureaucracy, 'a nameless, faceless, rule bound organization treating everyone the same without regard to their individual identity, relying solely on whether the rules are being correctly applied' (Wallis, 2011: 60).

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

Professionalization of the bureaucracy refers to depoliticization of the civil service on the basis of hiring, firing and promoting state bureaucrats on a professional, meritocratic basis. Highly selective meritocratic recruitment and promotion and, in general, professionalization of the bureaucracy were the key to creating a cohesive bureaucracy with an *esprit de corps*, with its own professional criteria of success.

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: 146). Peter Evans, who did perhaps the most to translate and apply Weberian ideas to the comparative study of evolving market economies (Evans, 1992, 1995), argued that the key factor explaining variation in state capacities was the corporate coherence of the autonomous state: the existence of defences of the civil service against short-term political or economic interests.

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[4]Note that Figure 1 does not represent any EU expectations about sequencing of change. During the first wave of Eastern enlargement Brussels left it to the aspiring member states to choose their own sequencing strategy. Further, Figure 1 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.

Based on this discussion we can formulate as a second guiding hypothesis that the sooner there is progress in the implementation of reforms that strengthen the professionalization of the civil service, the faster will be any progress in the implementation of measures that increase the independence of the state bureaucracy. These reforms include civil service laws that establish sanctioned rules guiding interactions between politicians and bureaucrats. Also, neo-Weberian scholars stress the need for the right level of competitive remuneration as a further condition for both the capacities and autonomy of the bureaucracy (Evans, 1992, 1995).

Competition policy: the Smith channel (sequencing across institutional channels starting with the demand side for institutional change)

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* them.

The underlying idea that is in common in all these approaches is that the major hindrance to institutional change is a 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 paralyse the state and prevent change.

Change, according to the first approach, should start outside the core state institutions, 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 change to progress in other institutional arenas, including the sphere of the civil service. The key is the speed of changes (Åslund *et al.*, 1996: 217), not allowing time to react and resist the implementation of the correct measures. As far as institutions are concerned, this approach would prefer to strengthening those institutions enforcing market competition as a sort of Archimedean point from where the war for liberating the state could start (Guriev and Rachinsky, 2005; Motta, 2004; Rajan and Zingales, 2003). The enforcement of the rules of the freer movement of the various factors of production might allow the emergence of a robust coalition of domestic and external actors with high stakes in supporting encompassing institutional change that could lead to a better functioning state. In short, the liberation of markets will allow for the liberation of states.

We here call this the Adam Smith channel. In *The Wealth of 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, 1991 [1776]: 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, 1991 [1776]: 368)

Based on this discussion we can formulate the hypothesis that the sooner there is progress in implementing institutional change in the field of competition policy, the faster there will be progress in civil service reform and the reform of the judiciary.

Changing the supply side of institutional change first (Montesquieu and/or Weber)

A different view from the above, a first step in the complex processes of economic transformation is to build up the defences of the state. Opening up the markets without first strengthening general state capacities could get to stalemate at 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 to create first the institutional conditions of a functioning judiciary and bureaucracy.

Putting in place an independent and capable judiciary could set in motion at least two interlinked mechanisms that would reinforce positive change in other institutional arenas. The even-handed and predictable enforcement of rights can improve the position of a wider circle of economic and non-economic players, and thus contribute to the broadening of the political basis for further state reform. The increasing economic and social returns of judicial autonomy and efficiency can also alter the incentives of state incumbents to supply improved institutional conditions in more specific policy areas so as to further improve the revenue basis of the state.

One can formulate similar arguments for furthering reforms that could strengthen the autonomy and the capacity of the bureaucracy. Civil service reforms that increase the professionalization and depoliticization of the bureaucracy can increase general state capacity to provide public goods to broader groups of citizens, including various non-economic groups. Autonomous bureaucracies serve not only as the tool empowering decision makers but also as a third party between citizens and the ruling elite that prevents the latter from acting against constitutional and legal principles (Brousseau *et al.*, 2010; Merton, 1940; Nee, 2000; Weber [1922] 1978). As with the judiciary, the reforms of the bureaucracy can help incumbents to put together a broad supporting bloc for further institutional reforms within the state.

What is the relationship between these two core state institutions? Institutional economists stress the importance of the judiciary, specifically the need to create 'market-preserving state capacities' first to uphold freedom of property and contracting (Besley and Persson, 2011, 2014; North, 1990; North and Weingast, 1989). Neo-Weberians stress the causal importance of coherent and autonomous state bureaucracies for inducing economic development (Acemoglu *et al.*, 2015; Evans, 1995; Evans *et al.*, 1985; Geddes, 1994; Weiss, 1998). Finally, constitutional political economists would stress the robust complementarity between the two institutional arenas. Implementing reforms that increase the capacities of the judiciary will help to keep the bureaucracy within the boundaries of the rule of law and also to increase its autonomy from political pressure whether it comes from within or outside of the state (Brousseau *et al.*, 2010). Increased professionalization of the bureaucracy, on the other hand, could further increase the capacities of the judiciary. Together 'they guarantee the credibility and evolutivity of the social pact as well as the implementation of an institutional framework favoring division of labor, collective action, and innovation' (Brousseau *et al.*, 2010: 254).

Based on this discussion we can formulate the hypothesis that the sooner there is progress in implementing civil service reform or the reform of the judiciary, the faster there will be progress in the field of competition policy. On the basis of the above-mentioned political economy approach (Brousseau *et al.*, 2010), we can add the other hypothesis that progress in judicial capacity will yield progress in bureaucratic autonomy and *vice versa*, progress in bureaucratic autonomy will yield increase in judicial capacity. Reforms creating a judiciary endowed with institutional guarantees of independence and a depoliticized civil service is expected to bring about two veto points within the state and increase its capacity to resist capture.

3. Measurement

Our data set results from quantifying annual reports about candidate countries progress towards accession to the EU (European Commission, 2017). This generates a longitudinal database that reflects

Table 1. Institutional inputs and outcomes

Channel	Concepts	Outcomes	Inputs
Weber	Public administration (bureaucracy)	• Independence (*de jure*) • Capacity (*de facto*)	• Training • Salaries • Civil service law
Montesquieu	Judiciary (rule of law)	• Independence (*de jure*) • Capacity (*de facto*)	• Workload • Procedures • Supreme Court
Adam Smith	Competition policy (market regulation)	• Independence (*de jure*) • Capacity (*de facto*)	• Procedures • Resources • Competition law

Note: All variables are measured on a 1 to 4 scale, where 1 represents very low conformity with EU practices and norms, and 4 represents very high conformity.

changes in three key institutional arenas, encompassing *de jure* (independence) and *de facto* (capacity) institutional measures for 17 EU candidate countries yearly since 1997.[5]

However, the Commission never differentiates between inputs and outcomes in the progress reports (European Council, 1997). It evaluates each of the aspects individually without considering the potential relationships among them. This determination is entirely ours: based on our understanding of each regulatory area, we decided which variables are inputs and which are outcomes. For each of the three arenas, we identify two main outcomes (capacity and independence, which are the same across the three areas) as well as the various inputs into the delivery of these outcomes (which are different across the three areas).[6] Table 1 summarizes.

For each input and outcome, we develop a four-grade scale that ranges from 'severe deficiencies in the conformity with EU requirements' to 'full conformity with EU requirements'. These are categorical variables taking values between 1 and 4, with 4 indicating levels of institutional development comparable to EU member states, 3 for satisfactory levels, 2 for deficiencies in conformity with EU requirements, and 1 reflecting severe deficiencies in conforming to EU norms.[7]

Coders, all doctoral students dealing with European integration, used the *Atlas.ti* software to create a high degree of inter-coder reliability. Two coders, independently of each other, coded each chapter simultaneously. In cases of disagreement a third coder was called in to make the final judgement. The use of the *Atlas.ti* software has the advantage of increasing the transparency of the coding process since it allows researchers to go over the coding and see on what basis a country was given a score.

The objective of this section is twofold: to discuss how we operationalized each of the inputs and outcomes of the three regulatory arenas, and to present basic facts and trends reflecting how these arenas develop in the run-up to EU membership.

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[5]Our sample is as follows (i.e. Progress Reports exist and were coded for the following countries for every year in these intervals): Albania 2005–2013; Bosnia 2005–2013; Bulgaria 1997–2006; Croatia 2005–2013; Czech Republic 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.

[6]For further details see data codebook (Bruszt and Lundstedt, 2016).

[7]For example, in 1999 we graded Poland 2 in the legislative state aid dimension, which is part of EU 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' (European Commission, 2000: 41). 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 (European Commission, 2003: 27); so our evaluation gave Poland a score of 3 for that dimension.

Judicial arena (Montesquieu channel)

Outcomes are measured in terms of both judicial capacity and judicial independence. Capacity refers to access to the necessary resources and expertise, while independence stresses autonomy and is defined in terms of the appointment and promotion of judges. EU norms establish basic parameters for the functioning of the judiciary. Conformity with these norms speaks to the workload and to delays in the workings of the judicial system.

Regarding the judiciary, we focus on three inputs that we expect to lead to the 'production' of capacity and independence. One regards the constitutional input (existence and strength of a Supreme Court), the second regards the workload ('behavioural input') and the third, the 'legal procedures input' of the judicial system.

The constitutional dimension of the judiciary centres on the existence and functioning of the Supreme (or Constitutional) Court. Important features of a Supreme Court endowed with the necessary powers are the possibility for citizens to refer complaints to the Supreme Court, and the inability of parliament and/or the executive to overturn the decisions it makes.

The workload reflects the operation of the judiciary. EU norms establish basic parameters for the functioning of the judiciary. Conformity with these norms speaks to workload and delays.

The third and last 'input' into judicial capacity and independence refers to the existence and effectiveness of legal procedures. This dimension reflects ease of access to the courts and the expected certainty of judicial decisions in terms of both their content and their enforcement. The scale used reflects again the degree of conformity with EU practices.[8]

Bureaucracy arena (Weber channel)

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

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 so 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.

We consider three key inputs into the Weberian channel, namely (1) the extent and quality of the training of civil servants, (2) the structure of the salaries of public administrators, and (3) whether the civil service law in place is appropriate and effective.

Competition policy arena (Smith channel)

The third dimension we consider is competition policy. The relevant national authority often goes by the name of the Competition Office, Competition Council or Division of Competition and State-aid. Some countries divide responsibilities between several bodies, while others have a single agency.

We evaluate three key inputs into the Smith channel: (1) alignment of anti-trust and merger legislation with EU requirements,[9] (2) resources available for the enforcement of anti-trust and merger legislation, and (3) procedural structures for market surveillance (with reference to the free movement of goods).[10]

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[8]This input 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. Note that any corruption concerns are reflected by this last item.

[9]Legislation on anti-trust and mergers includes legislation on competition, cartels, abuse of dominant market position, market concentration and restrictive practices.

[10]In the Progress Reports, these variables appear under 'Competition Policy' and refer to anti-trust and merger policy.

The 'resource input' into competition policy refers to the quantity and quality of staff, physical resources (computers and buildings) and financial resources. Procedural structures consist of the ability of the agency to use its competences and powers to operate independently. 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 that responsible authorities are in place, they are independent and impartial and they respect the principle of proportionality.

Outcomes from the Adam Smith channel capture 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 that is enjoyed by the competition authority.[11]

What do the data say?

This section tries to give a flavour of our measurement efforts by focusing on the six outcome variables. We compare the unweighted averages of capacity and independence of the bureaucracy, judiciary and competition policy for the 17 countries in our sample. For ease of exposition, we divided them into New Member States (NMS) and Candidate countries. Progress Reports for most of the former are available between 1997 and 2005, and for the latter between 2005 and 2013. We take advantage of these common nine-year windows to base each group on a different time window: NMSs 1997–2005 and Candidates 2005–2013.

There are three main worthwhile observations. The first is that irrespective of whether we examine NMSs (most of which have joined the EU by 2004) or Candidate countries (of which none has acquired member state status by 2013), in not one of the six institutional outcomes areas do we obtain an average indicating that these countries have reached a stage at which their institutions are satisfactorily comparable to those of the average EU member state. The highest average (3.5 out of 4 for the NMS group) is for independence of competition policy. This indicates that the experts preparing the Progress Reports do not view all countries that joined the EU as having achieved levels of institutional development fully comparable with the EU norm (as there are no 4s.) This suggests that measurement error due to political influence is not severe.

The second observation is that there is unexpectedly little difference between NMSs and Candidates at the start. Indeed, there is even one area (judicial capacity) in which Candidates' average score is higher than NMSs' at the beginning of the period. Of course, the beginning of the period is different with 1997 for NMSs and 2005 for Candidates, which may have allowed catch-up among the latter group. Yet the possibilildy that the institutional gap between NMSS and Candidates is not considerable at the start of their process of EU accession is an argument that is difficult to find in the literature.

The third observation is how surprisingly strong and clearly visible the pull from EU accession turns out to be. There is a clear and strong EU pull in judicial capacity and competition policy independence, almost no pull in judicial independence, and a strong pull in the remaining three areas. The final levels tend to be higher for *de jure* dimensions (independence) than for *de facto* dimensions (capacity). What makes this remarkable is that these changes happen over nine years (not nine decades) and that Candidate countries cannot be treated as counterfactuals. These are all EU candidates and the EU pull happens to all.

4. Identification and methodology

The objective of this section is to discuss three main methodological issues and clarify how we address them in this paper. One refers to implementation sequences, another to our identification strategy and

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[11]The independence aspect of the outcomes from competition policy comes from a different chapter and refers to the capacity to deliver market surveillance. 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.

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 enter in one-period lags (a one-year lag in this case). This choice ameliorates endogeneity concerns and lends itself naturally to a discussion of temporal implementation sequences.[12] A finding that a change last year is statistically associated with a change this year is interpreted as a temporal sequence. Given the inertia in institutional change, as shown in the previous section, in all specifications we include the lagged dependent variable on the right-hand side.

The second methodological issue refers to the conceptual framework we put forward and how we go about testing it. Recall it centres on the Montesquieu, Weber and Smith channels, each with a different set of inputs. We empirically implement this framework in two stages: 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 (that is, independence and capacity) can be explained by the three inputs, while in the second we add to our estimates the effects of the other two channels.

There are various caveats 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 analysed here. Second, there are other ways of carrying out this exercise (e.g. network analysis) but we believe the step-by-step approach we favour above is more transparent. Last, but not least, it is likely that other institutional reforms may be important, and their omission biases our results in important ways. The third issue is how to 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 options. One is the OLS fixed-effects panel estimator, of which the main advantage is that it is simple and standard. The use of country and year fixed effects would be helpful to ameliorate omitted variable biases, which may be important in this context. The second choice is the System GMM (Blundell–Bond linear dynamic panel data implemented in the Stata *xtdpdsys* facility) estimator, which has as its main advantage that it accounts for the presence of the lagged depended variable and hence is the natural choice for the estimation problem at hand. One issue these two options do not address is that most or our variables of interest are categorical and thus an estimator like the Ordered Probit would be a more satisfactory way of handling this matter.

We first observe that the use of these three estimators yields qualitatively similar results. We find that the key results are robust across the three estimators. Also note that measures of goodness of fit in both the fixed-effects and ordered probit cases is satisfactory and that for the System GMM two-step estimator, the AR(1) and AR(2) tests suggest that the instruments are valid and that the model is correctly specified. Given institutional inertia and the absence of substantial differences between these results, we decided to report and focus our analysis on the System GMM results.

The System GMM estimator is designed for unbalanced panels with a 'small T and large N' and the left-hand side variable is defined as dynamic in that it depends on its own past realizations (Plümper *et al.*, 2005). Moreover, the System GMM handles right-hand side variables that are not strictly exogenous and may be correlated with past and current realizations of the error term, (country-level) unobserved heterogeneity, measurement error and omitted variables, and potential heteroscedasticity and autocorrelation within or across individual units' errors. The System GMM approach seems the best option, especially because results do not differ qualitatively compared to OLS and probit. So we consider the following dynamic panel data model:

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

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[12]We assessed the trade-off between having the number of lags estimated specifically for each institutional area and decided for the benefits of transparency from the strategy of '1-year lag throughout'. The concern that institutions change very slowly to be captured by such choice is diminished in light of the results and discussion on the previous section.

where y_{it} can be one of six options (judicial independence or capacity, bureaucratic independence or capacity and competition policy independence or capacity), with α_j and p as parameters to be estimated, β_1 and β_2 as vectors of parameters to be estimated and the panel effects v_i and ε_{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 inputs, while w_{it} is a vector of exogenous covariates that may include the remaining five reform area outcomes.

5. Empirical results

In this section, we focus our presentation on the results for the Weberian channel (public administration or bureaucracy) and then use the diagrammatic scheme above to present all results succinctly and compare them with those for the judiciary and competition channels.

Table 2 presents our two-step 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 receives much empirical support. Civil service law, salaries and training in the previous period do not seem to be empirically associated with current level of bureaucratic independence.[13] Instead, this is better explained by other outcome variables (that is, inter- rather than intra-channel) such as bureaucratic, judicial and competition policy capacity.

Notice that this pattern of results (bureaucratic independence being better explained by outcomes other than its own inputs) does not change if we split the sample between the countries that have become EU members and those that have (so far) not. Moreover, the model seems to pick up well the fixed effects characterizing individual county features, because results are also unaffected by the addition of various other controls such as initial level of development (proxied by per capita income in 1989), economic growth rates, trade openness (the ratio of exports plus imports to GDP) and the evolution of political rights (proxied by the Freedom House index.) We also expect this to ameliorate omitted variable biases.

The last three columns of Table 2 show the results of the effects of the other five outcome variables on the level of bureaucratic independence. It shows the dominant role played by competition and judicial capacity in this case.[14]

Table 3 shows System GMM estimates for equations in which the dependent variable is bureaucratic capacity. First, we examine the relative importance of its own inputs and the main findings here are different from those for bureaucratic independence: inputs seem to be more important than the other outcomes. Civil service law and training in the previous year are positively (while salaries are negatively) correlated with the current level of bureaucratic quality. Another difference is that inertia is stronger: previous realizations of bureaucratic quality are strongly related to current levels of it while the same cannot be said for bureaucratic independence. Also note that we find previous levels of capacity are positive related to current levels of independence, so one can argue that the effect of the three inputs on independence is indirect, that is, it takes place through capacity.

The last three columns of Table 3 show the results of the effects of the other five outcome variables on bureaucratic quality. It shows that unlike the results we obtain for independence, the dominant role is not played by competitive and judicial capacities, but instead by inputs (that is, intra- rather than inter-channel), in particular by aligning domestic civil service law with EU standards and by training civil servants. Note that accounting for other outcomes turns the coefficient on salary, which was negative and statistically significant above, into a value that is statistically insignificantly different from zero.

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

[14]Notice that the coefficient for competition policy independence is negative and statistically significant. When we estimate the specification in column 8 excluding competition policy capacity, the coefficient for competition policy independence becomes positive and statistically significant.

Table 2. Determinants of the independence of the bureaucracy

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bureaucratic independence	0.558***	0.477***	0.816***	0.482***	0.546*	0.401**	0.600***	0.354
	[0.110]	[0.136]	[0.276]	[0.181]	[0.324]	[0.198]	[0.167]	[0.253]
Bureaucratic capacity	0.295***	0.255*	0.174	0.182	0.256*	0.191**	0.293	0.329**
	[0.0924]	[0.152]	[0.127]	[0.143]	[0.128]	[0.0934]	[0.220]	[0.164]
Civil service law	−0.00374	0.0529	−0.0905	0.0516	0.0549	−0.0793	0.0237	0.0369
	[0.0387]	[0.0939]	[0.0668]	[0.0477]	[0.0785]	[0.0560]	[0.0660]	[0.0648]
Training of civil servants	0.0194	0.0534	0.0134	0.0311	−0.0107	−0.00943	0.0201	0.0586
	[0.0221]	[0.0874]	[0.0247]	[0.0290]	[0.0418]	[0.0230]	[0.0572]	[0.0571]
Civil servant salary	−0.104	−0.0571	−0.0674	−0.111	−0.0463	−0.0328	−0.284	−0.366
	[0.0904]	[0.148]	[0.0842]	[0.100]	[0.0733]	[0.0942]	[0.353]	[0.348]
Income per capita, 1989		3.92e-05						
		[8.75e-05]						
Political rights (Freedom House)		−0.103						
		[0.0979]						
Economic growth				−1.05e-06				
				[7.64e-06]				
Trade openness					0.206			
					[1.408]			
Judiciary capacity						0.325**		0.208*
						[0.126]		[0.125]
Judiciary independence						0.179**		0.104
						[0.0839]		[0.116]
Competition policy, capacity							−0.0736*	−0.0807**
							[0.0441]	[0.0383]

(Continued)

Table 2. (*Continued.*)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Competition policy, independence							0.375***	0.318***
							[0.122]	[0.0797]
Constant	0.684***	0.436	0.682*	0.895***	0.836***	0.207	0.479*	0.383
	[0.121]	[0.534]	[0.400]	[0.162]	[0.212]	[0.363]	[0.277]	[0.404]
AB test AR(1)	0.0337	0.0248	0.0614	0.0782	0.0774	0.0417	0.0328	0.0655
AB test AR(2)	0.2533	0.3069	0.4720	0.3988	0.2571	0.544	0.8966	0.8022
Observations	104	84	104	93	94	104	104	104
Number of id	16	13	16	16	16	16	16	16

Notes: All right-hand side variables enter one-period (year) lags. System GMM two-step estimates. Standard errors in brackets. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 3. Determinants of the capacity of the bureaucracy

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bureaucratic independence	0.724***	0.665***	0.748***	0.725***	0.684***	0.741***	0.593***	0.450*
	[0.125]	[0.126]	[0.121]	[0.174]	[0.116]	[0.125]	[0.189]	[0.245]
Bureaucratic capacity	0.0503	0.109	−0.0226	0.0813	0.0540	0.0623	0.0623	0.0415
	[0.0783]	[0.119]	[0.0482]	[0.0988]	[0.0805]	[0.0878]	[0.0731]	[0.0995]
Civil service law	0.124**	0.0473	0.158***	0.126*	0.132**	0.125*	0.110	0.137*
	[0.0606]	[0.0880]	[0.0462]	[0.0651]	[0.0555]	[0.0705]	[0.0755]	[0.0819]
Training of civil servants	0.130***	0.185**	0.128***	0.105***	0.110***	0.129***	0.120***	0.114**
	[0.0304]	[0.0819]	[0.0338]	[0.0352]	[0.0343]	[0.0433]	[0.0417]	[0.0507]
Civil servant salary	−0.222**	−0.101	−0.269**	−0.276**	−0.204*	−0.236***	−0.191	−0.0812
	[0.0983]	[0.127]	[0.125]	[0.108]	[0.113]	[0.0819]	[0.137]	[0.206]
Income per capita, 1989		3.02e-05						
		[8.05e-05]						
Political rights (Freedom House)			−0.233**					
			[0.0960]					
Economic growth				2.26e-05**				
				[1.05e-05]				
Trade openness					0.929			
					[0.818]			
Judiciary capacity						−0.0257		0.0157
						[0.0523]		[0.0982]
Judiciary independence						0.0901		0.116
						[0.134]		[0.170]
Competition policy, capacity							0.0422	0.0323
							[0.0542]	[0.0497]

(*Continued*)

Table 3. (*Continued.*)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Competition policy, independence							−0.0840	−0.0573
							[0.100]	[0.177]
Constant	0.367**	0.0538	0.935***	0.413**	0.548***	0.182	0.617**	0.318
	[0.165]	[0.511]	[0.251]	[0.196]	[0.168]	[0.319]	[0.247]	[0.574]
AB test AR(1)	0.0031	0.0557	0.0038	0.0118	0.0074	0.0034	0.0166	0.0417
AB test AR(2)	0.8413	0.2008	0.6095	0.2470	0.9590	0.6456	0.8264	0.9496
Observations	104	84	104	93	94	104	104	104
Number of id	16	13	16	16	16	16	16	16

Notes: All right-hand side variables enter one period (year) lags. System GMM two-step estimates. Standard errors in brackets. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.
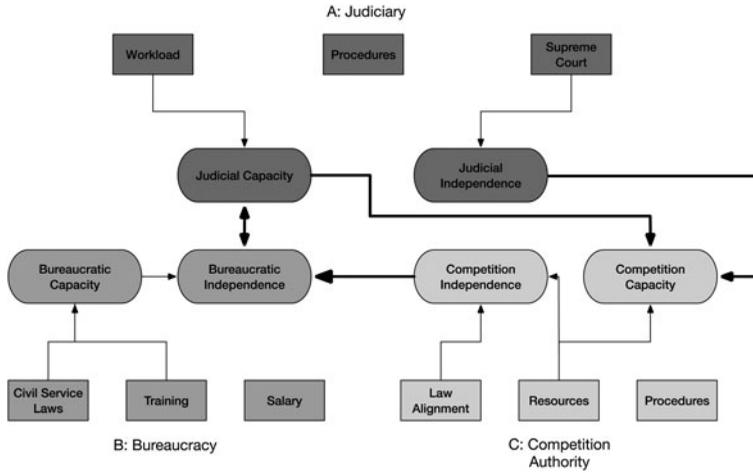
Figure 2. Diagrammatic representation of main econometric results

The level of inertia we observe for bureaucratic capacity is stronger than the one we estimate for independence. 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.

We repeat the same exercise for both the judiciary and competition (Montesquieu and Smith channels) but devise a more economical way to report and discuss our results than a standard tabular format. As a departure, we use Figure 1, which shows all three channels, their inter-relationships and all inputs we assess in each one of them to build Figure 2, which only shows those links for which we find robust econometric support (represented by arrows).

Starting with the Montesquieu channel, our results indicate that the only input driving judicial capacity is workload, while the only input driving judicial independence is the effectiveness of the Supreme Court. Neither procedures nor the Supreme Court affects judicial capacity in a sequential manner. By the same token, neither procedures nor the workload affects judicial independence. We also find an interesting link from judicial capacity towards competition policy capacity.

However, our most important result is the intricate, self-reinforcing, bidirectional relationship between judicial capacity and bureaucratic independence. Judicial capacity in the previous year is positively related to bureaucratic independence in the current year. And uniquely among our results (as can be seen in Figure 2, this is the only case in which arrows go both ways), bureaucratic independence in the last period is positively related to judicial capacity in the current year. It can be said that this is the key relationship because it is the end point for all robust sequences we uncover.

Regarding the Smith channel, 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, in its turn, is shown to increase bureaucratic independence. On the Montesquieu channel, we note a sequence from the Supreme Court in a previous period towards improvements in current levels of judicial independence that, in its turn, is related to improvements in the quality of the enforcement of competition policy in future periods.

In summary, using the framework, measures and methods discussed above we document that deep integration indeed contributes to increases in key state capacities and throw 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 prospect of becoming an EU member. In short, inter-channel seem to predominate over intra-channel changes and the link between judicial capacity and bureaucratic independence seems central.

6. Conclusions

The objective of this paper was to investigate whether and how deepening integration increases state capacity. To do so, we constructed a conceptual framework (Montesquieu, Weber and Smith channels) and used a new panel data set on the accession process to the European Union of central and eastern European countries.

We find, first regarding the bureaucracy, that inputs such as the training and the quality of civil service law positively affect the capacity of the bureaucracy, which in turn affects bureaucratic independence. Regarding the Montesquieu channel, we find strong support for the notion that the sooner there is progress in establishing an independent constitutional court, the faster countries were able to put in place an independent judiciary. Our findings also support the shared expectation of Montesquieu and the authors of the Federalist Papers: progress in judicial independence increases the capacity of the state to uphold the freedoms of market, by way of strengthening the enforcement of anti-trust regulations. We find limited support for the notion that market reforms will further state reform on their own. The enforcement of anti-trust regulation does not have the expected effect on other key aspects of the state reform, such as the transformation of the judiciary. On the contrary, it is the increase in judicial capacity that seem to lead to improvements in enforcement of anti-trust regulation. Similarly, our empirical results do not support the hypothesis that supply-side reforms focusing solely on one of the core state institutions could on their own yield encompassing institutional change. Instead, we found an intricate, central and bidirectional relationship between judicial capacity and bureaucratic independence. This crucial relationship is the only case for which we find evidence of a self-reinforcing relationship and this proves that the political economy approach introduced in the theoretical section is right (Brousseau *et al.*, 2010). Complementary reform of these core state institutions forms a nucleus of the sequences of institutional reforms.

Our findings have key implications for the literature on externally induced institutional change. Deep integration might induce encompassing institutional change by providing incentives for and external anchoring of simultaneous change in core state institutions. These changes might help the coming about of a new supporting bloc of actors whose rights were extended by a capable and autonomous bureaucracy, steeled by a capable judiciary. But, as the example of Hungary and Poland has recently demonstrated, the early removal of external anchors might also set in motion backsliding in domestic institutional change. Political elites in both countries have started re-establishing previous privileges by removing the independence of the constitutional court, retaking control over the judiciary and re-politicizing the bureaucracy. The lack of enforceable EU standards on core state institutions have prevented effective external intervention in these processes.

Our findings may open various avenues for future research. We highlight three. One is that future research should further investigate each of the three key arenas above. The second is that future researchers should consider additional arenas and try to empirically assess whether such alternative channels alter our findings. The third suggested direction for future research is to investigate the economic and political implications of these increases in state capacity. This could be done by addressing questions such as: Do they have clear effects, like increases in income or exports or decreases in inequality? What are the domestic political conditions that could help the stable lock-in of the upgraded core state institutions? When could the external anchoring of domestic institutional change be declared superfluous?

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