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IMPERIAL LEGACY?  
THE EU'S DEVELOPMENTAL MODEL AND  
THE CRISIS OF THE EUROPEAN PERIPHERY  
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## ABSTRACT

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The high hopes for rapid convergence of Eastern and Southern EU member states are increasingly being disappointed. With the onset of the Eurocrisis convergence has given way to divergence in the southern members, and many Eastern members have made little headway in closing the development gap. The EU's performance compares unfavourably with East Asian success cases as well as with Western Europe's own rapid catch-up to the USA after 1945. Historical experience indicates that successful catch up requires that less-developed economies to some extent are allowed to free-ride on an open international economic order. However, the EU's model is based on the principle of a level-playing field, which militates against such a form of economic integration. The EU's developmental model thus contrasts with the various strategies that have enabled successful catch up of industrial latecomers. Instead the EU's current approach is more and more reminiscent of the relations between the pre-1945 European empires and their dependent territories. One reason for this unfortunate historical continuity is that the EU appears to have become entangled in its own myths. In the EU's own interpretation, European integration is a peace project designed to overcome the almost continuous warfare that characterised the Westphalian system. As the sovereign state is identified as the root cause of all evil, any project to curtail its room of manoeuvre must ultimately benefit the common good. Yet, the existence of a Westphalian system of nation states is a myth. Empires and not states were the dominant actors in the international system for at least the last three centuries. If anything, the dawn of the age of the sovereign state in Western Europe occurred after 1945 with the disintegration of the colonial empires and thus historically coincided with the birth of European integration.

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# IMPERIAL LEGACY? THE EU'S DEVELOPMENTAL MODEL AND THE CRISIS OF THE EUROPEAN PERIPHERY

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## 1. Introduction

The Eastern and Southern enlargements of the European Union (EU) gave rise to strong hopes for a rapid convergence of the new members towards the per capita GDP levels of the North-Western core countries. Increasingly, these hopes are being disappointed. With the onset of the Eurocrisis in 2010 convergence has given way to divergence in the southern member states as especially the countries that are receiving EU/IMF assistance are experiencing a dramatic decline in their GDP. More than twenty years after the disintegration of the Soviet Empire many of the Eastern member states of the EU have made little headway despite increasing prosperity. Per capita GDP measured as a percentage of the German level in Hungary, Latvia and Lithuania has barely made any progress at all since 1991. In Poland and Estonia instead, convergence takes place at such a slow speed that it would take far over a century to complete it. The EU thus compares unfavourably to the trajectories of the Asian success cases such as 19th and 20th century Japan and post WW2 South Korea, Singapore, Hong Kong and Taiwan. Indeed the current trajectory also compares unfavourably to Western Europe's own rapid catch-up to the USA after 1945. Given Europe's disappointing performance, there is a need to rethink the European model of development. Historical experience seems to indicate that successful catch-up requires an activist developmental state which helps create comparative advantage and to that extent temporarily discriminates against foreign competitors in favour of nascent domestic firms. Put differently, successful catch up requires that less-developed economies to some extent are allowed to free-ride on an open international economic order.

A necessary – but by no means sufficient – condition for successful catch-up within the framework of the EU would thus be that European integration incorporates such possibilities for free-riding by less developed members in its developmental model. Instead, the EU's model is based on the principle of a level-playing field in which discrimination is considered an unfair practice. Although already included in the Rome Treaties, it was only with the Single European Act (SEA) of 1986, the deregulation of cross-border capital flows since 1998, the agreement on Economic and Monetary Union (EMU) followed by the creation of the single market in financial services and the strengthening of competition policy since the 1980s that the notion of “level-playing field” came to dominate the EU's developmental model. Accordingly, that model increasingly contrasts with the various strategies that have enabled successful catch up of industrial latecomers. Instead the EU's approach, both in terms of mechanism and outcomes is more and more reminiscent of the relations between the pre-1945 European empires and their dependent territories.

One reason for this unfortunate historical continuity is that the EU appears to have become entangled in its own myths. The official view sees integration as a peace project designed to overcome three centuries of almost continuous war in the Westphalian system of sovereign (nation) states. As the sovereign state is identified as the root cause of all evil, any project to curtail its room of manoeuvre must ultimately seem to the benefit of the common good. Yet, the existence of a Westphalian system of nation states is a myth. Empires and not states were the dominant actors in the international system for at least the last three centuries. As its imperial legacy has disappeared from view, so has the fact that, European empires failed dismally in their self-proclaimed task of propelling their dependent territories to prosperity. As a result of this historical blind spot the EU's hope of becoming a “model power” for the rest of the world seems vain. Rather than marking the return to the inter-

national prestige it enjoyed during the 19th century, Europe's new empire may rather mark the last phase of its international decline.

The remainder of this paper is structured as follows: Section two argues that if there ever was an age of the nation state in Western Europe it coincided with its alleged demise after 1945. Section three reviews the obstacles to convergence in the age of empires. Section 4 argues that whereas the successful catch-up of West European economies after 1945 was predicated on a heavily interventionist state, the developmental model the EU applies to its periphery is very much the opposite. Section five concludes by arguing that, at least in the short to medium term, the prospects for solving the EU's crisis are dim. Because competitiveness has replaced comparative advantage as the alleged key to success in the global economy, the EU has turned economic development into a zero-sum game such that successful catch-up by the periphery will almost inevitably be interpreted as a threat by the core states.

## 2. When was the Westphalian System of Sovereign States?

European integration is commonly interpreted as a breath-taking new departure, coming as it did after the three-century-long reign of the Westphalian system in which states jealously guarded the absolute sovereignty they enjoyed within their clearly defined borders while trying to increase their power by means of warfare. The beginning of European integration hence appears as a *Stunde Null*; an entry unto new and uncharted territory with the implication that the past can provide little guidance to the future other than that a failure to encroach on the prerogatives of the members states in favour of supranationalism will doom Europe.

The Westphalian system takes its name from the Peace Treaty of 1648 that ended the thirty years war. The international system it is said to have ushered in differed in three respects from what went before.

First, state boundaries were precisely defined replacing the medieval system of frequently overlapping territories. Secondly, within these borders states enjoyed absolute sovereignty. Thirdly, the principle of Westphalian sovereignty implied acceptance of the principle of non-intervention in the domestic affairs of other states.

Historical research has not been kind to the hypothesis of a Westphalian system. One line of criticism focuses on the account of the treaties that has entered most International Relations texts. The treaties as such in no way were the watershed they are depicted to have been. Some features of the Westphalian system existed prior to it and others came into being only later. (Durchhardt 1999:308). The principle of *cuius regio, eius religio* was abolished instead of established by the treaties (Osiander 2002: 272). Nor did the treaties enshrine the principle of inviolable Westphalian sovereignty as the non-German signatories, France and Sweden, reserved the right to intervene on the territory of the Holy Roman Empire of German Nation (Winckler 2009: 125-6).

More relevant for the current purpose, is the fact that violation of Westphalian sovereignty was and remained the norm rather than the exception (Krasner 1999). The main reason for this was that power disparities between political units made empires and not states the dominant political actors. As John Darwin (2007: 23) has expressed it elegantly: "Indeed, the difficulty of forming autonomous states on an ethnic basis, against the gravitational pull of cultural or economic attraction (as well as disparities of military force), has been so great that empire (where different ethnic communities fall under a common ruler) has been the default mode of political organization throughout most of history. Imperial power has usually been the rule of the world." (See also Osterhammel 2009 Ch. 8; Tilly 1997: 2).

Empires, in contrast to nation states do not derive legitimacy from a common national identity but are multi-ethnic constructs with a more or less pro-

nounced hierarchical order between the various territories that constitute it. Empires do not have precisely defined borders, because, as was often the case with European colonial empires, on their frontiers they met grey zones of uncertain political belonging. Finally empires generally lay claim to authority beyond their borders, through such constructs as informal empire and zones of influence.

European empire building had started with Vasco Da Gama's rounding of the Cape in 1498 and Columbus' voyages to the Americas, which would result in Portugal, Spain, France, England, and the Netherlands each acquiring vast overseas possessions. But the empires of the Atlantic powers were by no means the only ones. After 1480 the Muscovite Rus commenced an unrelenting expansion that eventually resulted in an empire spanning almost all the length of Eurasia. The conquest of Constantinople in May of 1453 lay the foundations of the Ottoman Empire, which controlled the Balkans, Anatolia, the modern Middle East and most of North Africa at the height of its power.

To the north-west of the Ottoman Empire, substantial areas from modern-day Ukraine and Poland, the northern Balkans, Bohemia and Northern Italy formed part of the Austro-Hungarian empire. Further to the North lay Prussia, no doubt the least of the European empires until well into the 19th century. Its rise dated from the conquest of Silesia in 1740, one of Austro-Hungary's richest provinces. Almost annihilated by Napoleon, it emerged from the peace of 1815 with substantially expanded possessions in the Rhineland. Apart from Scandinavia, where Sweden largely had to abandon its imperial ambition on the continent by the 18th century, paradoxically only the non-Prussian parts of the misnamed Holy Roman Empire of German Nation, Switzerland and parts of Northern Italy were governed by political units that were both too small and internally too homogeneous to be classified as empires.

Nor would it seem correct to locate the start of the age of the nation-state in the 19th century. Also in this case historical research has not been able to un-

earth much evidence for the hypothesis that in 19th century Europe organic national communities united by a strong common identity successfully managed to overcome imperial rule. Instead 19th century nationalism appears primarily an elite driven-strategy with only limited success (Bayly 2004: 205; Gellner 1981, Hobsbawm 1992, Tilly 1994). For local elites, nationalism held out the lucrative prospect of gaining control of the monopoly to tax, but it was tempered by the improbability of survival as an independent state in a world of empires.

19th century Europe witnessed the rise of only eight new states. Five of them had previously been part of the Ottoman Empire (Greece 1832, Romania 1856, Montenegro 1860, Serbia and Bulgaria 1878). The remaining three states were Belgium, Germany and Italy. Belgium was created in 1830 after having been part of the Netherlands for 15 years. Italy was united in stages between May 1859 and September 1870. Germany was unified under Prussian leadership after the war of 1870-71 against France.

Whether and when new states did emerge had little to do with the strength of nationalist movements but much more with great power politics (Davies 1997: 815). The Balkan states including Greece owed their existence to a common British, French and Russian interest in weakening the Ottoman Empire. Not surprisingly, these new states did not enjoy Westphalian sovereignty but essentially exchanged formal incorporation into an empire for membership in the informal empires of France and Britain.

Prussia very likely would not have succeeded in unifying Germany against the wishes of Austria if the Crimean war had not broken up the Austro-Russian alliance. Likewise Italian independence would have been impossible without French support aimed at weakening the Austrian Empire and without the Prussian-French war that toppled Napoleon III and allowed the Italian government to seize the papal states (Winckler 2009: 812). The Belgian revolt against the Netherlands would hardly have succeeded

without the support of French troops and British diplomats, as well as the refusal of Prussia and Austria to side with Czar Nicolas I who was eager to intervene on the side of the Dutch king (Winckler 2009: 516-7). Unlike the Balkan states, Belgium, Germany and Italy could mount a stronger claim to Westphalian sovereignty, but this exactly defined their anomalous position as states without dependent territories. Belgium overcame this anomaly when its king managed to convince the participants of the 1885 Berlin Congress to grant him the lion's share of the Congo basin. German foreign policy increasingly came to focus on acquiring imperial possessions, especially after Chancellor Bismarck's resignation in 1890. Italy was soon to direct its attention towards northern Africa. Having lost its overseas territories at the end of World War 1, the German conviction, shared equally in Japan, that a densely populated nation-state heavily dependent on trade would hardly be able to defend its independence in a world of empires became one of the main causes leading to World War 2; particularly after the Great Depression when many European nations were tempted to withdraw behind the protective walls of their empires.

The disintegration of the Ottoman and Habsburg Empires and President Wilson's insistence on the nationality principle for redrawing borders did create a host of new nation states, while simultaneously extending the French and British (informal) empires in the middle east. Yet, for Eastern and Southern European nations independence was short-lived as they were gradually drawn into Germany's informal empire followed by inclusion in its formal empire, again to be exchanged for a somewhat longer lasting inclusion in the Soviet Empire.

At best, one could argue that the nation state became the prevalent form of political organisation in Western Europe only after 1945. Decolonisation reduced Belgium, the United Kingdom, the Netherlands and Italy from empires to nation states. The defeated Germany had lost its Eastern Empire and a significant chunk of its own territory to the Soviet Union.

Moreover, as a result of the combined effects of the Great Depression and War, international economic relations remained far more regulated than they had been before 1914 and national governments thus exerted a much strengthened authority over their own territory. Accordingly, the age of the nation-state coincided with its alleged demise at the hands of European Integration.

Moreover, since its inception in 1958 the EU (EEC) gradually acquired all the salient attributes of an Empire (Zielonka 2006; Anderson 2007:19). It does not derive legitimacy from a common national identity, but is a "multi-ethnic conglomerate held together by transnational organizational and cultural ties," to use Deepak Lal's (2003: 29) definition of empire. Like an empire, the EU has fuzzy borders and multiple power centres. Not being a governance structure for a clearly delineated and easily recognisable nationality, the question of where the natural borders of the EU lie can only have more or less arbitrary answers. Like empires, the EU reaches beyond its borders. The informal empire of the 19th century finds its corollary in the EU's various neighbourhood programmes, which seriously compromise the sovereignty of these states (Zielonka 2008).

Of course, the mechanism and forms of this new supranational construct were novel; but then again, this equally applied to the succession of different empires that had populated the globe in earlier times. With some exceptions, smaller entities were often forcefully incorporated into Europe's pre-1945 empires. Post-1945 enlargement of the EU functioned according to a fundamentally different principle, especially since the 1993 EU Copenhagen summit when strict eligibility criteria were set for new entrants. Yet, this different mechanism of enlargement does not suffice to make the EU an entity sui generis. The pre-1945 empires could not have survived for as long as they did without being able to count on the cooperation of local elites that perceived clear benefits from the arrangement (Hobsbawm 2008: 79-80). Essentially, what held those empires together was that they pro-

vided both political and economic security to the core and held out the promise of political and economic modernization to the periphery. In important respect, the motives that drove European integration were thus similar to the gravitational pull that allowed empires to overcome the centrifugal forces of nationalism.

After having lost its Indonesian colony, the Dutch government expected economic catastrophe and eagerly looked to gain better access to European markets. Much the same held true for West Germany which had seen its traditional trade relations with the East cut off. In addition, of course, integration with its European neighbours was a necessary condition for Germany to regain its sovereignty. Britain's initial refusal to join the Common Market had much to do with a mistaken belief in the continuing strength of its empire.

For France, much of the attractiveness of European integration derived from the possibility to undo at least some of the radical drop in status it had experienced as a result of the Second World War. With Germany unable to lead, integration held out the promise of increasing France's standing in the world by placing it at the head of a European block. Moreover, integration also helped France to hold on to what was left of its empire. Robert Schuman may have presented the ECSC (European Coal and Steel Community) as a means to make war between Germany and France impossible, but securing German coal for its steel industry certainly helped France continue its colonial wars. In addition, part of the concessions France obtained for its agreement to the Common Market consisted in EEC financial support for the cost of the remaining French empire.

For the countries that joined the EU in the 2004 and 2007 enlargements, prosperity and security from a possible reawakening of Russian appetites provided the crucial motives for relinquishing part of their sovereignty almost the moment they had regained it. Similarly for what is now the southern periphery of

the Eurozone, probably the most decisive argument in favour of EU membership was economic modernisation.

Hence, the emergence of European integration, in a sense, may be considered business as usual as it confirmed that Westphalian states rarely are viable entities in the international system. When Jean Monnet was voicing his conviction that the resources of the nation states no longer sufficed (Bache & George 2006:95), he was not so much expressing a radically new view but a rather widespread conviction that empire was necessary for prosperity.

Blotting out Europe's imperial past in favour of an imaginary Westphalian system, however, serves to seriously constrain the understanding of European integration. First, as Jan Zielonka (2006), and others. (Beck & Grande 2010, Colomer 2007) have pointed out, awareness of the historical role of empires helps to discern alternative future trajectories beyond the unhelpful dichotomy of a United States of Europe versus the dominance of the nation state. Secondly, by postulating that the dominance of (nation) states is coterminous with warfare, successful integration becomes coterminous with more supranationalism and a-priori excludes the possibility that (certain forms of) supranationalism may in fact be inimical to successful integration. Third, seeing the Westphalian state as the historical standard, European integration becomes a construct *sui generis*, which means that Europe's past cannot hold many useful lessons.

In contrast, the realisation that "supranational" empires have traditionally been the dominant actors in international relations, almost inevitably invites comparison of the EU to its imperial predecessors. How does the EU differ from these previous supranational constructs? What were the strengths and weaknesses of such Empires and how can the former be amplified and the latter avoided in contemporary Europe?



	<b>1500</b>	<b>1600</b>	<b>1700</b>	<b>1820</b>	<b>1870</b>	<b>1913</b>	<b>1950</b>
Total Western Europe	774	894	1024	1232	1974	3473	4594
Total Western Offshoots	400	400	473	1201	2431	5257	9288
Total Latin America	416	437	529	665	698	1511	2554
Japan	500	520	570	669	737	1387	1926
Total Asia (excluding Japan)	572	575	571	575	543	640	635
Africa	400	400	400	418	444	585	852

Source. Maddison 2001: 264

### 3. Economic Convergence in the Age of European Empires

The main weakness of the European empires, no doubt, was the failure to develop their peripheral areas. Although generally justified in terms of a mission to bring civilisation and prosperity to its colonies, European overseas imperialism coincided with a “Great Divergence” in per capita GDP levels in the world economy. Europe did already have a head-start at the beginning of the 16th century, but at that point, according to the estimates of Angus Maddison, Asian per capita GDP still stood at roughly 74% of the West European level. By 1950 it had fallen to about 14% (Table 1).

The official justification underlying 19th century European attitudes towards development of the periphery, as well as much of current thinking, was that free trade, free capital movements and gold standard membership would suffice to bring about convergence. European industrialisation did indeed create buoyant markets for the producers of primary goods in the periphery and a stream of foreign investment (mainly British) that helped to create the necessary infrastructure for this trade. Especially from the 1870s to 1914 solid export growth allowed many primary producers to record rates of GDP

growth comparable to those in the core countries (Findlay & O’Rourke 2007: 414-15). But specialisation in primary products did not lay the foundations for sustained convergence as spectacularly demonstrated by, for example Argentina whose per capita GDP in 1913 was on a par with that of the industrialised countries (della Paolera & Taylor 2001: 7).

What was needed for sustained convergence was diversification and especially a domestic manufacturing base (Williamson 2006: 147), and this in turn required high levels of investment, i.e. strong investment demand had to be matched by an ample supply of investment funds. As argued in early work by Alexander Gerschenkron (1962), and subsequently confirmed by more recent research (Amsden 2004; Chang 2003; Lin & Chang 2009; Reinert 2007; Rodrik 2007), late development of manufacturing depended critically on active state involvement. Partly due to economies of scale, underdeveloped systems of investment finance, long learning curves in manufacturing, coordination problems due the imperfect tradeability of intermediate goods and the absence of a domestic entrepreneurial class, less-developed economies could not hope to catch-up by relying entirely on the market mechanisms.

As first argued by Alexander Hamilton (1791) and later popularised and diffused in Europe by Friedrich

List (1885), one upshot of this view was that nascent industries required tariff protection. Although such infant industry tariffs came to be widely employed in the periphery, especially since the interwar period, the strong focus on tariffs was misplaced. Tariffs were one and not even a necessary element in a broader strategy of late industrialisation. The use of tariffs alone would suffice only if a nascent industry was already present or could be assumed to spring up automatically in response to changed price signals. Lack of industrial experience and the many coordination problems involved in creating a diversified manufacturing base from scratch implied that such was not necessarily the case. Late industrialisation thus required a broader strategy of what (Chang 2003) has called Industrial, Technology and Trade policies (ITT). ITT strategies in general comprise a mix of horizontal and vertical state aid, such as upgrading of the education system and the transport infrastructure, promotion of research & development, model factories, state owned companies, subsidies to priority sectors as well as selective credit allocation, preferential access to foreign exchange, dual exchange rates or undervalued currencies.

At first sight, interference with open capital markets and the rejection of fixed exchange rates, the other pillars of classic European liberalism, might not seem to be in the interest of convergence. Foreign investment, of course would allow the periphery to accumulate capital at a much faster rate than by relying on domestic savings alone. Moreover, there is substantial evidence that adherence to the Gold Standard lowered borrowing costs (Obstfeld & Taylor 2003) and promoted trade (Flandreau & Maurel 2005). Yet, financial and monetary integration often turned out to be a two-edged sword. Exchange rate manipulation could effectively complement or substitute tariffs in promoting domestic manufacturing. Indeed, India was placed on the Gold Standard by the British administration in 1892 mainly because its depreciating silver standard was seen to confer an unfair advantage on its exports. The advantages of lower borrowing costs could be easily offset by the destabilising effects

of a speculative overexpansion of credit followed by a sudden drying up of foreign funds. The costs would multiply if default and devaluation were eschewed in such a credit crisis in favour of austerity and defence of the gold parity (McLean 2006). Indeed, many analysts of the pre 19-14 Gold Standard concluded that it served to destabilise peripheral members (Galarotti 1995:37-41; Notermans 2012). Finally, adherence to the Gold Standard in times of relative gold scarcity would inhibit the ability of monetary policy to promote an ample supply of domestic investment funds necessary for sustained growth.

As state-led development strategies proved necessary for catch-up, the relation of peripheral countries to the metropolitan areas was of crucial importance. Colonies were most restrained in this respect as they were not permitted significant deviations from the free trade doctrine and colonial administration did not count industrial development amongst their priorities. As Josiah Child (Child 1751), director of the British East India Company, had already set out in 1751, European nations should assign their colonies to the role of suppliers of raw materials and consumers of European goods and investment while preventing them from turning into competitors for European manufactures. As a result none of the colonies managed to catch up under European rule and India, which clearly was technologically more advanced than Britain in the crucial area of textiles as late as the beginning of the 19th century, experienced substantial de-industrialisation under British rule (Ferguson 2004: 369).

Partly as a reaction to the revolt of the American colonies in the late 18th century, the British dominions of Canada, Australia and New Zealand, enjoyed much more autonomy. Home Rule, was granted to all of them early on, and this included the right to set their own tariffs; a right which they used liberally in an effort to promote their own industrialisation (Findlay & O'Rourke 2007: 395). Moreover, the Dominions benefitted from a continuous inflow of British and Irish immigrants which brought with them the skills

and entrepreneurial experience most colonies were lacking, while Australia, in addition received large amounts of British subsidies in the first decades after the founding of a British penal colony there in 1788 (Boot 1998). As a result the British dominions, alongside the breakaway colony of the USA were the only countries to successfully close the development gap with Europe before Japan embarked on its ascent in 1868.

Although they were less constrained than the colonies, the techniques of informal imperialism meant that even formally independent states might enjoy less autonomy in some crucial policy areas than the dominions in the British system (Gallagher & Robinson 1953). Especially since the second half of the 19th century European colonial powers employed such techniques to open markets, secure supplies of raw materials and protect its investors from sovereign default. Japan, China, the Ottoman Empire and a host of other countries signed so-called unequal treaties that seriously circumscribed their sovereignty; especially with respect to tariffs, market access and trade. (Findlay & O'Rourke 2007: 400-402). Ottoman tariff autonomy, for example had already been largely lost in 1838 in exchange for British support against Egypt's Mehmed Ali Pasha, and was never recovered. Sovereign default repeatedly served as another route through which European powers constrained the economic policy options of independent territories (Fishlow 1985: 403-4). The 1832 treaty recognising Greek independence, for example, limited its fiscal autonomy in the interest of debt service. Not unlike the proposals floated by Merkel and Sarkozy in February of 2012, western creditors placed fiscal policies under the control of the International Finance Commission (IFC) when the country proved unable to service its debt after defeat in the war with the Ottoman Empire in 1897. The IFC controlled a large part of public revenues and had a veto on the issuing of new debt. (Andreopoulos 1988; Lazaretou 2004). In response to the Ottoman default of 1875, Britain and France established the Public Debt Council which effectively placed the management of Ottoman public finances

into their hands (Anderson 1964, Pamuk 1987). Similar devices were used in the Balkans (Tooze & Ivanov 2011). In Egypt, where Anglo-French control of public revenues after the sovereign default of 1875 provoked a nationalist backlash, the British instead saw it necessary in 1882 to proceed from informal empire to occupation.

But a considerable degree of autonomy from the European empires was a necessary but not a sufficient condition for successful development because autonomy neither implied a willingness to pursue such policies nor the presence of a state apparatus that could prevent such a strategy from degenerating into pure rent-seeking. In 19th century agricultural exporters such as Argentina and Brazil as well as the confederate US states, policies of forced industrialisation could not necessarily command political support, particularly in times of improving terms of trade. The production of export crops by means of a latifundia system created a strong interest of the political elites in free trade, exchanging agricultural exports for manufactured imports. When many Latin American countries did embark on an inward looking development policy since the Great Depression serious problems of crony capitalism developed. The constellation was much the opposite in the Northern states of the USA, which became the most successful early case of catch-up after they had broken away from the British Empire in the late 18th century and embarked on highly protectionist trade policies.

In the end, outside of the European offshoots the conditions for successful convergence before 1945 were only met in Japan. The threat of colonisation and the absence of concentrated primary good exporters ensured the political primacy for a programme of forced industrialisation after 1868. Japan did not enjoy tariff autonomy between 1858 and 1911 but this handicap was compensated for by extensive use of horizontal and vertical state aids. An exceptionally centralised and efficient state apparatus insured that such strategies could be implemented efficiently. The central government's ability to raise substantial tax

revenues made this strategy invulnerable to excessive foreign indebtedness. Indeed, the example of the British occupation of Egypt in 1882 provided a strong incentive in the first decades of the Meiji era to avoid significant foreign public indebtedness (Jansen 2000: 373), and for similar reasons private foreign direct investment was discouraged. Finally, Japan joined the Gold Standard only in 1897, a time when silver-based currencies were appreciating (Mitchener, Shizume & Weidenmier 2010: 29).

#### 4. The Crisis of the European Periphery

The post-1945 history of Western Europe itself confirms that catch-up required an interventionist state and the active management of international economic relations. After two world wars and one Great Depression, Western Europe's lead over the rest of the world by 1945 had been lost. In 1950 French, German and Italian per capita GDP stood at 55%, 41% and 37%, respectively, of the US level (Maddison 2001: 264). Economic catch-up then became the most pressing priority of West European governments.

The initial American plans for the post-war order might have hindered convergence as they envisaged free trade, fixed exchange rates, current account convertibility and the end of European imperial preferences; a combination which would have allowed the US to exploit its economic superiority to the full. With the emergence of the cold war, that programme was unceremoniously scrapped in favour of the Marshall plan, a massive devaluation of almost all West European currencies against the Dollar in 1949, and support for closer economic cooperation which allowed Europe to discriminate against US trade.

Hence it was with US support that Western Europe tackled the task of catch-up on the basis of a further substantial increase in the role of public authorities in economic management. In Britain, the Labour government of Clement Attlee, elected in late 1945, embarked on a programme of nationalisation of strategic industries. The French government, and to a

lesser extent the Dutch one, instituted an ambitious programme of indicative planning in what was to become a highly successful policy of forced industrialisation. Tax policy in virtually all countries was designed to promote industrial investment. Similarly, almost all governments kept interest rates low while employing selective credit rationing in order to channel investment funds to priority sectors and keep inflationary pressures arising from the monetary overhang at bay. Public involvement in wage-bargaining increased significantly with a view to keeping inflation down and promoting the competitiveness of manufacturing, the extreme case being the Netherlands where wages were de facto set by the government until well into the 1960s.

Highly cautious liberalisation of external economic relations was part and parcel of this strategy. No attempt was made to resurrect the Gold Standard. Contrary to what had been envisaged at Bretton Woods in 1944, currencies remained inconvertible until late December 1958 and parity adjustment were frequently used afterwards to correct external imbalances. Convertibility for capital account transactions was introduced in all EU member states only after Council Directive 361 of 1988. Trade liberalisation made little headway until the mid-1950s when the post-war boom was well under way, and even then, introduction of a customs union for goods with a common external tariff between only six members meant that competition from non-members was kept at bay.

By the 1980s the gap with the USA had largely been closed, but that same decade saw the beginnings of a widening gap within the EU as a result of the Mediterranean (1981, 1986) and Eastern enlargements (2004, 2007, 2013). In 2012 the per capita GDP of the richest member, Luxembourg was more than 15 times that of Bulgaria, the poorest members, while the per capita GDP of Denmark, the second richest country - still exceeded the Bulgarian one by more than 8 times.

The convergence performance of the EU's own periphery is disappointing compared both to western Europe's own performance after 1945 as well as Ja-

pan and the so-called four Asian tigers. Post-1945 Japan managed to catch up in a little over three decades, Western Europe took roughly four decades, and South-Korea, which started from a much more unfavourable position in 1955 than the new member states, did so in about five decades.

Table 2 shows per capita GDP as a percentage of the German level of the GIIPS countries in 2011 and the year of their accession. Greece and Italy actually are poorer compared to Germany than they were in 1981 and 1970, respectively. In the 27 years that have elapsed since their accession, Portugal and Spain have only made very modest progress. The only exception to this pattern is Ireland whose speed in catching up is reminiscent of Japan and South- Korea.

Table 2: GIIPS GDP Per Capita as a Percentage of the German Level

	Per Capita GDP (%)		
	Year of Accession	Year of Accession	2011
Greece	1981	58.82	47.73
Ireland	1973	61.44	105.76
Italy	1970 <sup>1</sup>	79.88	72.26
Portugal	1986	39.60	44.08
Spain	1986	54.36	58.87

Notes: 1, earliest year of data availability.

Source: Calculated on the basis of GDP/Capita in constant 2000 US\$, World Bank, World Development Indicators Database.

With the exception of Poland and the Slovak Republic, the eight Central and Eastern European (CEE) countries that joined in 2004 have made very little progress at all. While one should not expect miracles in a span of seven years, the picture does not improve much when comparing the 2011 level with 1991. Estonia and Poland have made notable progress, but it still took Estonia two decades to reduce the gap to Germany by about 10 percentage points, and at that speed it would take more than a century to close

the gap. Hungary, Latvia and Lithuania instead have made no progress at all.

Table 3: CEE GDP Per Capita as % of German Level

	1991	2004	2011
Czech Republic	23.40	28.17	30.25
Estonia <sup>1</sup>	13.57	23.34	24.90
Hungary	22.24	23.14	21.93
Latvia	19.96	19.40	20.34
Lithuania	21.89	19.21	22.11
Poland	15.82	21.54	26.16
Slovak Republic	27.12	27.18	33.17
Slovenia	42.66	49.12	48.42

Notes: 1, 1995

Source: Calculated on the basis of GDP/Capita in constant 2000 US\$, World Bank, World Development Indicators Database.

Paradoxically, perhaps, the EU's strategy for promoting economic convergence did not build on the lessons of empire and post-1945 success. The disappointing performance of the core countries itself provides the main explanation. Despite the Commission's belief that the various step towards further integration, from the SEA to EMU and enlargement, would boost growth, and notwithstanding the Lisbon Strategy's high-flying ambition to become "the most competitive and dynamic knowledge-based economy in the world" by 2010, overall GDP growth rates in the Union have been disappointing compared to the post-war decades while mass-unemployment has become an endemic problem. Against this background competitiveness came to be seen as the key to growth with the EU de facto embracing a theory of absolute advantage. In Ricardo's classic focus on static comparative advantage the lower cost structures of peripheral countries are not a threat to more developed economies as they reflect the overall lower productivity levels of these countries. The heterodox focus on dynamic comparative advantage, in addition, derives a need for an activist developmental state. Instead, in the EU's focus on competitiveness, both features are

considered a potential threat to the more developed economies. Competition from low-wage countries is seen to threaten a race to the bottom in labour and social standards and many features of a developmental state are said to confer an unfair competitive advantage.

On the global level, these perceived threats informed the EU's strategy of "Managed Globalisation", which is built on the notion that the liberalisation needs to be accompanied by regulatory harmonisation. As it would improve e.g. labour, safety and environmental standards, many EU officials and some scholars interpret harmonisation as a mutually beneficent social democratic alternative to the Anglo-Saxon strategy of liberalisation tout court (Abdelal & Meunier). The rejection of this strategy at the 2003 Cancun ministerial meeting of the WTO showed that emerging economies instead tend to interpret it as an attempt to "kick away the ladder."

The enlargement strategy is informed by much the same desire to maximise the EU core countries' opportunities in the new member states and minimise the threats from them by means of a mix of liberalising and regulatory measures.

The most damaging blow to the economic prospects of the periphery would seem to be the combination of a single currency, the abolition of capital controls and the creation of a single market in financial services. Since the late 1990s, when the Euro was introduced and it became clear that the CEE countries, who generally fixed their exchange rates to the EU by such means as ERM2 membership and currency boards, would join the EU shortly, interest rate differentials virtually disappeared and substantial capital inflows financed large current account deficits. As a result GDP growth rates in Europe were higher in the Eastern periphery and in Spain and Greece until 2007. That decade thus seemed to confirm the EU's conviction that economic liberalisation plus the *Acquis* equals convergence.

All this changed since 2008, when the financial systems of the metropolitan countries came under stress, thus confronting the periphery with a sudden drying-up of capital inflows, not unlike the "sudden stop" crises that destabilised peripheral countries during the classical Gold Standard (Notermans 2012). Countries like the Czech and Slovak republics and Hungary, where a substantial share of foreign direct investment (FDI) had been employed in manufacturing enjoyed some protection from sudden stops, whereas in the Baltics, Spain and Ireland, where capital inflows fuelled real estate booms, the collapse in GDP after 2008 was on a scale not seen since the Great Depression. In Greece, instead, the bulk of capital inflows had financed the public deficit.

The original aim of introducing the common currency or fixed exchange rates was to promote structural reforms by forcing employers and trade unions to internalise the effects of wage and price setting decisions. But the mere impossibility of devaluation proved insufficient to eradicate deeply rooted differences in industrial relations systems such that fixed exchange rates commonly implied real appreciation. This effect was greatly strengthened by massive capital inflows with the result that what was left of potentially competitive export industries was further weakened.

While fuelling a speculative boom, adherence to the common currency in turn deepened the recession. The experience of the pre-1914 gold standard would seem to indicate that devaluation and default would minimise the costs in terms of GDP for peripheral countries confronted with a sudden stop. (McLean 2006) Adherence to the common currency instead dictated a policy of austerity and internal devaluation, which was not only a recipe that prolonged the crisis - dramatically so in the Southern Eurozone - but also one that could not succeed in the aggregate. In addition to macroeconomic policies, European integration also placed successively tighter limits on the use of ITT policies (Scharpf 2002: 648). The abolition of capital controls and the harmonisation

of financial markets within the Union made it difficult for the new Eastern member states to prevent western companies from acquiring what might have become serious competitors over time (Jacoby 2010: 418-19). Extensive foreign ownership in manufacturing, in turn, promoted an enclave economy with only limited technological and managerial spillovers (Ellison 2008; Jacoby 2010: 425). Moreover, competition between foreign banks in the newly opened up areas of Eastern Europe did much to spark consumption and real-estate bubbles (Reinert & Kattel 2013: 21). Competition policy, although included in the Rome Treaties, remained a dead letter as long as creating national champions formed part of the catch-up strategy of countries such as Italy and France. But as competition policy was tightened in the wake of the SEA such strategies are no longer permissible, including the use of public utilities and public procurement for industrial policy ends. Equally since the 1980s, state aid, has come under the province of competition policy. Although here the EU can wield less power than in the other fields of competition policy, crucial elements of “financial repression” such as “preferential interest rates and favourable loan terms” are now considered inadmissible (Rutkiewicz 2011: 45). The same applies for most of the instruments that were initially employed, especially in the Visegrad countries, to attract foreign investment. Industrial processing zones, for example were outlawed by the EU in Hungary. Temporary monopoly concessions in order to increase the incentives for large scale FDI were equally ruled incompatible with EU rules whereas significant limits were placed on the use of tax breaks to attract FDI (Ellison 2008).

Finally, the non-negotiable requirement that new members adopt the *acquis communautaire* in its entirety also served the function of preventing the poorer members from deriving an advantage from a “lighter” regulatory structure. As John O’ Brennan (2006: 133) argued: “The enlargement process would ensure that CEE producers would gradually become subsumed into EU regulatory structures, thus ensuring that CEE advantages in respect of the costs of inputs

would dissolve over time.”

Against this array of harmonising measures stands the structural policies, which are specifically designed to promote the convergence of less developed regions. Although being the second largest expenditure item, support generally amounts to no more than 2.5% of GDP in the new member states and the policy is widely criticised for its inefficient management (Borgho et al 2012). Indeed the EU’s conclusion that the major recipients, Spain, Portugal and Greece, suffer from serious structural problems testifies to the inefficiency of these policies. Moreover, the reorientation of regional policies increasingly comes into conflict with classic developmental state strategies. The shift to horizontal, as opposed to vertical aid reduces the ability to channel support to priority sectors, while the concentration of spending on the poorest regions makes little sense in the presence of industry clustering due to external economies of scale.

## 5. Conclusion

What made the classic liberal view of the world economy so much more attractive than its mercantilist rival was that the latter could only see a zero-sum game whereas Smith, Ricardo and others saw mutual benefits. As Smith (2007: 381) had already pointed out in the *Wealth of Nations*, a country could only benefit from having rich instead of poor neighbours. It is paradoxical then that the revival of core parts of the liberal economic policy orthodoxy since the 1980s should have again enthroned a zero-sum view of economic competition between nations. Since the 1980s, Europe considers competitiveness and not comparative advantage as the key to success in a global economy, which implies that economic relations necessarily are cast as a zero-sum game (Krugman 1994). In analogy to competition between private companies, the countries with the most innovative manufacturing, most favourable tax system or the lowest cost structure are expected to thrive whereas the others will fall by the wayside.

At the latest since 2010 it should be clear that countries are not companies. Greece, Spain, Portugal and Ireland had apparently lost out in the race for competitiveness, but unlike a company they could not simply be dismantled and the valuable pieces sold off. The EU's short term solution was massive financial assistance combined with fiscal austerity while the long-term solution is expected to arrive from improving competitiveness, i.e. radical cost cutting in the crisis economies. Thus the EU becomes increasingly entangled in a web of contradictions. After all, the alleged purpose of insisting on the wholesale export of the Acquis to new members, as well as the Managed Globalisation strategy, was exactly to prevent a downward race of cost cutting. Moreover, if competitiveness decides the economic fate of the periphery its recovery must necessarily come at the expenses of the core countries. It may be increasingly difficult to convince the electorates of the latter to guarantee billions of financial assistance while simultaneously accepting that the competitiveness of their economies needs to decrease.

In order to exit from this zero-sum trap of low overall growth and increasing regional disparities the EU will need to a development model that combines a rejection of export led-growth in favour of domestic sources with the recognition that the lower development levels of the periphery justify exemptions from the principle of reciprocity.

Yet, Europe's fundamental problem may lie much deeper than an embrace of dysfunctional economic ideas. The 1980s switch towards a neo-liberal macroeconomic strategy that lies at the root of the EU's low growth was not driven by the inherent attractiveness of what essentially were pre-Great Depression convictions but by the difficulty of controlling distributional struggles in a policy regime where the state accepted its macroeconomic responsibility for assuring adequate growth and low unemployment. But a policy regime that excluded macroeconomic growth strategies for reasons related to the process of interest intermediation had no other option but to interpret

economic success in microeconomic terms of competitiveness. Similarly, as pointed out e.g. by Dani Rodrik (1995) East Asian types of developmental strategies require a substantial degree of state autonomy relative to societal interest groups in order to prevent developmentalism from degenerating into crony capitalism. It is doubtful that the current systems of interest intermediation in many peripheral member states would be able to successfully implement such an approach.



## ENDNOTES

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1. Many thanks to Luigi Bonatti and Andrew Martin for challenging comments on an earlier version (Notermans 2013).
2. As Hobsbawm (2008:74) pointed out, at the onset of the First World War most of the world's population lived in empires. Despite the intervening age of nation-state building, not much had changed then since 1750 when, according to Bayly (2004: 27-8), around 70% of the global population lived in empires.
3. Joseph M. Colomer (2007: 65) argues that the claim that European integration is *sui generis* “only means that we are not using a sufficiently broad analytical concept, capable of including this case among those with common relevant characteristics. The appropriate concept could be that of ‘empire.’”
4. Source: AMECO, Gross domestic product at current market prices per head of population.

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