The Political Limits of Economic Integration

Economic integration can be beneficial for all participating countries. But after a point, further gains from integration can be achieved only by trading off costs in one policy or sector against benefits in another. In this article we explore the relationship between these trade-offs and their political sustainability. We conjecture that a viable policy is politically sustainable when its benefits to citizens are visible to them. In the longer term, the trade-offs which are required to deepen integration become invisible, at which point reversing the process of integration appears to be in the national interest. We conclude that integration needs to be supported with domestic policies that mitigate the costs of integration borne by some groups or sectors.

The European Union has recently suffered several setbacks, many of them severe: financial instability and the institutional incompleteness of the euro, the UK referendum vote in favour of leaving the EU, deep disagreements on the appropriate response to migration, and the popular opposition to international trade agreements such as the Comprehensive Economic Trade Agreement (CETA) with Canada, the EU-Ukraine Association Agreement and the Transatlantic Trade and Investment Partnership (TTIP) with the United States.

Many explanations have been offered, ranging from voter alienation caused by political elitism to income inequality caused by the negative effects of globalisation. Undoubtedly, these factors have contributed to popular disaffection. In this article, however, we explore a different explanation that goes to the core of the integration process and suggests that there is a limit to the extent to which the economies of independent countries can be integrated.

We argue that in order for economic integration to proceed beyond a certain point, this integration must be based on arrangements which turn out to be politically controversial. It is not just that the achievement of consensus becomes progressively more difficult as integration encroaches into politically sensitive policy areas and challenges entrenched beliefs of national sovereignty. We present a different description of what may actually happen. Accordingly, the bargains that enable countries to cooperate on new policies necessarily involve the packaging of issues and depend on a delicate balancing of negative and positive effects. This packaging creates political opposition, which over time overwhelms the forces in favour of integration.

The slogan of Brexiter in the run-up to the June 2016 referendum was disarmingly simple and powerful: “Take back control”. How can anyone disagree with such an apparently reasonable exhortation? Yet this slogan begged the question as to why the UK joined the EU in the first place if there was a chance that it could lose control over its own affairs. Many answers have been given over the years, covering a wide range of plausible explanations: the UK was not really aware of the implications of what it signed, the EU has changed significantly since the UK agreed to join in 1972 and has become more centralised, the EU is now dominated by the eurozone, the EU’s economy is overregulated and no longer dynamic, or the rest of the world is now growing faster and offers more trade opportunities. Indeed, the EU may have become a less attractive place to do business.

However, Brexiter appear to have given little thought to how the EU can still impact on the UK even when it formally ceases to be a member. It is not surprising that proposals regarding the relationship that the UK could or should have with the EU in the future have multiplied like mushrooms after the first autumn rain. These scenarios reflect the different expectations of what would happen in the absence of the EU – or in other words, the counterfactual situation of not having common European rules.

Speculation on how the exit of the UK may affect the EU has also been rife. There is no doubt that the future direction of the EU is now less certain. But the impending withdrawal of the UK also poses a deeper and more fundamental question: is the theory of integration in need of substantial revision? The theory has been predicated on models that presuppose mutual benefits. The Brexiter, instead, see costs, stifling regulation, missed opportunities, democratic unaccountability and loss of control over their own affairs.

Phedon A. Nicolaides, College of Europe, Bruges, Belgium; and University of Maastricht, Netherlands.

Joanna Hornik, College of Europe, Bruges, Belgium.
Integration, by definition, implies some loss of control and some loss of decision-making discretion. However, this is the *sine qua non* of gaining control over the actions and policies of other countries that affect you. Hence, by itself, loss of control is only one side of the coin and does not tell the whole story. Loss of control is the price that has to be paid for gaining control over the policies of others. Loss of control is a pure cost only when the counterbalancing benefits of the other side of the coin are ignored. We explain in this article that in order to advance economic integration and to benefit from closer policy coordination, it may be necessary to incur such costs. However, the political process that makes such bargains possible also tends over time to obscure or ignore the benefits from integration and focus instead on the cost side.

Therefore, the purpose of this article is to present a model of how policy integration is achieved and then argue that economic and political processes and principles eventually collide. The very process by which countries become better off through integration sets off a political reaction. The model explains why the compromises and trade-offs which are required in order to advance mutually beneficial integration also trigger political opposition. The article concludes by considering a possible resolution of this intrinsic conflict between the economics and politics of integration.

**The process of integration: from agreement to implementation to non-compliance**

Economic literature describes the stages and necessary components of integration: from free trade areas, customs unions and trade liberalisation to common markets, in which factors of production move freely; this is followed by the harmonisation of specific policies, such as competition, agriculture, trade, and regional development; the final stages are to optimum currency areas and, in the context of the European Union, the evolution of monetary cooperation and integration in Europe.¹ No textbook on economic integration that we are aware of goes into any formal analysis of the counter-forces that may be unleashed by the very process of integration. Nor is there any systematic attempt, apart from indirect or incidental mentions, to consider how politics interacts with economics, with the exception of textbooks which focus on the politics of integration and supranationalism.

While the various economic models of integration explain why and how countries might decide to cooperate, they rarely explore what happens after an agreement is sealed. They implicitly assume that countries just comply with the agreement.

In fact, the explanation of why cooperation continues, after it is first agreed, is difficult, because in some situations a country may be able to become better off by ceasing to cooperate. Several important elements affect the compliance of member states with common rules: the costs and benefits associated with implementation, the design of the rule itself, the capacity of national administrations to apply the rules, and progressive internalisation of shared preferences. From a theoretical perspective, it is possible that member states agree initially yet later deviate from what is agreed. It is also conceivable that the initial agreement to adopt common rules may contain the seeds of its own self-destruction, as countries realise they can become better off afterwards by breaking the rules while everyone else complies.²

As recent events have shown, neither the existence of enforcement procedures and institutions nor the possibility of penalties will eliminate non-compliance. Scholars, mostly in political science and law, have been trying to identify the underlying causes of the EU’s failure to achieve perfect compliance.³ The extreme manifestation of non-compliance is *disintegration*, such as the imminent exit of the UK from the EU. A small but growing literature on disintegration analyses the conditions under which agreements on common markets or policy cooperation collapse.⁴ The fundamental assumption of these studies is that there is a change in the conditions that underpin the initial cooperation agreements. This could mean, for example, changes in market conditions, policy prefer-

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