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The Developmental Impact of the EU Integration Regime: Insights from the Automotive Industry in Europe's Peripheries

László Bruszt, Julia Langbein, Visnja Vukov, Emre Bayram and Olga Markiewicz

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The Developmental Impact of the EU Integration Regime: Insights from the Automotive Industry in Europe's Peripheries

László Bruszt, Julia Langbein, Visnja Vukov, Emre Bayram and Olga Markiewicz

Abstract

How do diverse EU strategies used to integrate less developed economies in the Eastern peripheries of Europe effect local development? Introducing the distinction between 'shallow' and 'deep' EU integration regimes, we compare the evolution of the automotive sectors in four European countries (Poland, Ukraine, Romania, and Turkey). We show that diverse EU modes of integrating potential member states and economies without the clear prospect of membership create very different constraints and opportunities for developmental pathways. The shallow mode of integration used for countries lacking a (credible) membership perspective combines trade liberalization and selective rule imposition with very little assistance. It results in rather divergent developmental pathways for the EU 'outsiders' – depending on the stronger or weaker capacities of the domestic public and private actors. In contrast, we found that the deep mode of integration used for would be member states created more opportunities for convergence towards competitive industries, even in countries with weak initial domestic capacities.

Our insights imply that encompassing deep integration may yield not only superior developmental results, but may also increase the potential for further economic integration. In the shallow mode of integration the EU may, however, loose support for European integration among rule taking countries once citizens realize they cannot count on measures mitigating and/or compensating for present economic hardships. In countries like Ukraine, the EU therefore risks to become a factor of economic and political destabilization.

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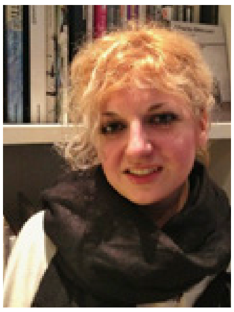

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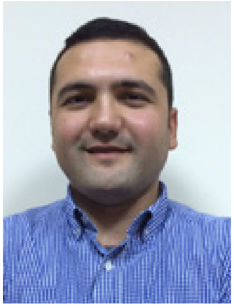

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1. Introduction

The most pressing problem of any regional integration regime concerns the application of the same rules and policies in economies at different levels of development, with domestic economic actors endowed with different capacities to implement and/or benefit from these rules (Stiglitz/Charlton 2006; Ismail 2007). Two specificities make the EU an interesting case that might offer lessons for the management of core-periphery relations both within and beyond the EU regime. First, compared to other transnational integration regimes, the EU has the most extensive and encompassing programs that combine the imposition of a large number of non-negotiable market rules with strategies that try to manage the potential negative externalities of rule transfer (Bruszt/McDermott 2014). Second, the EU has different goals and means for the management of its different peripheries (Bruszt/Vukov 2015).

Our goal in this paper is to compare the developmental impact of the different strategies the EU uses to integrate the less developed economies in the Eastern part of Europe with or without the promise of membership. This paper introduces a distinction between shallow and deep EU integration regimes. The adjectives ‘deep’ and ‘shallow’ refer to differences in the goals and means of integration (on deep and shallow integration see also Stark et al. 2006; Bohle/Greskovits 2007; Langbein 2015a). In the deep mode of integration, trade liberalization is combined with encompassing regulatory integration in a large number of interlinked policy fields that extends to the transformation of economic state capacities buttressed by encompassing support programs targeting the capacities of diverse public and private actors. Shallow integration refers to trade liberalization that might be combined with some progress in regulatory integration in selected policy fields without any considerable assistance. The paper explores the developmental impact of these two EU integration strategies in the peripheries of Europe. We ask, what might be the comparative developmental advantages and disadvantages of these diverse strategies employed in the EU’s different peripheries? How do differences in the mode of integration shape possibilities for developmental experimentation and agency in the less developed countries? In what ways do they help or hinder domestic actors to alter their roles in and increase their gains from economic integration?

By doing so we contribute to two literatures that are related but rarely refer to each other. The first deals with core-periphery relations, dependency or patterns of development in Europe with a focus on the continent’s Eastern peripheries (Nölke/Vliegenthart 2009; Myant/Drahokoupil 2010; Bohle/Greskovits 2012). Here one can find the factors that shape divergent developmental pathways in Europe. This literature, however, presents at best a birds-eye-view of the role of the EU, and it can only provide very broad criteria for the evaluation of the strengths and weaknesses of specific modes of integration employed by the EU. The other literature deals exactly with these latter questions, but researchers in this strand analyze the effect the EU has on compliance with EU rules, i.e. how actors in the non-core country are made to play by the rules (for example, Andonova 2004; Schimmelfennig/Sedelmeier 2005; Dimitrova 2010). They rarely analyze the effects the EU can have on developmental outcomes, i.e. the question how the EU shapes the capacity of non-core countries to live by the EU rules (for a few exceptions see Jacoby 2014; Epstein/Jacoby 2014).

To analyze the effects of diverse EU integration regimes on developmental outcomes we compare the evolution of the automotive sectors in four European countries (Poland, Ukraine, Romania, and Turkey) exposed to different EU integration strategies: the automotive sector is a strategic case for such a study as this sector is one of the key representatives of the new era of Global Value Chains (Scepanovic 2013). Competition of industries fragmented along national lines is increasingly replaced by 'consolidated' regional and global markets dominated by a smaller number of Multinational Companies (MNCs) that control the distribution of roles in regional/global value chains (Gereffi/Korzeniewicz 1994). The dynamic analysis of this sector in four European peripheral economies allows us to better understand how the EU shapes and constrains possibilities of improving positions or roles in European value chains. The selection of two pairs of countries, each pair exposed to a different mix of EU policies, sheds light on the comparative advantages and disadvantages of being closer or further away from the EU integration machinery and being lower or higher on the EU priority list. Further, both pairs have one country with stronger and another with significantly weaker capacities of public and private actors at the start of integration. This allows us to explore the extent and the ways EU integration strategies shape domestic developmental agency.

More specifically, we compare two pairs of countries in Europe's peripheries: one pair exposed to the deep mode of integration (Poland and Romania), the other to the shallow mode of integration (Ukraine and Turkey). The deep mode of integration is currently applied to would be members only, whereas the shallow integration strategy applies to countries not considered for membership. As we will show, in the deep mode of integration the EU can contribute to developmental convergence among countries with large initial differences in domestic state capacities. In the shallow mode of integration, the EU contributes to increased divergence between countries with different domestic capacities at the start of integration.

We selected pairs endowed with different state capacities to develop and implement policies that serve the public good, including the capacity to implement regulation and foresee some of its developmental consequences, and varying organization of private economic actors to cooperate with the state in these matters. This approach allows us to assess how EU strategies conserve or alter pre-existing domestic developmental capacities and change the scope for domestic developmental agency. The comparison of Poland and Turkey demonstrates that countries with strong initial domestic capacities can both benefit from negotiating trade liberalization with the EU. Furthermore, Poland benefitted not only from liberalization but also from pre-accession assistance programs through which the EU helped restructure its industry and prepare it for liberalization. Turkey received less EU assistance. However, it had much more room to selectively apply the regulations of the EU, and it had more autonomy to shape its own developmental path.[1] In a nutshell, states with strong capacity before integration can benefit from deep integration (e.g. Poland) but do not necessarily need it to succeed (e.g. Turkey). By contrast, the comparison of Romania and Ukraine demonstrates how different modes of integration with the EU do result in different developmental outcomes, even though both countries are characterized by weak domestic capacities in the early years of transition

1 Despite Turkey's obligations under the Customs Union related to its participation in the single market for goods (with only a few exceptions), Turkey could, for example, use certain policies that would otherwise run afoul of state aid limitations that Poland would face. This 'freedom' is closely linked to the declining credibility of Turkey's membership perspective. As a result, Turkey's political and economic elites have become increasingly ignorant towards the need to comply with EU rules if it does undermine domestic interests (Atiyas 2013; Müftüler-Baç 2015).

(see also Langbein 2014). While shallow integration with the EU left domestic capacities in Ukraine weak and contributed to the collapse of the industry after liberalization, in Romania the EU eventually helped strengthen domestic state capacities and made Romania much more attractive for foreign direct investment (FDI), which led to the expansion and upgrading of automotive industry.

		Domestic capacities	
		Strong	***Weak***
Stage of EU integration	***Deep***	Poland	Romania
	Shallow	Turkey	Ukraine

Table 1: Modes of integration and domestic capacities in the automotive sector

2. Integrating Peripheries: Variation in EU Modes of Integration and Developmental Outcomes

At the highest level of abstraction integration refers to “measures designed to abolish discrimination between economic units belonging to different national states” (Balassa 1962: 1). More concretely, integration is a process that starts with the reduction of tariffs and might continue further with custom union, removal of non-tariff barriers and introducing common rules and policies. In this paper we refer to integration as convergence in policies and regulatory institutions towards an exemplary model, in our case the EU.

We define EU modes of integration by the goals and means for managing the integration of the less developed economies in Europe’s periphery to the EU Internal Market. Developmental outcomes refer to the position of domestic economies in transnational/regional markets, i.e. their capacity to export and move up the level of sophistication of exports towards the high-value added parts of the value chain. Alternatively, economic integration might weaken the competitive standing of domestic players and turn whole sectors into net importers and/or exporters of low value-added products (Gereffi/Lee 2009). In this paper we compare the EU mode of economic integration in the context of the Eastern enlargement (2004/07) to the mode applied vis-à-vis Turkey and the Eastern neighbours and investigate how different modes affect different developmental outcomes.

As for the goals of the EU, first, policies linked to creating a level playing field (“abolish discrimination between economic units belonging to different national states” (Balassa 1962: 1)) in terms of trade liberalization and regulatory integration are mandatory for actual and aspiring member states. This has not been the case for the neighbourhood countries, which could negotiate limited trade liberalization and selective convergence to EU rules and norms at the price of getting only selective benefits of (partial) integration.

Related to this, second, the EU cares about the actual or potential negative developmental externalities of regulatory integration to different degrees in the various contexts. From the perspective of the rule taking countries, such negative externalities might include the marginalization of firms and sectors with weak or no capacity to implement the rules of the regional market or withstand competition while implementing these rules. The economic, social or political costs of such developmental outcomes might spill over to the rule making countries, imposing on them excessive unwanted costs and reducing their net gains. In the worst case, such spillovers might endanger the previous achievements of integration.

The integration goals of the EU differed dramatically from the perspective of the readiness to consider the management of such developmental externalities of integration. The EU's goal to anticipate and alleviate these negative externalities of rule imposition was particularly pronounced during the Eastern enlargement, represented best by two economic Copenhagen criteria ("functioning market economy" and "capacity to withstand competitive pressure within the EU market") and the third Copenhagen criteria ("administrative and institutional capacity to effectively implement the acquis") (Bruszt/Vukov 2015; Bruszt/Langbein 2015). While the third criterion refers to the accession countries' capacities to play by the rules, the two economic criteria refer to their capacity to survive the EU market rules.

By contrast, in its relationship with Turkey and the Eastern neighbourhood countries, the EU was less concerned about these countries' capacities to play by and survive the EU market rules. While Turkey is a candidate country, the EU is trying to keep it at arm's length during accession negotiations (see also Müftüler-Baç/Çiçek 2015), and from the perspective of the mode of integration, it is closer to the neighbourhood countries than to the countries considered for membership. The Eastern neighbours lack a credible membership perspective, too. Selective regulatory integration in these contexts is not seen to pose a threat to the integrity of the Internal Market, let alone force the EU members to agree to fiscal transfers to help leveling the playing field (Langbein 2014, 2015b).

As for the means of economic integration, we identify three mechanisms:

The first one is a passive one and constant across all the peripheries of the EU: the pull of the EU market ('Brussels effect' in Bradford 2012). The 'Brussels effect' (like the California effect, see Vogel 1997 and similar to the concept of 'passive leverage' coined by Vachudova 2005 and of 'market power Europe' as introduced by Damro 2012) refers to mechanisms that allow the EU to shape convergence to EU norms and policies outside of the EU without even moving a finger. Potential gains linked to access to the EU markets and the competition for mobile factors of production (increased mobility of the tax base) within the EU might activate domestic agency for institutional change (Bradford 2012; Langbein 2015a). It may also activate multinationals to become agents for rule convergence if that helps them to reap the benefits of opening production facilities in peripheral markets, exploit lower production costs and thereby increase their competitiveness on the EU market.

The second mechanism refers to a more active EU strategy: the imposition or the bargained negotiation of policies linked to the liberalization of markets and the imposition or the bargained negotiation of common regulatory norms. While hierarchical imposition of non-negotiable policies and rules is encompassing vis-à-vis actual and aspiring member states and covers all the rules and policies that are mandatory for the members of the EU, the negotiated integration used to be selective and partial vis-à-vis the neighbourhood countries (Langbein/Wolczuk 2012; Langbein/Börzel 2013; Langbein 2015a).

Finally, the third one is another active EU strategy and relates to assistance that can target capacities of public and private actors to implement EU rules or the capacities of economic actors to benefit from market integration. Students of the EU regime in the context of the Eastern enlargement revealed that the character of EU assistance was multiplex in the sense that the EU targeted public and private actors, including state agencies, business associations, NGOs, sometimes even firms, to help them implement the EU rules (Bruszt/McDermott 2012). In addition, in order to increase the post-accession sustainability of its own rules and thus defend the integrity of the regional market, the EU was keen to ensure that domestic actors in the then candidate countries would be able to live by the implementation of EU rules (Bruszt/Langbein 2015). Assistance in the accession countries is extensive, and while in the pre-accession period it targets more elementary capacities to play by and live by the EU policies and rules, in the post-accession period it might also extend to goals linked to economic and social upgrading. We assume that the EU pursues a different approach vis-à-vis Turkey and the Eastern neighbours where EU assistance at best targets state actors in order to help them play by the EU rules. However, EU assistance in this context rarely entails firm-level assistance. Further, we assume that the EU hardly cares about economic or social consequences of economic and regulatory integration, should domestic actors not be capable of implementing EU rules or benefiting from implementation in this context.

2.1 Deep and Shallow Modes of Integration

The EU treats its two peripheries in different ways with different combinations of strategies resulting in two different modes of integration, deep and shallow, which produce different developmental outcomes.

In the Eastern periphery (consisting of the new member states of the EU) the EU has used a variety of means to induce institutional change and manage potential negative externalities of integration. Besides relying on the incentives coming from the gradual liberalization of the different factors of production, the EU has also created a massive pre-accession assistance program aimed at the transformation of domestic economic state institutions that has ranged from reforming the judiciary and the civil service to the upgrading (in many cases: the creation) of regulatory and developmental state capacities (Bruszt/Vukov 2015). Furthermore, in the post-accession period, the EU has also offered developmental assistance programs linked to the cohesion and structural funds aimed at increasing catch up growth and including goals linked to social and economic upgrading.

The depth of integration in the accession countries was intimately linked to the fact that as they were on the road of becoming new members of the EU, they had to take over all the pre-existing mandatory rules and policies of the EU from more than 30 different policy fields (Schimmelfennig/Sedelmeier 2005).

The takeover of a large number of policies and rules in itself entailed the risk of large scale negative developmental externalities that was increased by the complexity of the potential interplay among the large number of policy fields covered by integration. For example, depending on how they were implemented, EU food safety regulations could have marginalized or squeezed out of the markets hundreds of thousands of family farms in these countries, or alternatively, they could have helped them to become competitive in the EU markets. A similar logic applied to other policy areas like EU liberalization of trade, state aid policies, regulations of state procurement or the implementation of EU environmental regulations: depending on the way the transfer of EU policies and rules was managed, potential developmental economic outcomes could range from the collapse of whole industrial sectors to their consolidation in a 400 million large regional market (Bruszt/Langbein 2015). The capacity of the EU to completely externalize the developmental consequences of rule transfer was limited both because of the prospect of full membership rights of these countries, and, also because the promise of future membership dramatically increased economic ties, and with it the interdependence between the two parts of Europe. If the EU wanted to defend the integrity of the regional market and make sure that its rules were implemented in the new member states, control the costs and increase the potential gains of enlargement, it had to worry about its developmental externalities (Bruszt/Langbein 2015).

As discussed above, the goals of deep integration were encompassing both from the perspective of liberalization and regulatory integration. While the accession negotiations were primarily about the mode of the transfer of non-negotiable items, the EU proved to be a permissive negotiator as to the rhythm and sequencing of the elements of liberalization and regulatory transformation. It allowed for gradual phasing out of protections for domestic industry, leaving time for industry to restructure and adjust to the Single Market prior to accession.

In order to anticipate and alleviate the potential developmental externalities and to help to locate and solve problems in implementation, the EU created supranational capacities (Bruszt/Langbein 2015). The European Commission involved the governments of the applicant countries in nearly a decade of joint problem solving in more than thirty different policy areas. Special attention was devoted in these processes to building elementary economic state capacities in the Central and Eastern European countries (CEEC). State restructuring was growingly embedded by the Commission in twinning programs, a transnational network of technical assistance mobilizing thousands of public and private actors in the old EU member states.

Besides creating domestic capacities to implement the European policies and rules, the Commission also tried to strengthen (or in many cases, to create) basic planning capacities and the ability to foresee and manage negative development externalities from integration. In the first wave of Eastern enlargement the EU's assistance programs transferred €28 billion to the CEEC and were linked to the problems detected by domestic developmental plans. Such plans were, in turn, done in collaboration between domestic and external actors.

The different mechanisms of integration, the 'Brussels effect', the imposition of policies and rules and the assistance programs were mutually reinforcing. The promise of access to 400 million consumers activated domestic agency, and it helped to set in motion 'anticipatory integration'. The implementation of policies and rules of market opening, together with the building of general state capacities for market making improved the business environment. Meanwhile, the influx of FDI increased domestic demand for the adaptation of EU rules. Similarly, the various assistance programs helped alter the capacities of domestic players to play by the rules of the EU markets.

In contrast, for the ‘far Eastern’ European neighbours like Turkey or Ukraine, the EU largely relied on à la carte integration. In areas where convergence with EU rules and norms was compatible with domestic preferences, for instance in response to the ‘Brussels effect’, convergence progressed even in the absence of EU assistance or EU leverage (Ademmer/Börzel 2013; Bayram 2015). Moreover, as Müftüler-Baç and Çiçek (2015) show for the case of Turkey, the EU is not keen to close negotiation chapters but prolongs the process through stricter safeguard clauses and opening benchmarks as well as through vetoes by member states.

As for Ukraine and other Eastern neighbours covered by the European Neighbourhood Policy and more recently the Eastern Partnership initiative, the EU has offered only limited assistance to empower ‘minority traditions’ (Jacoby 2006), i.e. reform-minded but powerless domestic state and non-state actors. The EU did also not invest in creating comprehensive capacities of those state and non-state actors needed for the adoption and implementation of EU rules. To be sure, the EU financed twinning and technical assistance programs to support state restructuring in this context, albeit in a more ad hoc fashion without much consideration for assisting state bureaucrats in developing mid- or long-term strategies to prepare their economies for free trade with the EU (Langbein 2015b). However, as Langbein (2015a) has shown for Ukraine, state restructuring efforts were not flanked by corresponding assistance programs increasing the capacities of non-state actors, e.g. business associations and their constituencies, to implement the public-private governance arrangements EU internal market regulations are based on.

In Turkey, the EU did provide assistance for state restructuring to enable the adoption and implementation of Turkey’s obligations under the Customs Union (CU) and also provided firm-level support through European Bank for Reconstruction and Development (EBRD) credits. However, as we will show for the Turkish automotive sector, these efforts played a marginal role in restructuring the Turkish economy to make it fit for the competitive pressures from the EU Internal Market. In fact, EU assistance arrived relatively late when the major transformation of the industry was already well under way. Moreover, the administrative and financial assistance focused on improving the political criteria. For example, 91 twinning projects were implemented in Turkey from 2002 to 2008 and only two of them were about the internal market and the economic criteria, whereas 30 of them were solely about the Justice and Home Affairs (European Commission 2011).

Further, unlike in the deep mode of integration, the EU was less concerned about detecting the sources of non-compliance in the ‘far Eastern’ neighbours and did not act as a permissive negotiator when concluding agreements on free trade or regulatory harmonization. Instead, the EU largely used the asymmetry of power in negotiating the terms of integration without worrying much about the costs of economic integration in that context. In other words, unlike in the deep mode of integration, the EU could easily externalize potential negative consequences on the 'far Eastern' neighbours. Since the latter would stay outside the club in the foreseeable future, the EU did not fear that such selective integration would endanger the integrity of the EU Internal Market or force the EU to fiscal transfers in order to mitigate high political, social or economic costs caused by fast liberalization (Langbein 2015b; Bayram 2015). Again, this particular EU strategy is unlikely to limit domestic opportunities for development in Turkey given the latter's comparatively strong state capacity and well-organized private actors. However, in Eastern neighbours like Ukraine, where the state is captured by rent-seeking elites with little concern for the public good, we expect the EU's lack of attention to the political, social and economic costs of regulatory and economic integration to reduce opportunities or at least not to facilitate the opening up of opportunities for development.

3. Zooming in on the Case Studies

What are the developmental implications of the different EU modes of integration? We explore this question by examining the evolution of the automotive industry in four countries experiencing different modes of EU integration: Poland, Romania, Turkey, and Ukraine. The first two of these are now EU member states and have been exposed to the deep mode of integration, with the EU actively managing potential negative externalities of integration as well as strengthening domestic developmental capacities. On the other hand, Turkey and Ukraine have both experienced only a shallow mode of integration, with the EU imposing the terms of integration without worrying about the developmental consequences and offering limited assistance.

The four countries differ also in their initial domestic capacities at the beginning of the process of closer integration with the EU: Poland and Turkey are marked with relatively strong and capable states, while Ukraine and Romania are both cases of comparatively weak states.[2] Poland is pictured in the literature as a case of successful political and economic transformation from socialism to liberal democracy and market-based economy (see, for example, Orenstein 2001; Vachudova 2005). After 1989 the Polish state was capable of conducting comprehensive market reforms such as liberalization, deregulation and privatization. Moreover, it designed and put into operation a legal framework for firm and market governance. In introducing these reforms, the Polish state capitalized on a legacy of market-oriented institutions and practices introduced prior to its system change (Bohle and Greskovits 2012). Turkey has had a tradition of market economy guided by liberal principles and a system of democratic governance even before the 1990s, in a striking contrast to post-socialist countries. Turkey's political elites had already acquired a prior knowledge of governing the markets according to the new liberal mantra and had also partially transformed the economy along these lines over the course of the 1980s (Öniş 2003; Pamuk 2008).

By contrast, until the late 1990s Romania and Ukraine suffered from illiberal political institutions, allowing political elites to exploit state resources for their own benefit and the benefit of their allies (Gould/Hetman

2 World Bank governance indicators measuring government effectiveness, regulatory quality and control of corruption show that the quality of governance in the 1990s is twice higher in Poland than in Romania and twice higher in Turkey than in Ukraine (Kaufmann et al. 2005).

2008; Bohle/Greskovits 2012). While the situation in Ukraine remains largely unchanged (D'Anieri 2007; Dimitrova/Dragneva 2013; Langbein 2015a), elections in Romania (1997) brought more liberal elites to power. Democratic institutions survived even after subsequent political turnovers thanks to the EU's lock-in effect (Vachudova 2005). At the same time Romania, like Ukraine, is still suffering from comparatively high levels of corruption and generally weak state capacity (Vachudova 2009; Spendzharova/Vachudova 2012).

The EU's developmental effects on the automotive industry are explored based on three sets of comparisons. We undertake two pairwise comparisons of countries marked by the same endowment in domestic capacities but exposed to different modes of integration with the EU: Poland-Turkey and Ukraine-Romania. Furthermore, we compare the patterns of convergence and divergence within different EU regimes by examining how the EU creates opportunities for convergence in the deep integration regime despite the initial differences in domestic state capacities, while contributing to increased divergence among countries in the shallow integration regime.

3.1. Integrating the Strong: EU Integration and the Development of Automotive Industry in Poland and Turkey

The automotive industry in both Poland and Turkey has experienced substantive expansion since the 1990s, with both countries emerging as key export hubs for automotive production and becoming fully integrated into the European value chains. Total motor vehicle production in Turkey has risen from 242,780 vehicles in 1997 to over a million in 2013,[3] making Turkey the sixth largest automotive producer in Europe. Similarly, Polish production rose from 385,000 in 1997 to 600,000 in 2013.[4] Both countries also experienced the shift from producing primarily for their domestic markets towards increased export orientation, with roughly 80 percent of total Turkish production[5] and almost all of the Polish production[6] being exported to the EU member states. While Turkey specializes in manufacturing of light commercial vehicles and buses, Poland found its niche in A-segment small passenger cars and light commercial vehicles. Both countries also became significant suppliers of components for the EU market. By 2006, Poland became third-largest net exporter of motor vehicles and their components, after Germany and the Czech Republic (Domanski/Gwosdz 2009).

Yet it was not always like that. Until the mid-1990s the Turkish car industry was technologically backward and focused on the domestic market, while Poland emerged from socialism in 1989 with an indebted and technologically backward automotive sector. The major upgrading and reorientation of production

3 Data collected from the International Organization of Motor Vehicle Manufacturers (OICA) (2015) 'Production Statistics, Production of Passenger Cars and Light Trucks', available at http://www.oica.net/category/production-statistics/, accessed 29 April 2015.

4 Ibid.

5 Otomotiv Sanayii Derneği (Automotive Manufacturers Association, OSD) (2015) 'Automotive Manufacturers' Association Foreign Trade Report' (in Turkish), available at http://www.osd.org.tr/yeni/wp-content/uploads/2015/03/2015-02-OSD-D%C4%B1%C5%9F-Ticaret-Raporu.pdf, accessed 29 April 2015.

6 Polski Związek Przemysłu Motoryzacyjnego (PZPM) (2013) 'Automotive Industry Yearbook 2013', Warsaw: PZPM.

towards exports was in both countries triggered by integration with the EU and, more precisely, by the liberalization of trade between these countries and the EU. In Turkey, the major shift took place after the CU with the EU was put into effect in 1996. With the drop in tariffs MNCs invested heavily in production sites in Turkey and integrated them into their global strategies. In Poland the same shift took place after 2002 when trade between the EU and Poland was fully liberalized.

In both countries, liberalization was carefully prepared by domestic actors. The political and economic elites in Turkey and Poland had the vision, will and ability to implement the necessary political, economic and legal adjustments to make their industries integrated with the European and global markets. While in Turkey capable domestic actors prepared for liberalization and restructured the sector accordingly, Poland additionally benefited from EU assistance programs (Bayram 2015; Markiewicz 2015).

As Bayram (2015) details, the Turkish government and industry had worked hand in hand to prepare the sector for international competition since 1992 when Turkey decided to join the CU. This strong cooperation between automotive associations and state bureaucracy worked efficiently during the CU negotiations. The state played an active role in quickly adapting the EU regulations with strong support from the Turkish elite. The politicians assigned the best bureaucratic cadres to steer the integration process in the 1990s. Moreover, the state involved the automotive industry and civil society organizations in the CU negotiations. The EU can hardly be portrayed as a generous counterparty. The Turks had to fight vigorously for gradual liberalization in at least some product groups, which the EU only accepted because it was in the interests of its own MNCs. Turkey initially demanded a five-year derogation for imports of all automotive products. However, only used cars were exempted from the free movement principle, although Turkey did manage to defend its position.[7] Most notably, Turkey argued that the large majority of producers in Turkey are European in origin and would be hurt most from the unrestricted import of used cars. As such, Turkey was able to parlay the support of these firms, particularly Renault, into political pressure on the EU through the French government.[8] Finally, after 15 years, EU officials dropped the issue and allowed the derogation.

The negotiation and its aftermath enhanced business-state cooperation and increased state capacity in order to meet new challenges: apart from the gradual liberalization of automotive trade in the late 1980s, Turkish authorities also had to align technical regulation with the EU directives. The EU did not support Turkish state regulators or private business with the adjustment to costly EU rules, technical standards or customs. As opposed to in Poland, the EU demanded regulatory integration from Turkey but did not help build its capacities.[9] Furthermore, unlike the East European members, which solved the daunting tasks of ensuring compliance with EU technical regulations by relying on foreign (EU) capital, which brought in the right technologies, Turkey set up a series of institutions, including industry-specific consultative bodies and research and development centers, to help domestic companies fulfil EU requirements and strengthen

7 Authors' interview with the Director of the OSD, Prof. Ercan Tezer, Istanbul, Turkey, 26 November 2014.
8 Authors' interview with the Director of the OSD, Prof. Ercan Tezer, Istanbul, Turkey, 26 November 2014.
9 Authors' interviews with representatives of the Ministry of Industry, 17 March 2015, and in the Ministry of Economy, 19 March 2015, Ankara, Turkey.

their ability to compete.[10] Hence, in Turkey the successful liberalization and adjustment to EU technical regulations was achieved primarily thanks to strong domestic capacities.

In a similar vein, Markiewicz (2015) shows for Poland that a strong and capable bureaucracy played a key role in preparing the domestic automotive sector for market liberalization. After the collapse of state socialism in 1989 Polish state actors engaged in the restructuring of the state-owned sector, with the aim of transforming it into one capable to withstand international competition (Government Economic Committee 1993). International competiveness was to be achieved with the help of foreign capital. By 1996 state actors managed to sell all three passenger car factories to Original Equipment Manufacturers (OEMs), such as Fiat, Volkswagen and Daewoo, and attract one green field investment – General Motors (GM)/Opel. From the second half of the 1990s state actors were focused on luring FDI to the component sector. By 2006 Poland managed to attract nine out of the ten largest global suppliers who together with smaller players built more than 175 new green field plants (Domanski/Gwosdz 2009). Yet, in Poland unlike in Turkey, transformation of domestic industry was supported by the EU, which played a more complex role than simply providing access to its market. In Poland, the EU strengthened the ruling elite in its restructuring efforts and helped it to steer the integration of domestic industry into the European value chain of automotive production.

The EU became an important player in the Polish automotive industry in 1992 when the commercial part of the Europe Agreement (EA), the so-called Interim Agreement, came into force.[11] In line with the agreement the EU opened its market for vehicles manufactured in Poland, while Poland was allowed to protect its industry for ten years. Protective measures included import tariffs and non-tariff barriers. In regard to tariffs Brussels allowed Poland to introduce a prohibitive import tariff of 35 percent and accepted the schedule of phasing it out by five percentage points every two years to reach 0 percent in 2002. In regard to the non-tariff barriers, Poland was allowed to adopt measures stimulating production of finished vehicles and generating local demand: (i) the ban on the import of cars older than 10 years; (ii) the excise tax on all used cars; (iii) duty free quotas for the import of equipment and parts for car assembly. Moreover, to attract FDI to the component sector in 1995 Poland created Special Economic Zones (SEZ), which offered investors various privileges such as tax holidays and investments grants. Although SEZ were at odds with the EU state aid, to which Poland had agreed to conform to in the EA, Brussels initially tolerated them.

The EU not only allowed Poland to use the aforementioned protective measures, but also to some extent strengthened the state in its efforts to stimulate the industry during the 1990s. In 1994, the EBRD supported the modernization and expansion of Fabryka Samochodów Małolitrażowych (FSM), a passenger car factory jointly owned by Italian Fiat and the Polish state. By acquiring a minority stake in the Polish entity and by arranging a credit line, the EBDR helped to transform production sites and integrate them into the

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10 Authors' interviews with the director of the Automotive Technologies Research and Development Company (OTAM), 10 March 2015, the director of the OSD, 26 November 2014, and ODD (Automotive Distributors' Association), 24 October 2014 in Istanbul, and in the Ministry of Industry, 17 March 2015, Ankara.

11 'Europe Agreement Establishing an Association between the Republic of Poland, of the One Part, and the European Communities and Their Member States, of the Other Part', 27 January 1994, in Dziennik Ustaw (Journal of Laws), Annex to No. 11, Position 38.

European automotive value chain.[12] As trade liberalization between the EU and Poland was gradually increasing, the EU became even more engaged in the transformation of the Polish automotive industry. The EU-financed advisors assisted the Ministry of Economy in updating its initial developmental strategy for the automotive sector (Government Economic Committee 1996). Advisors helped state actors to prepare for the gradual withdrawal of support instruments for final producers and to manage support instruments (such as SEZ) for component producers.[13] Moreover, in response to demands by the European Commission, the ministry had to tighten the rules for semi-knock down (SKD) assembling.[14] In many cases, SKD assembling was used by MNCs to avoid import tariffs on final cars. While the Commission had no objections against European MNCs, like Volkswagen and GM/Opel, pursuing this strategy, Brussels became concerned when Asian MNCs, like Daewoo or Hyundai, increasingly followed suit. The Commission was under the pressure of the European industry, which was afraid that cheap Korean cars assembled in Poland would first push the European cars off the Polish market and in the next step from the Western markets.[15] Another example of EU engagement in the Polish automotive sector included Brussels' financial support for the development of the Central Register of Vehicles and Drivers (CEPIK).[16]

With the full liberalization of automotive trade in 2002 Brussels' approach towards Poland's industrial policy changed. In line with the EA Poland could no longer use any protective measures and the Commission became very strict as to the use of policy tools for the stimulation of the automotive industry, such as state aid and non-tariff barriers. The Commission became particularly concerned with the amount of state aid given to the industry in SEZ. During the membership negotiations the EU considered SEZ as a violation of state aid rules and wanted Poland to liquidate them. Yet, Poles like other CEEC were determined to preserve the benefits they had already granted to the manufacturers, and managed to receive some concessions and transition periods for automotive producers (Bohle/Husz 2005). The Commission was also very persistent in detecting any attempts made by Polish authorities to limit the import of used cars. As a result the Polish market was flooded with the import of second-hand cars from the West, which significantly undercut the demand for local production.[17]

12 Altogether the investment amounted to $175 million. The funds were used for the modernization of production lines in Bielsko-Biala and Tychy and the development of a new model for production in Poland (Janowski 1994).

13 Measures planned for final producers included: (1) decreasing duty free quotas for components imported by final producers; (2) review of privatization deals and checking whether investors fulfilled their obligations; and (3) lifting the ban on the import of used passenger vehicles, see KPRM, document adopted by the Government Economic Committee, 1996.

14 SKD and CKD (complete knock down) production refers to a common procedure in the automotive industry where cars are assembled from kits produced at other sites. The assembly site is located in the market where the vehicles are to be sold. SKD production takes place when an imported vehicle kit contains elements that have already been preassembled, such as the autobody (welded and painted). CKD implies assembly from a larger number of components and is more work intensive (Meyer 2008). Simple SKD assembly was limited in Poland from 1998 onwards and banned from 2000 onwards.

15 Authors' interview with a representative of the Polish automotive industry (October 2014, Warsaw) and press articles that reported about the EU concerns and pressure on Poland: Walewska (1996), Grzelec (1996), Bielecki (1997).

16 The pilot program for the launch of CEPIK was financed from 'Poland and Hungary: Aid for Restructuring of the Economies' (PHARE) funds dedicated for the Centralised Informatics - PHARE PL 9414.

17 After EU accession Poland imported on average 800,000 used cars per year (Kipigroch 2011).

Whereas liberalization almost killed the market for new cars, it did not harm production. In fact, car production tripled between 2003 and 2008 reaching almost one million of units in 2008.[18] Such an upsurge was driven by the change in the strategy of OEMs operating in Poland. Throughout the 1990s OEMs that came to Poland assembled vehicles from imported parts, initially in SKD and later in CKD system. This allowed them to produce a large number of models in small quantities to serve the domestic market. When the tariffs were phased out, SKD and CKD production became no longer profitable and some of the OEMs like Ford left. However, others, like Fiat, Volkswagen and GM, stayed and switched from assembly to state-of-the-art production supplied by local component producers.[19] This required production and product upgrading. Therefore, significant investment in modernization and expansion of production capacities took place from 2002 to 2004.[20] For instance, Volkswagen, which had been present in Poland since 1993, invested €600 million in 2003 in its facility in Poznan (Winter 2008). Regarding product range, Polish facilities stopped assembling several models and became sole production sites for particular models like Panda (Fiat), Caddy (Volkswagen) or Agila (GM) that were sold on the EU markets. Similarly, liberalization had positive effects on component production. Poland became net exporter of parts and components in 2001, mainly as a result of export-oriented strategies of MNCs, which came to Poland in the second half of the 1990s. Interestingly, after 2000 MNCs slowly started to move non-production activities like research and development (R&D) and administration to Poland, yet the process is still in its nascent stage (Domanski/Gwosdz 2009; Winter 2008).

Despite the change in the EU approach to Poland's policy towards its automotive industry, the EU continues to have a positive effect on the sector. Polish industry benefits from the access to the EU market where almost all its output is sold. Moreover, with the accession to the Community Poland also gained access to Structural Funds. The government and business associations see the EU money as an opportunity to upgrade production and move toward R&D activities.

The previous discussion suggests that both the Polish and Turkish automotive industry experienced expansion and upgrading in the past decades. Their developmental trajectories nevertheless reveal important differences. We explain this outcome with their embeddedness in different EU modes of integration as well as different timings and patterns of transnationalization that emerged in the automotive industries in these two countries:

In Poland, the transitional recession and industrial restructuring closely overlapped with the opening of new markets, and the only way to make use of this opportunity was to supplant the lack of domestic technology and manufacturing capacity with foreign investment as quickly as possible. The clear Polish prospect of EU membership as well as the retained tariffs on imported cars in the 1990s facilitated significant

18 Data collected from the International Organization of Motor Vehicle Manufacturers (OICA) (2015) 'Production Statistics, Production of Passenger Cars and Light Trucks', available at http://www.oica.net/category/production-statistics/, accessed 29 April 2015.

19 The international strategy of OEMs goes through stages that start from SKD assembly through more complex CKD assembly to the establishment of the state-of-the-art factory with the competencies and capabilities of home location (Van Tulder/Ruigrok 1998).

20 According to Poland's National Statistical Office automotive companies invested most heavily in innovations (machines, buildings and R&D) in 2002 and 2003 – roughly around to three billion PLN each year (www.stat.gov.pl).

FDI inflows and new investments in the automotive industry, resulting in a profoundly transnationalized industry in Poland. Multinational OEMs bought existing plants in Poland and established new production facilities. Similarly, a new and transnationalized components industry emerged in Poland to serve these newly flourishing plants as well as to supply producers in other European countries.

In Turkey, MNCs established their presence already in the 1970s and 1980s, primarily through joint ventures with domestic producers. After the liberalization of foreign investment in the 1980s, they increased their shares, but the dominant form of ownership in the vehicle industry (with the exception of the newly-arrived Asian firms) remained that of joint ventures (Eder 1993). This form of ownership in the leading firms has been shown to be conducive to greater involvement of domestic suppliers (Javorcik/Spatareanu 2004), which is also evident in the Turkish case. This is quite exceptional in the international comparison, as the car industry tends to prefer a form of transnational organization that replicates the same structure of suppliers in all production locations (via a follow-the-customer system).

Due to Turkey's status as a candidate country, the Turkish government is still free to pursue a largely autonomous industrial policy, though it cannot apply trade restrictions on EU goods. The Turkish government can circumvent the EU's rigorous limits on direct intervention tools, such as state aid. True, recent EU progress reports do criticize Turkey for non-compliance with EU state aid regulations (European Commission 2013). According to one of our interview partners, however, this development can be explained by Turkey's diminishing interest in European integration since 2009 and the declining credibility of the EU membership perspective. [21] At the same time, Turkey has limited access to EU funding and is not part of the EU's numerous initiatives to promote industrial development and innovation via horizontal policy tools. Even more, the majority of EU funding came after 2002 when the industry had already completed its transformation and adapted to the new environment.[22] Nevertheless, Turkey remains more successful than Poland in keeping research and development activities on its territory: while in 2009 in Turkey research and development represented 6.8 percent of total value added in the automotive industry, in Poland it was only 1.2 percent around the same time.[23]

Hence, both Turkey and Poland represent cases of gradual liberalization and strong domestic capacities that helped nurture and restructure the industry prior to the full integration into the EU market. Still, important differences characterize their automotive industries. In Poland gradual liberalization took place for about ten years, and the state used this time to lure MNCs that could restructure the industry and prepare it for full EU integration. Restructuring in Poland was assisted by EU programs and, given the clear prospect

21 Authors' interview with an expert bureaucrat in the Ministry of Economy, 19 March 2015, Ankara, Turkey.

22 This is not to say that the EU has not provided any financial or administrative assistance to Turkey. After 1996, it provided support under the Mediterranean Development Assistance (MEDA) Program in order to promote the Customs Union and economic and social development. Since 2002, with the Council decision on 17 December 2001 (No. 2500/2001), Turkey has received additional funding, €177 million annually (Central Finance and Contracts Unit (CFCU) 2004). From 2007 to 2013, Turkey was supported through the Instrument for Pre-Accession Assistance (IPA). During this period Turkey received €4.8 billion (European Commission 2011, Ministry for EU Affairs (MfEUA) 2013). Furthermore, in 2008 it became eligible for EBRD loans and since then 140 projects have been funded (of which three were automotive projects).

23 Eurostat Structural Business Statistics (2015) 'Structural Business Statistics', available at http://ec.europa.eu/eurostat/web/structural-business-statistics, accessed 29 April 2015.

of membership, resulted in substantial FDI inflows and new investments. Both domestic and external factors conspired in Poland to push the sector towards a transnationalized path that yielded impressive export performance, though a less impressive record in research and development. By contrast, in Turkey restructuring the automotive industry took longer and was governed primarily by domestic actors: Turkish state authorities in cooperation with domestic business associations. The shallow integration regime in Turkey left more room to domestic actors for developmental experimentation benefiting also domestic capital and domestic R&D.

3.2 Integrating the Weak: EU Integration and the Development of Automotive Industry in Romania and Ukraine

During the 1990s, the automotive sectors in Romania and Ukraine shared similar starting conditions: following the breakup of the Soviet Union, which resulted in the disintegration of traditional trade networks among the formerly socialist countries, both sectors witnessed a sharp production decline and were not able to privatize key assets in their automotive industry with the help of foreign capital (Pavlinek 2002). Hence, both countries were unable to attract much-needed investment for technological upgrading as well as new product development in their car industry and did not manage to integrate into European or global value chains. To be sure, the EU completely liberalized access for cars from Romania and Ukraine in the early 1990s, but this did not trigger a re-orientation towards the EU market since domestic brands simply lacked competitiveness. For example, during the 1990s even Ukrainian consumers considered Ukraine's key model, the Tavria – a comparatively cheap small sized car – as considerably lower quality than imported cars from the West (Yegorov 2004). Thus, at this stage the 'Brussels effect' alone was not sufficient to increase the incentives of Western multinationals to invest in Ukraine or Romania. Nor did the 'Brussels effect' activate the Ukrainian and Romanian states, who owned the major car manufacturing plants during the 1990s, to support upgrading and institutional change. Neither of these countries had state capacities to prepare industrial policies, or even to anticipate and alleviate outcomes of market liberalization; and the incentives to create such capacities were dramatically reduced by the dominance of the state by rent-seeking elites in both countries (Langbein 2015b; Vukov 2015; see also Hellman 1998; Pleines 2005; Bohle/Greskovits 2012).

Regulatory integration was also largely absent in the 1990s. Romania signed an EA with the EU as early as 1993, which foresaw the reduction of import tariffs and binding regulatory approximation of EU rules. However, the EA did not trigger a process of 'anticipatory adaptation' in Romania during the 1990s. Thanks to the prolonged rule of its barely-reformed communist party, Romania saw much slower privatization than in the CEEC and continued soft-budget constraints for the state-owned enterprises. This precluded the restructuring and upgrading of industry (Bohle/Greskovits 2012). Weak economic reform, economic and political instability, and the uncertain prospect of EU membership (the accession negotiations started only in 2000) all reduced the attractiveness of Romania for FDI.

Meanwhile, Ukraine's EU membership prospects were even more distant than Romania's. The Interim Trade Agreement, which Ukraine and the EU signed in 1996 and which became part of the Partnership and Cooperation Agreement between the two parties two years later, did not oblige Ukraine to take on EU internal market rules (Petrov 2008). Like Romania, Ukraine lacked elementary state capacities. At the same time the EU did hardly anything to empower the reform-minded minority within the Ukrainian state (on the way the EU did that in the CEEC see Jacoby 2006); actors who could have created "islands of efficiency" within the otherwise feeble state (on "islands of efficiency" see Evans 1989: 577; Langbein 2015b).

Hence, both countries were hardly attractive for foreign investors, who rather resorted to markets with a more predictable institutional environment, such as Poland, Slovakia, the Czech Republic or Hungary. Rather than emphasizing foreign-led restructuring of their automotive industries, both the Ukrainian and Romanian governments resorted to national development policies based on protectionism (Pavlinek 2002). The cost of bringing a new car into Ukraine was at more than 100 percent of the declared costs of the new car up until 1996. Further, the government granted Ukrainian producers value-added tax exemptions to cushion the effects of increasing imports of used cars. That said, the Ukrainian government did find a foreign investor – Daewoo – for Ukraine's major car manufacturer, AvtoZAZ, but the deal only came about thanks to the government's willingness to introduce discriminatory measures against foreign car importers. By 2000, however, the Daewoo deal turned out to be a complete commercial failure (Yegorov 2004). To be sure, the Daewoo investment did certainly not cause the collapse of the industry in the first place. As mentioned earlier, the Ukrainian state and the local industry simply resorted to protective measures to save the industry. They did not, however, invest in upgrading local production plants to increase competitiveness vis-à-vis imports from the EU or Russia or in building institutions that would attract long-term investments. When the Daewoo investment arrived, the Ukrainian car industry had already collapsed and the Koreans did certainly not help the sector to restructure, but were rather interested in fast profit to avoid the bankruptcy of their mother company.

Romania, on the other hand, also kept its domestic market protected (Egresi 2008). It kept excise duties on new car imports as well as excises of up to 27 percent on the import of used cars (WTO 2005). However, production was declining, and there was hardly any restructuring of industry. The dominant domestic producer – Dacia – was still state-owned and lacked capital and technology to modernize production. The state did manage to find a foreign partner for the other car plant, establishing a joint venture with Daewoo in Craiova, but similar to Ukraine, this enterprise turned into a failure after the bankruptcy of the Daewoo mother company.

Hence, both in Romania and in Ukraine the EU allowed elements of protectionism. However, in the absence of a clear EU membership perspective, with lack of a broader economic reform agenda, as well as in the absence of general state capacity for managing economic transformation, protectionism was not used to restructure the industry and attract MNCs. The EU integration regime vis-à-vis both Ukraine and Romania was shallow during the 1990s, partly also because of the lack of domestic capacities that precluded deeper engagement with the EU (Langbein 2015b; Vukov 2015). Similar to Central and Eastern European (CEE) frontrunners like Poland, PHARE programs helped economic restructuring in Romania by financing industrial strategies. In contrast with Poland, where such strategies were actually used as the basis for restructuring the industry, in Romania they were typically shelved (European Commission 1997).

Both the Ukrainian and Romanian states were, therefore, left with room for protectionist policies while lacking domestic capacities for upgrading industry. The result was a production decline in both countries throughout the 1990s.[24]

Interestingly, the developmental pathways of the Romanian and Ukrainian automotive sectors started to diverge around 2000. Both sectors witnessed an increase in production. However, only the Romanian car industry became increasingly transnationalized, with FDI dominating both the OEMs and the suppliers' sector. Romania also recorded a tremendous rise in exports, with production reoriented towards the European rather than the domestic market, and it has even experienced some functional upgrading. By contrast, the Ukrainian car industry attracted SKD assembling from 2000 onward but attracted little FDI and remained completely oriented towards the domestic market even as its production volume grew. The Ukrainian car industry was still characterized by a trade deficit in almost all segments of the industry even during this relative boom phase.

Can EU factors explain these divergent developments subsequent to 2000? The beginning of accession negotiations with Romania in 2000 marked a change in the EU's integration strategy towards the country. As a candidate country, Romania was required to align its regulations with the EU acquis, reform the procedures for granting state aid, and complete trade liberalization by the time of accession. More importantly, the EU helped build the basic framework of a functioning market economy and improve the business environment. Together with the clear prospect of membership, these reforms made Romania much more attractive to foreign investors. Following Renault's landmark investment in 1999, FDI poured into Romanian suppliers' network, and both OEMs and suppliers used Romania as the hub for exporting to other European markets (Egresi 2007).

The EU also pushed Romania to develop EU-conforming developmental policies, such as a national industrial policy and a national strategy for increasing competitiveness[25] (European Commission 2000). However, the menu of developmental instruments still left to Romania was substantively smaller: the state lost the ability to protect the market from Western imports, while also having to gear its state aids towards 'horizontal' goals. Yet while transforming the rules on state aid as well as providing technical assistance for building the state-aid institutions in Romania, the EU by no means abolished such possibilities entirely. Indeed, the automotive industry continued to benefit from generous state subsidies, appearing as the biggest beneficiary of state aid schemes.[26] Furthermore, EU accession also brought access to EU-level financial instruments, such as the Structural Funds and the European Investment Bank (EIB) loans. Multinationals investing in Romania effectively used these opportunities. The biggest research and development automotive centre in Romania – Renault Technologie Roumaine – has been financed by the EBRD and EIB loans in 2009, while the EIB loan also provided a sizeable portion of the total Ford investment in Romania. Hence, to a certain extent, the EU actions substituted for Romania's weak state capacity (see also Bruszt/Langbein 2015).

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24 In Ukraine, passenger car production declined from 155,000 units in 1990 to only 2,000 units in 1997. Romania's passenger car production declined from 100,000 units in 1990 to 77,000 units in 2000 (Pavlinek 2002).

25 Authors' interview with an official at the Romanian Ministry of Economy, Bucharest, 6 February 2015.

26 Authors' interview with officials at the Romanian Directorate for Foreign Investment and Public Private Partnership, Bucharest, 5 February 2015.

By contrast, Ukraine production increases between 2000 and 2008 can hardly be explained by EU factors but were purely domestically driven. As Langbein (2015b) details, after the failure of Daewoo's investment in early 2000, the government reduced import tariffs to 5 percent for parts and components, while leaving tariffs for cars at 25 percent. Ukrainian car dealers had effectively lobbied for this decision. Around 2000 the latter had acquired major stakes in the manufacturing industry and wanted to increase incentives for foreign car producers to have their models assembled at Ukrainian plants in order to circumvent the comparatively higher import duty on cars.[27] Growing production was also a result of increasing domestic demand thanks to economic recovery and widespread access to private credit. However, foreign investors were reluctant to establish joint ventures and support even CKD assembly (let alone full-scale production) because Ukraine's investment climate was still unpredictable. Ukraine was not a EU candidate country, so the EU – unlike in Romania – did not engage in comprehensive institution building and did not substitute for the lack of reformers to improve the investment climate. While the Ukrainian government tried to attract foreign investors through subsidies (e.g. tax exemptions in Special Economic Zones), these did not outweigh investors' uncertainty regarding property rights, standardization or customs (Yegorov 2004; Pavlinek 2008). Hence, multinationals were only willing to support SKD assembly. Moreover, unlike in Romania, investors in Ukraine could not expect financial support through Structural Funds or EIB credits.

The developmental pathways of the two sectors diverged even more after the financial crisis. The 2008 crisis did not hit Romanian automotive industry particularly hard, primarily due to Romania's specialization in producing small, low-cost cars, which continued to be successful in West European markets, thanks especially to the scrappage schemes introduced by West European governments. Production and exports thus continued to increase after 2008 (Vukov 2015). By contrast, the financial crisis, paired with Ukraine's accession to the World Trade Organization (WTO), led to a sharp downturn in automotive production. During WTO accession negotiations, Ukraine had agreed to reduce import tariffs for a variety of products, including cars. Moreover, the financial crisis diminished domestic demand for new cars. Consequently, multinationals scaled back SKD assembly and began to serve the Ukrainian market from plants in EU member states. Since Ukraine's car producers had not managed to restructure the industry during the boom phase, i.e. by building strong supply networks or by investing in skill improvement, they could not withstand the competitive pressure that followed trade liberalization (Langbein 2015b).

All in all, the Romanian and Ukrainian comparison demonstrates the effects of different integration regimes on developmental outcomes. Despite similar sectoral starting conditions and equally weak state capacities, the sectoral pathways diverged when the EU adopted a deep integration strategy from 2000 onwards vis-à-vis Romania but maintained its shallow integration regime in the Ukrainian case. By offering membership to Romania and integrating it into the EU Internal Market both in economic and regulatory terms, the EU contributed to increasing investors' confidence and enabling Romania to become the cheapest production location within the EU market. Hence, the EU substituted for Romania's weak state capacity. By contrast, the EU did not invest in building up domestic capacity in Ukraine. The lack of a membership perspective for Ukraine left the EU not only unwilling to support institution building in an equally comprehensive manner but also weakened the 'Brussels effect'. As a result MNCs preferred investing in the CEE states to increase

27 Authors' interview with a former employee of AvtoInvestStroy (AIS), Kyiv, 12 November 2014.

their stake in the EU Internal Market, while partnerships with Ukrainian car manufacturers were mainly designed to serve the Ukrainian market without much concern for upgrading or integrating Ukrainian supply networks into European or global value chains.

3.3 Convergence and Divergence in Different EU Regimes

EU integration changed the developmental pathway of the automotive industry in all four countries. However, the precise influence of the EU differed greatly in its new members, candidates and neighbours. Consequently, the national auto sectors experienced different patterns of convergence and divergence. In the deep integration regime directed at Poland and Romania, EU integration contributed to the convergence of the automotive industry on a rather similar pattern. Poland and Romania's automotive sectors both experienced deep transition and are controlled by European multinationals; both are primarily export oriented and used as production hubs for exports to other European countries with their primary asset being relatively cheap and skilled labour force; and both have experienced growing sophistication of their components exports as well as some functional upgrading. In both, however, R&D intensity is still below the EU core countries, or even other peripheral countries like Turkey or Spain. Despite the fact that transnationalization and restructuring of the industry in Poland started in the early 1990s while in Romania it happened almost a decade later, the two sectors today share rather similar features and play a similar role in the European division of labour: supplying components at a competitive price for assembly in other EU countries as well as exporting finished vehicles mostly in the low-cost market segment. Furthermore, the expansion and upgrading of the sector took place in both of these countries despite the stark differences in their initial developmental state capacities (Markiewicz 2015; Vukov 2015).

On the other hand, the industries in the shallow regime actually experience increased divergence over time. Turkey reoriented from technologically backward production for its domestic market towards a competitive export hub supplying light commercial vehicles to the European market. By contrast, the automotive industry in Ukraine witnessed a sharp production decline after the break of the Soviet Union and has remained oriented towards the domestic market. After a brief period of expansion based on SKD assembly, it witnessed a dramatic downturn once again after the 2008 crisis and the accession to the WTO. This increased divergence is, however, not driven purely by domestic factors; rather, trade liberalization and the integration with the EU played an important role in both sectors. Contrary to the deep integration regime where the EU represents the factor of convergence, in the shallow regime the EU actually deepens developmental disparities among the non-members.

We have shown that the different effects of the EU in these two groups of countries stem from the combinations of elements through which the EU shapes sectoral developments in its peripheries. In the shallow integration regime, the key EU mechanism was trade liberalization, while the EU refrained from using other instruments for managing the integration of its neighbourhood. Even though Turkey has enjoyed greater liberalization than Ukraine since the mid-1990s, the EU integration regime differed little across the two countries in other aspects. The EU did not support regulatory integration by providing technical assistance for state administrators or financing infrastructure projects or firm-level assistance. Turkey has an investor friendly institutional environment, but it had established this on its own before accession negotiations started (Bayram 2015). As for Ukraine, even if it had been granted a more liberal trade regime with the EU, it would not have been able to exploit that market access. Ukraine lacked the domestic capacity for ‘independent’ upgrading Turkish-style, but it also lacked the liberal reformers and credible perspective of EU membership that could have facilitated the transnational version of upgrading apparent in the EU’s new member states (Langbein 2015b). Hence, to the extent that the EU integration regime relies solely on trade liberalization without engaging in deeper institution building, the EU can actually exacerbate pre-existing differences in the developmental capacities of non-members. Market opening made the strong even stronger, while contributing to the complete collapse of the weaker industry.

By contrast, in the deep integration regime the EU employed a battery of instruments to manage the integration of future members. In addition to market opening and requiring regulatory convergence, the EU provided financial and technical assistance for adapting the regulatory institutions to the acquis. It strengthened the developmental capacities of the states by providing technical assistance for restructuring plans, as well as by strengthening the general state capacities for creating functioning market economies and improving business environments. All of this contributed to the profound transnationalization of the automotive industry in the new member states of the EU and their inclusion into the European and global value chains. Despite initial differences between Poland and Romania, integration with the EU has fostered upgrading in both automotive sectors and resulted in transnationalized, export-oriented and competitive industries. In both countries the EU eventually forbade protectionist instruments for nurturing domestic industry, but it did so gradually and with simultaneous provision of technical assistance for managing the restructuring of the industry.

Moreover, joining the EU meant the simultaneous strengthening of the liberal elements of the state, making the countries more attractive for foreign investors as well as replacing the ‘old’ developmental instruments based on selective promotion and protection with the developmental framework based on ‘horizontal’ policies. In this new framework, the EU played an active role both by assisting the building up of domestic institutions for horizontal state aid as well as by providing access to the supranational developmental instruments such as the Structural Funds and the EIB loans. The EU’s deep integration regime thus proved capable not only of strengthening domestic market-friendly developmental capacities, but also of substituting for domestic state weakness, by providing a general framework of economic and political stability as well as by providing access to supranational developmental policies. In contrast with the diverging influence of the EU integration in the neighbourhood countries, the deep and comprehensive management of integrating the peripheral new member states offers more opportunities for convergence.

4. Conclusion: the Business of Integration

In this paper, we have demonstrated that the diverse EU modes of integration create very different constraints and opportunities for developmental pathways in Europe's peripheries. The shallow mode of integration based on trade liberalization and selective rules imposition with very little assistance for peripheral actors results in rather divergent developmental pathways for the EU 'outsiders'. For countries with strong public and private domestic capacities, there are indeed certain benefits from shallow integration, which leaves them more scope for domestic developmental experimentation. For countries with weak states and weak domestic private actors, however, shallow integration with the EU can have detrimental developmental effects. Exposed to competition from stronger industries in the EU core, and without any assistance and institution building that would strengthen their developmental capacities, initially weak EU neighbours are prone to get even weaker in the course of integration.

In contrast, the deep mode of integration consisted of managed liberalization, encompassing regulatory integration and substantive EU assistance for public and private peripheral actors and created more opportunities for convergence towards competitive industries, even in countries with weak domestic capacities. By requiring full regulatory integration, providing assistance to domestic actors for implementing these rules and by managing potential negative externalities of integration, the EU contributed to the deeper transnationalization and faster industrial upgrading in its new member states.

The diverse EU strategies of integration are themselves the function of the different structure of costs and benefits that integration implies for the core EU actors. In the shallow integration regime, the core EU actors have more opportunities to externalize the potential costs of integration stemming from the possible failure of peripheral economies to adjust to the competitive pressures of the EU market. Without a credible membership perspective, neighbouring countries are seen to represent much less of a danger for the core. While the present Ukrainian crisis represents a basic challenge to this perception, up until the present, neighbouring countries are seen neither in a position to hinder further market integration, nor as entitled recipients to transfers from the EU should the integration result in dire economic consequences. So far, the relation between the EU and its neighbouring periphery has thus primarily been one of asymmetric power relations in which the EU acts by defending the interests of its insiders in a zero-sum game. The Ukrainian crisis and ongoing conflict in Eastern Ukraine questions the viability of this approach, clearly showing that the EU is not protected against the political and economic collapse of its neighbourhood countries.

The integration of the East European new member states has, however, presented a rather different constellation of costs and benefits for the EU core. By offering a credible membership perspective, the EU transformed the relation into one of asymmetric interdependence with its would-be members and lost the possibility to completely externalize all negative consequences of integration. The potential economic costs emerging in the East European periphery were much more likely to spill-over to the core, either via undermining further market integration within the EU-15 (by way of not playing by the rules of the EU market), or via requiring higher economic transfers (by way of playing by the EU rules but at the price of not being able to live by them, because of excessive economic and political costs). Given the asymmetric interdependence between the EU and its would-be members in Eastern Europe, the integration of the latter was conceived as a positive-sum game in which the EU insiders would have gained less and would have lost more, if they had cared about the capacities of the peripheral actors to increase their benefits from the game.

Furthermore, different integration instruments apparent in the deep mode of integration (trade liberalization, regulatory integration, assistance programs) actually reinforce each other. By improving the business environment and fostering FDI, deep integration changes the composition of domestic actors and creates a positive feedback-loop through which the domestic demand for the adoption of EU rules is increased. The effects of the shallow integration regime, however, might be exactly the opposite: by allowing for selective rule adoption and by failing to provide a clear membership perspective, shallow integration resulted in much less transnationalized neighbouring economies, failing to create domestic demand for further integration. Furthermore, in the neighbours with weaker domestic capacities, shallow integration may impose costs on domestic actors. Since the latter are not remedied by any EU assistance (as in the deep regime), such costs are likely to increase resistance to further integration once citizens realize they cannot count on the intertemporal trade-off of getting future membership in the richest club for tolerating present economic hardships.

From the perspective of maximizing the integration capacity of the EU, the lesson is thus that encompassing deep integration may yield not only superior developmental results, but may also increase the potential for further integration. Such beneficial effects will however be apparent only to the extent that the EU mode of integration succeeds in changing the composition of economic actors in the candidate countries and bringing about a more transnationalized development path. As for the economic integration of countries without the promise of membership, the EU has to consider moving towards the deeper mode of integration if it does not want to become a factor of economic and political destabilization in these countries.

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“Maximizing the integration capacity of the European Union: Lessons of and prospects for enlargement and beyond”

The ‘big bang enlargement’ of the European Union (EU) has nurtured vivid debates among both academics and practitioners about the consequences of ‘an ever larger Union’ for the EU’s integration capacity. The research project MAXCAP will start with a critical analysis of the effects of the 2004-2007 enlargement on stability, democracy and prosperity of candidate countries, on the one hand, and the EU’s institutions, on the other. We will then investigate how the EU can maximize its integration capacity for current and future enlargements. Featuring a nine-partner consortium of academic, policy, dissemination and management excellence, MAXCAP will create new and strengthen existing links within and between the academic and the policy world on matters relating to the current and future enlargement of the EU.