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Development by Stealth

Governing Market Integration in the Eastern Peripheries of the European Union

László Bruszt and Julia Langbein

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Abstract

Why and in what ways did the European Union care about the potential developmental consequences of integrating the economies of Central and Eastern Europe? The relevance of these questions is given by the fact that thus far the Eastern enlargement is the only successful case for the deep market integration of economies at lower levels of development. EU insiders had no formal obligation to care about the developmental effects of integration and, according to the standard literature, enlargement was solely about rule transfer without any need to consider the interests of rule takers. We challenge this view and show that due to increased economic interdependence, the Eastern enlargement was a case for large-scale experimentation with mechanisms to manage developmental consequences of rule transfer. Using contract theory, we identify three mechanisms that could force stronger actors to care about the developmental effects of integration on weaker actors. We also show that the key governance challenge of deeper market integration is to manage uncertainty and develop mechanisms to match uniform market rules with diverse local developmental needs. In the case of Eastern enlargement EU insiders could define alone the scope of developmental interventions that were limited to preventing large-scale dislocations, without greater politicization or publicity, hence 'by stealth'. Our insights do not only open up new avenues for research on how to manage the integration of economies at different levels of development but also have direct implications for the way the EU manages existing economic disparities in its internal market.

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1. Introduction

There is a striking gap in the literature dealing with the politics of market integration that involves economies at different levels of development. In the literature that deals with world regions in which most of the integration attempts fail, such as the global South, researchers link failure and progress in regulatory integration to problems in matching uniform market rules with diverse local developmental needs (Bruszt/Palestini Cespédes forthcoming; Estevadeordal et al. 2004; Locke et al. 2007; Piore/Schrank 2014). The European Union (EU)'s Eastern enlargement of 2004/07, the only successful large-scale regional market integration of lesser-developed economies thus far, might entail some interesting lessons for integration efforts in other areas of the world. But learning the lessons from this case is hindered by the fact that the literature dealing with integration of the Central and East European (CEE) countries into the EU internal market is almost completely silent about EU strategies aimed at managing the developmental consequences of integration.[1]

This lack of interest is even more surprising given the fact that official EU policy documents have linked difficulties in market integration in Europe since the 1970s directly to the way problems of economic disparities are managed (Laffan 1985) and that such issues also came up explicitly in official EU documents during the Eastern enlargement (Bruszt/Vukov forthcoming).

Why, how and with what effects did the EU care about the developmental consequences of the regulatory integration of the CEE economies? Filling the above-mentioned gap in the literature would require answering these questions. In this paper our goal is more modest. The systematic exploration of possible effects is beyond the scope of this paper. While we offer some evidence on these effects, our primary goal is to examine why and how the EU cared about developmental consequences of the largest attempt thus far to integrate economies at lower levels of development.

The first of these questions is basically about the mechanisms that could transform highly asymmetrical relations into relations of *interdependence* during the process of rule transfer. In the mainstream literature on the EU's Eastern enlargement the integration is described simply as the transfer of non-negotiable market rules without much need to care about the developmental consequences of adopting these rules.[2] From this perspective the Eastern enlargement is a least likely case for the development of mechanisms that would allow the stronger actors to care about the developmental consequences of rule transfer: EU insiders had no formal obligation whatsoever to care and the CEE countries had no say in the content of the market rules that they had to take. We challenge the standard view. Using contract theory, we identify three mechanisms that could force stronger actors to care about the developmental consequences of rule transfer. More specifically, we argue that instead of being a case for a simple exchange, the Eastern enlargement had all the key features of an incomplete contract and is a most likely case for the use of mechanisms that helped anticipating and alleviating the major negative developmental consequences of

1 In this paper we use the expression integration as a shorthand for economic integration that refers to the transfer of the rules and policies of the EU internal market to the CEE countries. This has included besides the removal of tariffs the transfer of nearly 80 thousand pages of regulations in 33 different policy areas.

2 For an excellent overview of this literature see Sedelmeier 2011.

the integration. The parties could not foresee the distributive consequences of honoring their obligations and the stronger party could control the costs and gains of the deal only by using such mechanisms.

More generally, we argue that the deeper national economies enter into the various stages of market integration, the more they have to cope with governance problems linked to increased economic and political interdependence. Deepening of integration amplifies uncertainty about the welfare effects of ever more complex economic relations and increases the necessity of matching uniform rules with diverse local developmental needs. The alternative to internalizing major developmental consequences of integration could be to leave out from such agreements issues that the parties think might grossly harm their interests in the future. While that could allow for signing a more or less complete contract, the parties have to stop market integration at a much more shallow level (Cooley/Spruyt 2009). Examples for such agreements include the NAFTA or the more recent attempts at closing a Transatlantic Trade and Investment Partnership and Trans-Pacific Partnership.

The second question that we explore is about the mode of governing deeper forms of market integration. The governance of rule transfer cannot be left solely to centralized monitoring and sanctioning, as the standard view on the EU's Eastern enlargement holds (Schimmelfennig/Sedelmeier 2005; Vachudova 2005) because of the high level of uncertainty about the right ways to deal with the developmental consequences of rule transfer.

We will show that the shared interest of EU insiders to control the developmental effects of integration gave rise to a largely ad hoc supranational capacity building. The European Commission (EC) loosely coordinated the predominantly informal governance arrangement aimed at anticipating and alleviating major negative developmental consequences of rule transfer. As the goal was to defend the common interests of the EU member states, the management of interdependence happened in the framework of technocratic problem solving, or using the expression coined by Genschel and Jachtenfuchs (2013), *by stealth*, avoiding publicity and preventing the politicizing of the mode and content of EU interventions.

We start the paper by briefly discussing the standard view on the integration of the rule taking CEE countries and by presenting evidence that challenges this standard perspective. The second section provides a simple analytical frame for understanding why, despite the high level of power asymmetry, the EU had to care about the developmental consequences of rule transfer. The third section discusses the factors that could account for the extent and the mode of managing the developmental consequences of rule transfer. This section also describes the key elements of the governance mechanism and provides some evidence to illustrate its functioning. The fourth section closes with a discussion of important questions for further research.

2. Challenging the standard view about enlargement

The standard view in the literature on EU enlargement in general and its economic component in particular holds that enlargement was basically about rule transfer: the transposition and the implementation of the existing rules of the common market to the aspiring member states (Dimitrova 2002; Grabbe 2005; Schimmelfennig/Sedelmeier 2005). The focus of this literature is on the diverse mechanisms that could facilitate rule transfer ranging from persuasion to coercion (Jacoby 2006). The (developmental) interests of domestic actors from rule taking countries did not count in this standard view (Bieler 2002, 2006; Bohle 2006; Jacoby 2010; see for an exception Dunn 2003).

The challenging of this standard view is complicated by the fact that EU desk-officers participating in the Eastern enlargement are themselves very cautious about using the language of development when talking about the Eastern enlargement. "*We were responsible for negotiations about non-negotiable rules*" – we were told several times during our interviews in Brussels. Instances of defending the developmental interests of the most developed EU insiders were actually more common than references to the interests of the rule taking countries:

> "We [the Commission], or rather some of the member states' governments, feared that our sectors would be affected by the Central and Eastern European countries due to low cost production/low salaries. So we had to make sure that these countries at least fully comply with the *acquis* because this would also increase their local production costs".[3]

Instead of the word 'development', the key word which we heard more often than not in the Commission was 'viability', of firms, of sectors, of regional or local economies. Viability, a word that is explained in dictionaries as "ability to grow, survive outside womb"[4], was a concept very much in line with the key economic membership eligibility criteria for the CEE economies. Formulated in 1993 as part of the so-called Copenhagen criteria, it referred to "the capacity to cope with competitive pressure and market forces within the Union" (European Council 1993: 13). In plain English this meant the requirement of integrating the CEE economies afloat into the common market. Viability, understood as the capacity to simultaneously adhere to EU rules and live by them, was mentioned in our interviews and case studies in several different forms, linked to the sequencing and phasing of the implementation of different EU measures, capacity building, assistance to or demands for derogation. The following two citations are exemplary in this respect:

> "It was always important in negotiations to know what was economically viable both for the CEE countries and the EU-15. Therefore we introduced transition periods and safeguard clauses, set up numerous pre-accession instruments".[5]

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3 Authors' interview with an EU official (A) who was involved in planning the fifth enlargement, Brussels, February 2015.

4 Merriam-Webster (2015), available at http://www.merriam-webster.com/dictionary/viable, accessed 4 November.

5 Authors' interview with an EU official (B) who was involved in planning the fifth enlargement, Brussels, February 2015.

> "There was a lot of discussion going on within DG ECFIN[6] whether we should promote a particular economic model with regard to industry in the various countries or whether this is the responsibility of the market. We were not really sure. We could not come up with five-year plans on how to restructure certain economies. Of course, we had an idea about whether it would be wise to shift the focus from heavy manufacturing to textile industry. But what we did was to come up with analyses to study factor endowments of countries, e.g. when we prepared the Commission's Opinions on these countries before opening of accession negotiations, so we could actually assess when an accession country X would suggest to introduce safeguard clauses for the shipbuilding industry, whether this would be really the right way to go about it or whether this is not really helpful to ensure economic viability".[7]

In the period of Association Agreements, accession countries could negotiate six to 10 year long periods for phasing out the state sponsored promotion and protection of some of their strategic economic sectors. Although it would be hard to call the length of these grace periods generous, in our comparative case study of automotive sectors in the CEE countries we found that, holding other factors constant, from the perspective of survival of the sector these grace periods have made a difference as they allowed the rule takers to prepare the sector for competitive pressures (Bruszt et al. 2015).

Evidence from the steel sector provides further evidence for our argument that the EU, the Commission in particular, cared about negative consequences of rule transfer and tried to mitigate them by making the CEE economies more viable. As Lienemeyer (2005) details, the Commission demanded the candidates to write restructuring plans and the goal was to identify ways to make the industries viable, i.e. that they could compete on the EU internal market, would work profitable and apply EU law. The restructuring plans were guided by three principles: viability, minimum amount of state aid necessary to achieve viability and reduction of production capacity if the state continued to pay state aid. Social protection was secondary. If the state could not demonstrate long-term profitability of certain mills without subsidies, the EU forced the candidate to close them. At the same time, the state could continue using state aid to support payments to workers who had to be laid off.

From this perspective the EU was a permissive negotiator when preparing the fifth enlargement. Notwithstanding the entering into force of the Europe Agreement in 1994, Poland, for example, was allowed to continue the payment of subsidies until EU accession but had to clearly justify why this was necessary. The EU did not object when the Poles asserted that it was necessary to continue state aid for employment restructuring or debt reduction before accession in order to make a particular steel mill more competitive or attractive for foreign investors. At the same time the EU demanded privatization and forced the Czech government to consolidate the sector by merging four steel mills into one to attract an investor when the government failed to develop a convincing alternative (Sznajder 2006). Even after accession the EU permitted the Czech Republic, Poland and Slovakia transitional periods for restructuring their steel sectors during which state aid could be paid under certain conditions.

6 Directorate-General for Economic and Financial Affairs.

7 Authors' interview with an EU official (C) who was involved in planning the fifth enlargement, Brussels, February 2015.

In our case studies on the dairy sectors in Romania, Poland and Hungary we found that the Commission supported programs to help the viability of dairy farms and processing firms (Bruszt/Langbein 2014; Karas 2015). However, it was left to local authorities to define eligibility criteria for EU support, approving both plans that aimed at securing tens of thousands of smaller farms and those that wanted to 'consolidate the market', support only the largest firms and let the others perish.

EU officials we have interviewed have stressed that the EC's concern about potential negative effects of enlargement on candidate countries was more a by-product of the enlargement process, above all accession negotiations, and did not result in the creation of a kind of master plan on how to cushion social costs or on how to help the restructuring of economies to make them robust for competitive pressures of the internal market. PHARE[8] provided support to nurture EU-conform planning capacities in these countries and establish and implement a strategic approach to reforms and project design. But this did not imply a positive developmental plan on the part of the EU and a rather limited engagement in technology transfer or investing in small and medium-sized enterprises (SMEs). As one EU official who was first part of a negotiation team during the fifth enlargement and started to coordinate pre-accession instruments later in the process remembers,

"The EC wanted to avoid that these countries [the then applicant countries from CEE, the authors] collapse. […] the EC's policy in this respect was more ad-hocish".[9]

To avoid collapse of CEE economies (rather than advancing the integration of their economies in European value chains), the Commission repeatedly cooperated closely with the international financial institutions (the IFIs), the European Bank for Reconstruction and Development (EBRD) or the European Investment Bank (EIB) with the explicit goal of matching the requirements of implementing EU market rules and economic viability. The EU often co-financed projects with IFIs[10]: as one EU official who used to be in charge of coordinating accession negotiations during the fifth enlargement recalls,

> "When country X said that it could not implement the *acquis* because this would result in major job losses, we then tried to cushion negative social effects by setting up support programs through our Operational Programs. DG Enlargement was in charge of accession negotiations and Operational Programs so we could react quickly when countries had difficulties to comply with the *acquis*. Or we talked to EBRD and IFIs to sort out our opportunities for co-financing certain

8 PHARE stands for Poland and Hungary: Aid for Restructuring of the Economies. In December 1989 the EU passed Council Regulation (EEC) No 3906/89 on economic aid to the Republic of Hungary and the Polish People's Republic. In 1994, PHARE's tasks were adapted to the priorities and needs of each applicant country from Central and Eastern Europe, mainly in the areas of institution building and investment financing.

9 Authors' interview with an EU official (D) who was involved in planning the fifth enlargement, Brussels, February 2015.

10 The European Commission signed a Memorandum of Understanding on 2 March 1998 with the EBRD and the World Bank to reinforce their cooperation and to facilitate co-financing. In January 1997, the Council of Ministers agreed an envelope of 3,520 million for the lending activities of the EIB in central Europe, for the period from January 1997 to January 2000. The EIB's pre-accession support covered particularly those projects which facilitated the adoption of the *acquis communautaire* and strengthened integration with the EU (European Commission 2001a).

projects. I was actually on the phone with the EBRD every day during my time as coordinator of accession negotiations”.[11]

3. Why would the EU care? The fear of potential negative effects of integration

At first sight it seems to be counter-intuitive to assume that, prior to accession, the EU should have cared about the developmental consequences of enlargement. The EU is a club, the richest in the globe for that matter, with sovereign rights to decide about the rules of distributing the goods it possesses. Membership is the most precious one of those goods and countries that want to join have to accept the club’s rules. The relationship between applicants and EU insiders can easily be pictured as a simple contract: in exchange for the implementation of and full compliance with the *acquis*, applicants automatically gain membership. The governance of such a contractual relationship could be based on simple principles: monitoring by the EU should be strict and sanctioning should be based on meritocratic principles. Indeed, students of the Eastern enlargement have argued that rule transfer in the pre-accession period conformed to these principles (Schimmelfennig/Sedelmeier 2005; Vachudova 2005).

Picturing enlargement as a simple contract is, however, misleading. The relationship, we argue, has key features of an incomplete contract in which parties do not have all the relevant information to foresee the future distributive consequences of fulfilling their contractual obligations and cannot trust that revealed preferences at the time of contracting will be a good guidance for the further relationship among the parties (Cooley/Spruyt 2009).

Let us start with the issue of information about the distribution of the costs and benefits of enlargement among the parties. At the most general level of abstraction, enlargement refers to getting often diverse national economies and regulations under the command of EU internal market rules. Domestic states must give up large parts of their economic powers to control developmental outcomes. Moreover, they have to establish watchdog institutions within the state with the function of defending the common market from discrimination by domestic actors (Bruszt/Vukov forthcoming).

The process of integration to the common market consists of several stages starting with the removal of tariffs in the framework of Association Agreements, continuing with the stage of regulatory integration and finally leading to the fulfillment of the requirements of the European monetary regime.

From the perspective of the rule takers, each stage of the integration might entail uncertain developmental consequences that might range in their outcomes from complete economic marginalization or even exclusion from the common market to an increase in economic opportunities or competitiveness:

11 Authors’ interview with an EU official (B) who was involved in planning the fifth enlargement, Brussels, February 2015.

Reduction of tariffs, depending on the mode of its implementation, might allow for rapid growth due to increased market opportunities or, alternatively, it might result in the collapse of whole sectors. Regulatory alignment in the area of state aid, public procurement or technical standards, for example, can positively affect the competitiveness of certain industries in rule taking countries, attract FDI and might liberate domestic markets from powerful rent-seeking groups. But compliance might also wipe out entire industries unprepared for competition and, depending on the nature of domestic inter-sectorial ties, it might lead to complete economic collapse. Regulations tailored to resourceful actors in the more developed countries backed by capable states might impose prohibitive costs on economic actors in less developed countries that have to survive without a strong or capable state.

The previous discussion suggests that enlargement entails large-scale institutional monocropping: the imposition of uniform institutions and policies to a large number of dramatically different local contexts.[12] The bigger the amount of transferred institutions and the larger the number of organizational fields affected, the higher the probability of the emergence of complex and uncertain social, economic and political problems and potential recurring crises. As a result, the parties to the contract cannot have - *ex ante* - a perfect knowledge about the distributive effects and developmental consequences of rule transfer.

This situation might affect changes in the interest definition of rule takers, making them interested in a behavior that Wade Jacoby courteously called 'Potemkin harmonization' (Jacoby 1999) during the enlargement or, after having gained membership, to deviate from compliance.

The potentially large-scale mismatch between the uniform EU rules and diverse domestic developmental needs can affect the long-term willingness of the rule takers to play by the rules and might force them to challenge, after accession, the distribution of the costs and benefits of enlargement.

What about the EU insiders who have the power to decide about the rules and principles of accession? The above-discussed properties of rule transfer alter the way the rule makers will define their interests as well. The potential amount of their net gains and losses becomes, at least partly, the function of the gains and losses of the rule takers. We identify three mechanisms that might urge EU insiders to care about potential (negative) effects of rule transfer on the rule taking countries:

First, unintended negative developmental consequences of rule transfer, like economic collapse, political turmoil, or a large-scale migratory wave of displaced people from the rule taking countries are likely to reduce welfare gains of market integration for the rule makers or to impose high costs on them. The costs of unintended negative consequences of rule transfer cannot be completely externalized and prevented from spilling over to the rule takers. Due to geopolitical closeness and economic intertwining, EU insiders will be forced to internalize an unpredictable part of the costs of unforeseen negative developmental consequences. Potential gains by rule making countries might be lost if the unforeseen negative developmental consequences would prevent the more developed countries from expanding their exports to the new markets. Alternatively, large-scale economic dislocations caused by the negative consequences of rule transfer

12 On institutional monocropping see Evans 2004 and Bruszt 2014.

might undermine the capacity of the multinational companies to profit from the abundance of cheap and highly skilled labor in the CEE countries.

Second, an eventual large-scale non-compliance in the new EU member states can decrease the competitiveness of economic actors in the rule making countries. This might result in the massive transfer of firms to the new member states, induce a race to the bottom in the old member states and, as a result, undermine the integrity of the internal market.

Third and finally, the possibility of large-scale post-accession demand for fiscal transfer might endanger pre-existing distributive settlements among the member states and, in extremis, might dramatically weaken the decision-making capacity of the EU.

Consequently, based on the above analysis we assume that deep market integration transforms the simple asymmetrical relationship between rule takers to asymmetrical interdependence (Keohane/Nye 1977). We would expect that the rule makers would seek for governance solutions that could help them to anticipate and alleviate the potential large-scale negative consequences of rule transfer. Our empirical data based on a review of secondary literature, document analysis as well as qualitative interviews with nearly 20 EU officials who participated in the preparation of the fifth enlargement provides evidence for our argument.

3.1. EU fears and the demand for governing negative consequences of enlargement

We could identify two types of fears related to transferring the rules of the common market to the CEE economies. The first was linked to the potential failure of complete rule transfer; the second fear was linked to its eventual success. As for the former, the EU insiders feared that the new members would not be capable to *play by the EU market rules* and that partial implementation of the EU rules might induce unfair competition, increase protectionism and thus undermine the integrity of the EU common market. The latter fear referred to the possibility that the new members would not be able to *live by the EU market rules*; that competitive pressures and/or political costs resulting from the imposition of EU rules would be too high for them to take. Either way, the EU insiders risked losing control of the potential costs and gains of integration.

The overarching goals the EU sought to achieve through the fifth enlargement were to sustain political stability in Europe and to gain economic benefits from market enlargement (European Council 1994; European Commission 2001b; Moravcsik/Vachudova 2003). Realizing that the achievement of those larger objectives of the Eastern enlargement would be undermined if the developmental consequences remained unmanaged, the above mentioned two fears triggered increasing demand among the EU insiders for the governance of negative consequences of rule transfer:

The definition of the economic criteria of eligibility for membership at the 1993 Copenhagen Summit signaled the EU's new awareness of the potential developmental consequences of enlargement. By adding to the abolition of tariffs and implementation of the EU market regulations the requirements of having a 'functioning market economy' and 'the capacity to withstand competitive pressure', the EU dramatically departed from the dominating policy paradigm of the day that viewed these two latter factors as automatic outcomes of market liberalization. As interviews with EU officials revealed, key EU-15 member states and the Commission learned from the collapse of the East German economy caused by the unexpected consequences of the fast liberalization, the badly designed currency unification and the unplanned market integration after the German reunification.[13] The unfolding economic and political turmoil and the need for massive fiscal transfers between the two parts of Germany played a major role in convincing key players within the EU that they could not leave the task of integrating the future members into the internal market solely to the power of (transnational) market forces.

The added accession criteria were meant primarily to control the costs of enlargement. The core EU-15 countries were, on the one hand, not ready to increase considerably their contributions to social and economic cohesion within the enlarged union. They were not willing to do for the CEE economies what West Germany had done for East Germany in terms of transfer payments. The Southern members of the EU on the other hand - the major recipients of cohesion funds within the EU - had made it clear that they wanted to keep their shares (O'Brennan 2006).

The second fear of the EU core countries was that problems with the functioning of market economies and low capacity to withstand competitive pressures might undermine the readiness of the would-be members to play by the rules of the internal market in the post-accession period. EU insiders feared distorted competition and saw the integrity of the internal market at risk. As one EU official recalls the discussion at that time:

> "Before we started accession negotiations with the EU-10 and even still during the negotiations many within the Commission feared that enlargement would risk deepening. Jacques Delors believed that deepening and widening of the EU don't go together. There was a strong fear that enlargement would destabilize the EU including the functioning of the EU internal market. In fact, Agenda 2000 was written in that spirit and puts a lot of emphasis on this fear".[14]

Agenda 2000, the document mentioned in the above interview was published in 1997. In that, the Commission undertook an assessment of the challenges of enlargement and developed a strategy of integration. The document repeatedly mentions the necessity to avoid partial *acquis* implementation that is portrayed as a major threat to integration:

> "Market distortion and prejudice to EU consumers could result from possible inadequate implementation of the internal market *acquis*. Sensitive areas in this respect include implementation of the *acquis* regulating free movement of goods, the protection of health, environment and

13 Authors' interviews with Commission officials actively shaping the definition and the operationalization of the economic aspects of the Copenhagen criteria, DG ECFIN and DG Enlargement, Brussels, October 2012 and April 2013.

14 Authors' interview with Commission official (B) who was involved in planning the fifth enlargement, Brussels, February 2015.

consumers, indirect taxation, adequate management of the external borders, implementation of safety requirements and state aids. The capacity of acceding countries' administrations to manage the Community *acquis* will be a key element. The more this capacity is achieved before accession, the fewer problems will arise after it. If important problems were to remain after accession, protectionist political pressure could develop in both present and acceding Member States and could endanger the functioning of the internal market as a whole" (European Commission 1997: 99).

The fear of non-implementation of EU market rules has also appeared in another form. In light of the CEEC's factor endowments resulting in comparatively low production costs, the EU member states' governments were afraid that competitive advantages of the rule taking countries vis-à-vis the EU-15 would cause massive relocation of production sites from old to new member states (Hagen 1996). Therefore, the rule makers were keen to ensure full and sustainable rule compliance, as this would increase production costs in the East and reduce the danger that the new members would gain unfair competitive advantages.[15]

All in all, the dominant fears of the EU member states and of the European Commission were that enlargement would increase the pressure for fiscal transfers within the union, reduce potential welfare gains for the EU core countries, destabilize the internal market and distort competition. As a result, the EU could not focus solely on rule transfer, it also had to manage interdependence, have mechanisms in place to anticipate and alleviate the developmental consequences of integration.

4. How did the EU care? The governance of integrating peripheral economies

The scope of the management of interdependence between member states and the CEE countries was determined by the asymmetrical nature of the enlargement negotiations. The EU never aimed at designing and implementing a positive developmental program for the accession countries. Brussels did not develop a fully-fledged master plan on how to avoid massive unemployment in the CEE economies or how to improve their positioning in European value chains (Bruszt/Langbein 2014; Karas 2015; Trappmann 2013). The EU tried to avoid large-scale economic collapse, focusing on factors that could prevent the new members to play by and live by the rules of the common market.

Overall, the scope of EU pre-accession assistance should not be overestimated. Direct assistance programs linked to rule transfer to the ten candidate countries that entered the Union in 2004 totaled € 28 billion in the period from 1990 to 2005. This type of EU assistance must be considered marginal: in the period leading up to the accession of CEE countries, PHARE funds amounted to 0.4 to 0.5 percent of the region's GDP, while SAPARD[16], a pre-accession instrument specifically designated to the CEE agricultural sector, distributed funds of around 0.2 percent of the region's GDP (European Commission 2007, 2010). Yet, if one

15 Authors' interviews with Commission official (A) who was involved in planning the fifth enlargement, Brussels, February 2015; European Commission 1997: 134.

16 SAPARD: Special Accession Program for Agricultural and Rural Development. In June 1999, the EU passed Council Regulation (EC) No. 1268/99 on Community support for pre-accession measures for agriculture and rural development in the applicant countries of Central and Eastern Europe to prepare the candidates to take on the EU *acquis* for agriculture and food safety.

adds the development aid programs financed via the EBRD, and the EIB, the pre-accession support received by the CEE countries will reach already few percentage points of the regions' GDP. In comparison to other regional integration projects, such as the North American Free Trade Agreement (NAFTA), the EU thus pays by far the highest amount of funding to prepare future members for regulatory integration (Bruszt/ McDermott 2014).

The management of interdependence happened in the framework of technocratic problem solving. None of the various EU documents on enlargement introduced a kind of developmental program for the candidate countries. Development happened more as a by-product of enlargement without evoking public debate let alone politicization.

4.1. Managing uncertainty: Operationalizing the goals of integration

The first governance dilemma the EU integrators were facing during accession negotiations came from the fact that the two economic criteria of membership did not offer any clear and unambiguous guidelines on what the rule makers should actually impose on the rule takers and in what way.

Let us start with the challenge related to defining and operationalizing a 'functioning market economy': this was anything but a trivial task for the Commission in a regional integration regime in which at least three competing varieties of capitalism co-exist (Hall/Soskice 2001; Hancké et al. 2007). The concept of a functioning market economy used by IFIs changed at least four times during the 1990s and there were no two IFIs during that decade that could agree about a shared definition (Bruszt 2012). Except for some very general principles, the Commission has never published clear and unambiguous benchmarks that could guide progress in this area.

The same was true for the second economic criteria, the existence of the 'capacity to withstand competitive pressure within the enlarged EU'. Interviews with Commission officials who dealt with the fifth enlargement show that DG ECFIN, in charge of ensuring the fulfilment of these two economic criteria, did not base its assessment on specific thresholds that could signal a country's capacity to withstand competitive pressures in the internal market. Thresholds to determine the ideal structure of the economy, the share of SMEs, the concentration of market power or the diversification of export commodities simply do not exist. In contrast to the fulfillment of the third Copenhagen criteria, *acquis* compliance, the Commission, and DG ECFIN in particular, had to interpret the meaning of competitiveness in a broad framework.

DG ECFIN did not pretend to know what the ultimate definition of a functioning market economy was and it never even tried to use conditionality for the imposition of a single model on the accession countries. It did not define *ex ante* precise benchmarks for a functioning market economy or competitive capacities. Instead, it used strategies that took uncertainty seriously.

Instead of using rigidly defined goals and means, the Commission institutionalized a joint learning process: it enrolled a set of global and regional International Organizations (IOs) and think tanks with partly conflicting definitions for the above goals to come up with alternative opinions how accession countries could converge to these goals. These organizations provided the Commission with their sometimes conflicting assessments of what should be the necessary steps for the particular country under scrutiny in order to receive the status of a functioning market economy or to improve its competitiveness. State bureaucrats from the candidate countries or business representatives could reply to these models and economic ministries from the member states could also contest both these models and the reply of candidate countries to the suggestions derived from these models. The DG desk officers were aware of the fallibility of their own models and behaved like traders in highly volatile and uncertain financial markets: they deployed models to check their own estimates against those of their rivals (Beunza/Stark 2010). As one official working at DG ECFIN during the fifth enlargement remembers,

> "We had lots of consultations with experts in the World Bank and the IMF, both headquarters and local offices in the various countries, on these issues [how to operationalize the two economic criteria, the authors]. I spoke to my colleagues at the IFIs almost every day. Moreover, our EC delegations gained a lot of expertise over time through project experience. They knew which administrations to trust and whom not, where economic deficits are. We also talked to the private sector, to chambers of commerce. In the mid-1990s, DG ECFIN was the only DG with economic expertise about these countries but then gradually other DGs also developed quite some expertise, like DG Enterprise, DG Agriculture and so on. These DGs had experts on specific countries or horizontal issues, like state aid and they also provided very useful input for our assessments of how these economies should develop".[17]

Of course, what matters from a governance perspective is not such a conceptual uncertainty. IFIs, like the World Bank or the IMF, could feel free to impose benchmarks for market reforms in other parts of the world even in the middle of the loudest contestation of their meaningfulness. The more serious governance problem for the Commission was that, in the shadow of the ruins of the former economy of the German Democratic Republic and the fear to endanger the integrity of the EU internal market by extending the Union to the periphery (in economic terms), the EU had very little room to fail. Knowing that it could not as easily externalize the costs of governance failure as the IFIs could, the Commission had strong incentives to take uncertainty about the goals and benchmarks of progressing towards achieving these goals seriously and build the governance of integration on pragmatic principles.

17 Authors' interview with an EU official working at DG ECFIN during the preparation of the fifth enlargement, Brussels, February 2015.

4.2. Overcoming information asymmetries to detect and alleviate negative consequences of rule transfer

As for the third Copenhagen criteria, implementation of the rules of the common market, the governance dilemma was different. The Commission could prepare more or less clear benchmarks for the administrative and behavioral requirements of rule compliance. On the other hand, the Commission did not possess and never even pretended to have clear and universally applicable guidelines about the right way to reach these goals in dramatically diverse institutional contexts in 11 accession countries and more than 30 policy areas. The key governance challenge of rule transfer was that information on potential problems with the capacities of rule takers to live by and/or play by the EU rules were dispersed and the potential beneficiaries of the aggregation and use of such information in many cases did not have the capacity to collect and use such information. Governments in the accession countries had weak administrative and development-planning capacities, non-state actors lacked resources and organization.

The Commission developed a solid intelligence for the anticipation and eventual alleviation of potentially dangerous developmental consequences of rule transfer relying on inter-DG coordination, on capacity building in the accession countries and on the mobilization of a transnational network of private and public actors acting both as monitors of implementation and as participants in joint learning.

To start with capacity building, the Commission asked candidate countries to come up with a big variety of various plans on how, when and with what kinds of resources they wanted to meet the accession criteria. They had to come up with National Programs for the Adoption of the Acquis (NPAA) and various more specific plans linked to different policy areas and sectors. The development of national economic strategies was important for candidate countries to receive a positive assessment from the EC as regards access to pre-accession assistance. Further, DG ECFIN asked candidate countries to prepare annual economic plans on how to achieve macroeconomic and financial stability and to deal with structural problems. State bureaucrats from the candidate countries working in the various areas were trained to come up with complex plans following the Commission's methodology (Bruszt/McDermott 2012).

The Commission has supported and coordinated this planning exercise by sending thousands of experts, private consultants or bureaucrats from EU member states to the candidate countries who advised the local state bureaucracies on how to write their first plans in the various areas. While in many cases these consultants have produced a cacophony of advices and represented widely diverging models for public policy making, they have helped to convey the key message to public actors in the accession countries: while planning is a key aspect of doing business in the common market, there are no universal models for achieving compliance or increasing economic viability.

The monitoring of a (potential) candidate's progress with meeting the accession criteria also used methods that allowed collecting and contrasting a big variety of dispersed information. Just to give the example of the preparation process of a progress report, desk officers in the country units of DG Enlargement[18] and

18 In 2014 DG Enlargement was renamed DG NEAR (DG for Neighbourhood and Enlargement Negotiations).

at various DGs approached a big variety of actors to receive much-needed input. They enlisted business associations and NGOs from the EU member states and candidate countries, Central Banks or Chambers of Commerce, that were asked to share their knowledge about the progress achieved in the various areas and key problems as regards the meeting of the political and economic criteria as well as achieving *acquis* compliance (Pleines 2011; Sudbery 2010). Rather than engaging in pure ‘checklist monitoring’ the Commission asked these intermediaries to suggest solutions to overcome a candidate’s problems. Experts coming either from the member state governments or from the private sector of the member states to work in Twinning or other technical assistance projects with the candidate countries were also used as sources for the reports. Intermediaries were multifunctional: they helped building much needed planning capacities in these states and they served as informal monitors for the Commission as they had up-to-date knowledge of the progress achieved in their areas of expertise and/or of the vested interests preventing it.

As for the coordination of the various decentered attempts at matching EU requirements with diverse local needs, the various DGs basically circulated around the negotiating team from DG Enlargement like satellites and when a particular applicant country suggested certain transition periods or derogations or asked for financial assistance to cushion the costs of compliance with a particular directive, the DGs were always consulted to make an assessment of whether a derogation or an assistance project was really needed. In a similar vein, the DGs were in permanent contact with the negotiation team to help understand why a candidate country would delay the process of implementation. It was the task of all DGs to understand the weaknesses of candidate countries and why some of them would have difficulties to implement the *acquis*: DG Agriculture would, for example, alert the Commission’s negotiating team for a particular candidate country of the problems local producers/processors face when asked to implement EU food safety regulations. DG Enlargement would then - in cooperation with the applicant country and DG Agriculture - make sure that business operators receive at least some financial support either through EU funds or other sources of investment, including from the IFIs. DG Enterprise or DG Competition would highlight problems with state aid and – depending on the size of the problem – DG Enlargement in cooperation with DGs Enterprise, Competition or Economic and Financial Affairs would ask countries to write plans on how to restructure the sectors[19] and initiate certain co-financing measures with IFIs.

5. Conclusion

In exploring slow progress in regulatory integration, students of the global South have called attention to the need to manage the developmental consequences of establishing common regulatory institutions. These studies focused on integration attempts that have involved attempts at implementing a small set of common rules in a single policy area like labor standards, environmental regulations or food safety rules across a group of countries (Estevadeordal et al. 2004; Locke at al. 2007; Piore/Schrank 2014; Schrank et al. 2014). The key factor that has differentiated successful cases from the failed ones was the use of governance modes that could help actors to have common rules and make their implementation a common

19 See the work by Sznajder 2006; Trappmann 2013 for the EU’s effect on restructuring the steel sector in various CEE countries.

good. These are, however, all cases of shallow forms of integration: limited in their scope and leaving control over the making of market rules in domestic hands. But what happens when market integration gets much deeper in terms of scale and complexity and becomes all-encompassing? What happens when regulatory integration implies the replacement of domestic economic rule making with a transnational one?

We have argued that the market integration of lesser-developed economies can be fruitfully analyzed in the framework of incomplete contracts characterized by a high level of uncertainties, information asymmetries, and behavioral and distributional consequences that are hard to predict *ex ante*. The deeper economic integration gets, the more the costs and benefits of the integrators become the function of the mode of governing rule transfer.

We have identified three mechanisms that could induce stronger actors to care about the developmental consequences of rule transfer and we have argued that the key governance challenge of deeper integration is to develop governance solutions that could help to anticipate and alleviate the negative developmental consequences of integration for the lesser-developed economies.

The EU Eastern enlargement can be contrasted to the transnational market making attempts that address the problems of the developmental consequences of integration in a diametrically opposing way. Both of the more recent attempts at closing a Transatlantic Trade and Investment Partnership and a Trans-Pacific Partnership try to reduce uncertainties about the distributive consequences of market integration primarily by identifying and leaving out from the arrangement the potentially most divisive issues. While that allows for signing a more or less complete contract, the parties have to stop market integration at a much more shallow level of integration. As in these cases parties do not create mechanisms to govern the eventual distributive conflicts, linked either to unforeseen consequences of the original deal, or to attempts at extending it to more policy fields, these integration arrangements have little room for further deepening.

The mode of governing integration that we have discussed in this paper might have helped to bring 11 fledgling market economies afloat into the strongest regional market in the globe. It might have prevented the coming about of the need for large-scale fiscal transfers in the post-accession period and it might have contributed to turn the CEE markets into important export destinations and production platforms for EU insiders. However, as it was primarily a negative developmental intervention that focused on preventing large-scale dislocations, its longer-term effects on catch up growth or on the broad-based distribution of the benefits of market integration could have been fairly limited.

The weakness and the built-in asymmetrical bias of the EU mechanisms of managing interdependence in the pre-accession period might also become factors of freezing further integration and might even set in motion disintegrative tendencies. Even more so, in the post-accession period the EU has only very weak tools to influence domestic development policies that would try to accommodate the specific development needs of the peripheral economies while implementing the EU norms, let alone effective instruments to foster inclusive developmental outcomes and greater social cohesion within the economies of its member states. The EU development policies for less developed member states administered via the Structural

Funds (SF) are of questionable use. The SF failed to significantly reduce territorial disparities in the member states (Boldrin/Canova 2001) and the SF actually had negative effect on growth in several countries in the Southern peripheries of Europe like Portugal, Spain and Greece (Ederveen et al. 2006: 17). The enduring crisis in the weaker economies of the Southern peripheries of the EU has already shown the weakness of the way the EU manages interdependence. In the new member states of Eastern and Central Europe it is a growth of economic nationalism that signals the weakness of the same strategy.

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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.