Maximizing the integration capacity of the European Union

Varieties of Dis-embedded Liberalism

EU Integration Strategies in the Eastern Peripheries of Europe

László Bruszt and Julia Langbein

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László Bruszt and Julia Langbein

Abstract

This paper compares the European Union (EU)'s integration approach during the Eastern enlargement with the EU approach towards Eastern neighborhood countries. We argue that the EU has different goals and means for the management of its different peripheries resulting in deep, deep-light and shallow modes of market integration. In contrast to the post-1945 integration of Western Europe into the global economic system, coined by John Ruggie as embedded liberalism, the integration of the Eastern peripheries happens in the framework of a new liberal regional settlement. The latter takes large parts of the regulatory powers out of the hands of the states and compensates the dis-embedding of markets from national control to various degrees. We show that differences in political and economic interdependencies between the EU and the two Eastern peripheries explain the variation in integration strategies, and that each of them has its own weaknesses in terms of developmental effects.

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1. Introduction

The process of replacing national controls over markets with supranational ones, called 'market integration', might pose specific challenges to countries at lower levels of economic development. The creation of a formal 'level playing field' might increase the competitiveness of domestic industries and improve conditions for attracting foreign investment, but it might also increase the vulnerability of weaker economies, reduce the room for development and, at worse, marginalize or exclude from the market a large share of the economic actors in the weaker economies (Dunn 2003; Milberg/Winkler 2013). The deeper the market integration, the higher the risk that such negative developmental externalities of integration will also spill over to the stronger ones, thereby increasing the costs of integration and taking away opportunities from players in the stronger economies.

Largely due to such problems, most attempts at furthering market integration stop at a very shallow level involving limited tariff reductions combined with the acceptance of common regulations in few areas. For students of transnational market-making, the inclusion of the Southern and the Eastern peripheries of Europe in the regional market-making process offer a natural laboratory for the comparison of different strategies for furthering integration among economies at dramatically different levels of development (Bruszt/Vukov forthcoming; Jacoby 2010; Langbein 2014).

In this paper we focus on the Eastern peripheries and compare the European Union (EU)'s integration approach during the Eastern enlargement with the EU approach towards Eastern neighborhood countries (ENC). As we will show, the EU had different objectives and it used different strategies for the management of these two peripheries, resulting in three distinct modes of economic integration: deep, deep-light and shallow.

The strategy of deep integration, which was employed during the Eastern enlargement, combined the abolition of tariffs with regulatory integration in more than 30 different policy areas. The would-be member states had to give up national control over large parts of the autonomous policing of their domestic markets. In exchange, at least for the pre-accession period, Brussels instituted mechanisms to foresee and alleviate the major potential negative consequences of integration, and provided comprehensive assistance to institution building. During the post-accession period it extended assistance to support catch-up growth (Bruszt/Langbein 2015).

This strategy of integration can fruitfully be contrasted to the post-1945 integration of Western Europe into the global economic system. Coined by John Ruggie as *embedded liberalism*, the latter involved a compromise between the goals of free trade and the democratic states' domestic control over social and economic development (Ruggie 1982). Under embedded liberalism the promotion of free movement of goods and services was combined with the domestic regulation of markets and national control of capital flows. By contrast, the deep market integration of Central and Eastern Europe (CEE) happened in the framework of the new liberal regional settlement in Europe that took large parts of regulatory powers out of the hands of domestic states and deprived them from controlling capital flows. The dis-embedding of markets from national control was compensated in the lesser-developed parts of Europe by various EU-level assistance programs. The declared goal of these assistance programs was to reduce the need for welfare interventions by way of strengthening markets and furthering the capacity of key economic actors and various territorial and sectorial units of these economies to survive on the integrated markets.

The shallow mode of integration that largely dominated the EU's approach towards the ENC until lately was closer to the post-1945 strategy of economic integration in that it essentially left the control over capital flows and the regulation of economic activities in the hands of domestic states: in this mode of integration, bargained and limited trade liberalization was combined with some progress in regulatory integration in selected policy fields without any considerable assistance for capacity building among public and private actors. Since the states of the ENC were both controlled by rent-seeking groups and weak in terms of their regulatory capacities, the actual scope of market integration was slow and selective in that it reflected the interests of the strongest players (Langbein 2015, forthcoming; Langbein/Wolczuk 2012).

Starting in 2009, the EU's approach towards the Eastern neighbors was beginning to shift towards a lighter version of deep integration, a highly problematic mixture of shallow and deep market integration. The Association Agreements, which the EU has so far concluded with Georgia, Moldova and Ukraine – all in 2014 –, involve encompassing tariff liberalization and regulatory integration. Still, the EU has not developed strategies to manage potential negative consequences of rule transfer. EU assistance for institution building and easing potential negative effects of rule transfer on the partner countries remain far below the level of support provided for the would-be members during the Eastern enlargement. Moreover, the EU underestimated potential tensions with Russia as a result of the EU's increasing support for deeper integration with the Eastern neighbors.

Differences in the political commitment to integration of these two parts of Europe both in economic and political terms were one factor in causing the variation in integration strategies. An equally important factor was the dramatic variation in economic interdependence between the core EU countries and the two Eastern peripheries. Our analysis shows that each of these modes of integration has its own weaknesses in terms of developmental effects.

2. Modes of economic integration at different levels of interdependence

The integration of previously separated markets distributes opportunities and vulnerabilities unevenly among countries at different levels of their economic development. The deeper the market integration – proceeding from the establishment of a free trade area and a customs union to a single market and a monetary union (Balassa 1967) –, the longer the list of mechanisms that could increase the vulnerability of less developed countries.

To start with the liberalization of trade, the abolition of tariffs might allow for rapid growth of competitive firms in the lesser-developed countries due to increased market opportunities. However, in countries with weak state capacities to manage the insertion and the positioning of the domestic economy in transnational markets, trade liberalization might, at worst, result in the collapse of whole sectors or, at best, in their stable inclusion in transnational production chains at the low value-added part of the chain (Gereffi 1995; Milberg/Winkler 2013).

Regulatory alignment could positively affect the competitiveness of certain industries in rule-taking countries, attract foreign direct investment (FDI) and might liberate domestic markets from powerful rent-seeking groups. But compliance might impose prohibitive costs on weaker firms, wipe out entire industries unprepared for competition under the new rules and, depending on the nature of domestic inter-sectorial ties, lead to a complete economic collapse (Ismail 2007; Stiglitz/Charlton 2006). Alignment of policies and regulations with the goal to create a 'level playing field' might put lesser-developed economies into a straitjacket dramatically reducing their capacities to improve their positions on the transnational markets.

The newly democratizing countries from CEE were integrated into the evolving liberal European transnational regime by way of abolishing tariffs, integrating regulatory regimes and moving towards monetary integration. This emerging transnational regime dramatically differed from the post-1945 settlement that integrated the economies of the Western part of Europe into global trade. Baptized by John Ruggie as *embedded liberalism* it combined freer (but emphatically not completely free) trade with domestic control of social and economic development by democratic states (Ruggie 1982). As a condition for EU membership, the lesser-developed Central and Eastern European Countries (CEEC) had to comply with the rules of the evolving liberal EU regime which largely dis-embedded markets from national control. Market integration in the framework of dis-embedded liberalism exposed these economies to the above highlighted vulnerabilities.

Stronger economies in an integration regime, in principle, can choose between two strategies in dealing with the potential negative developmental consequences of including lesser-developed economies in market integration: They can try to externalize them, or they can decide to manage them by way of creating mechanisms helping to anticipate and alleviate a selected range of potential developmental problems of integration.

We speak of a deep mode of economic integration when rapid progress in putting domestic markets under the control of supranational rule-making institutions is combined with pro-active management of the potential large-scale developmental externalities of market integration. Under the deep mode of integration national governments lose key powers to manipulate economic processes. They have to learn to work together with new institutions built into domestic states with the function of monitoring domestic state and non-state actors in the economy and prevent them from discriminatory practices that could constrain the free movement of goods, capital and services (Bruszt/Vukov forthcoming). Assistance under the deep mode is extensive and goes beyond efforts to increase the capacity of lesser-developed countries to implement common market rules.

The deep mode of market integration is the exception rather than the rule. The typical mode of furthering market integration is shallow integration: a settlement that excludes from the deal sectors, regulatory areas or categories of actors, whose inclusion could result in net losses in the more developed countries, and imposes large-scale negative developmental externalities on the weaker countries. Shallow market integration implies some reduction of tariffs and the implementation of common regulations in few policy areas with a limited scope. Parties can negotiate some assistance, primarily in the form of 'aid for trade', which allows weaker economies to implement the regulatory standards that were included in the settlement. That said, more often than not, the weaker economies suffer from weak state capacities and are ruled by rent-seeking elites (Bruszt et al. 2015; Langbein forthcoming). Deals negotiated under the shallow mode, therefore, tend to cater to the interests of the strongest domestic actors on both sides.

Finally, the deep-light mode of integration represents a highly problematic mixture of the shallow and the deep mode. In the deep-light mode aims at the emergence of full trade liberalization and comprehensive regulatory integration without developing mechanisms to anticipate potential negative consequences of economic integration and providing assistance to alleviate them. Such externalization of potential negative developmental consequences by the more developed economies is particularly fatal for the weaker economies that usually have weaker and less autonomous states with low developmental capacities.

Why would stronger economies care about the developmental externalities of integration? In a previous paper we have argued that the EU has moved towards a deep mode of integration in the CEE countries because of the recognized strong political and economic interdependence between the old member states and the candidate members in the Eastern peripheries of the continent (Bruszt/Langbein 2015). The commitment of political integration will force the more developed economies to internalize at least some of the negative consequences of integration, so as to prevent the need for considerable transfer payments to the weaker economies after accession. A high level of economic interdependence might further increase the pressure to develop capacities to foresee and alleviate negative consequences of economic integration. Under conditions of weak political and economic interdependence developed economies are more likely to try externalizing the potential negative consequences of economic integration to the less developed economies, regardless of the desired depth of market integration.

Table 1: Modes of economic integration at different levels of interdependence

	Mode of integration		
	Deep	**Shallow**	**Deep-light**
Goals of integration	• Supranational control over domestic markets • Pro-active management of the potential negative consequences of market integration	• Negotiated extension of markets • Externalization of the potential negative consequences of market integration to the weaker economies	• Supranational control over domestic markets • Externalization of the potential negative consequences of market integration to the weaker economies

Means of integration	• Full trade liberalization • Encompassing regulatory integration • Comprehensive assistance to meet common market rules and alleviate negative consequences of rule transfer	• Limited trade liberalization • Selective regulatory integration (à la carte) • Limited assistance to meet common market rules and alleviate negative consequences of rule transfer	• Full trade liberalization • Encompassing regulatory integration • Limited assistance to meet common market rules and to alleviate negative consequences of rule transfer
Level of perceived interdependence	• High level of perceived political and economic interdependence	• Low level of perceived political and economic interdependence	• Low level of perceived political and economic interdependence

Source: Authors

3. How does the EU manage interdependence?

3.1. CEE countries - management of interdependence

As we have argued elsewhere, the relationship between the accession countries and the EU-15 was that of asymmetrical interdependence (Bruszt/Langbein 2015). EU insiders could determine unilaterally the rules of accession as well as the mode and the extent of caring about the developmental externalities of integration. At the same time, EU insiders feared that they would not be able to externalize the costs of potential large-scale negative developmental externalities of market integration and might lose potential gains from integration if they left outcomes only to the markets. As a result, besides managing the flawless transfer of the single market's rules, the other key governance challenge to deeper market integration was to develop mechanisms that could help manage the externalities of rule transfer in time.

The decision not to leave the outcomes of economic integration to market forces resulted in the first dilemma EU integrators were facing during accession negotiations. The key fears of EU insiders were reflected in two economic membership criteria: 'functioning market economy' and 'capacity to withstand competitive pressure within the EU' – goals to be achieved under the control of the Commission. But clear and unambiguous guidelines on what the rule-makers should actually impose on the rule-takers and in what way in order to achieve these goals did not exist. The Commission, in principle, could simply have imposed invented benchmarks for market reforms as International Financial Institutions (IFIs) did in other parts of the world. But due to the above-mentioned fears the EU had very little room to fail and externalize the costs of governance failure as easily as the IFIs could do in the 1980s. Hence, the Commission institutionalized a joint learning process enrolling 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 on how accession countries could converge to these goals. State bureaucrats or business representatives from both candidate countries and member states could reply to or contest these models.

As for the implementation of EU market rules, which is the third criterion of membership, the Commission could prepare more or less clear benchmarks for the administrative and behavioral requirements of rule compliance. Here, the governance dilemma was how to implement the mandatory EU rules in the dramatically diverse institutional contexts existing in the 10 CEE accession countries, who struggled with widely different problems of state-building and market-making.

The European Commission (EC) developed a solid intelligence for the anticipation and eventual alleviation of potentially dangerous developmental consequences of rule transfer. During the monitoring of a (potential) candidate's progress with meeting the accession criteria the ECused methods that allowed collecting and contrasting a big variety of dispersed information. Desk officers in the country units of the Directorate-General (DG) Enlargement, for example, enlisted business or civil society associations from the EU member states and candidate countries, Central Banks or Chambers of Commerce. Public and private experts, who were recruited from the member states to work in Twinning or other technical assistance projects with the candidate countries, were also used as sources for the reports. Rather than engaging in pure 'checklist monitoring' the Commission asked these intermediaries to suggest solutions in order to overcome a candidate's problems.

As for the coordination of the various decentralized attempts at matching EU requirements with diverse local needs, metaphorically speaking, the various DGs circulated around the negotiating team from DG Enlargement like satellites. 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*.

Since the economic power of the accession countries was negligible in comparison to the EU-15 countries, EU insiders allowed for trade liberalization to proceed in an asymmetrical fashion: the EU opened up its market to the CEE countries immediately upon signing the Europe Agreements in the early 1990s, with the exception of sensitive sectors, such as agriculture and textiles, but meanwhile allowed them to dismantle their own trade barriers more gradually.

The interventions of the EU, while focusing primarily on rule transfer, have directly and indirectly affected economic restructuring in these countries. Governments were pushed by the Commission to phase out loss-making firms or whole sectors in need of massive state aid. These pressures were, however, linked to plans to prevent a large-scale collapse, i.e. to control the potential major negative developmental consequences of transformation.

Still, the indirect effects of EU interventions on restructuring were every bit as important as the direct effects. During the pre-accession period the pressure for fast regulatory convergence with short exemption periods for the implementation of EU rules forced many CEE countries to abandon their hopes of nurturing domestic firms to be transnationally competitive. While the attraction of foreign investors may have helped local industries to converge quickly to product standards, this came not without costs. States had to provide enormous state aid in the form of tax benefits or subsidies to attract foreign investors and had to bargain hard with the EU to maintain at least some transition periods for the privileges they already granted to foreign investors (Bohle/Husz 2005; Bruszt et al. 2015).

At the same time, the CEEC also received extensive assistance from the EU in building economic state capacities to implement EU policies and rules, and to strengthen (or, in many cases, create) basic planning capacities and the ability to foresee and manage negative developmental consequences of economic integration. EU assistance targeted public and private actors, including state agencies and firms, to help them implement EU rules and manage adjustment pressures (Bruszt/McDermott 2012). This assistance also included the development of state aid schemes, which the European Commission judged to be competition-compliant: funding for the establishment of the first investment promotion agencies in the context of the Eastern enlargement came from pre-accession funds (Drahokoupil 2009). Relying on EU moneys, EBRD[1] or EIB[2] loans were used to finance the upgrading of production plants owned by Multinational Corporations (MNCs).

Overall, the scope of EU assistance should not be deemed negligible. 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. It is true that, in the period leading up to the accession of CEE countries, PHARE[3] funds only amounted to 0.4 to 0.5 percent of the region's GDP, while SAPARD[4], 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 also adds to these amounts the payments made in the framework of post-accession assistance programs, then at least in financial terms the EU's support surpasses the amount of roughly 100 billion US dollars in 2004 (Judt 2007) used in the framework of the Marshall Plan for the integration of the Western European economies in the new post-Second World War international economic order.

That said, the scope of the management of interdependence 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 (Trappmann 2013). Instead, the EU tried to avoid a 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.

3.2. ENP-East: management under the shallow mode

From the 1990s up until 2009, the EU engaged the ENC in a shallow mode of integration. In the Eastern neighborhood both the EU's commitment to promoting domestic change and its leverage on the partner countries differed substantially from that of the Eastern enlargement.

In the absence of the membership perspective, the pace of liberalization was more flexible and the rules could be transferred in a more piecemeal fashion. On the one hand, a more gradual pace of liberalization allowed these states to protect local firms through the maintenance of comparatively high import duties. More gradual trade liberalization also reduced the pressure on states and local firms to comply with EU

1 European Bank for Reconstruction and Development
2 European Investment Bank
3 Poland and Hungary: Aid for Restructuring of the Economies
4 Special Accession Programme for Agriculture and Rural Development

rules, regardless of whether the rules concerned the regulation of product standards or the governance of competition. On the other hand, more flexibility in adjusting to EU rules often came at the price of diminished access to the EU market. Moreover, the ENC were not able to attract as much FDI as their counterparts from CEE. MNCs were more reluctant in placing longer-term investments in these countries not only because of bad investment protection but also because they could not expect to receive EU financial support when it came to upgrading production facilities (Langbein forthcoming). All in all, the flexibility offered under the shallow mode of integration was first and foremost beneficial for rent-seeking ruling elites in the ENC for whom à la carte integration served as an opportunity to stabilize their power base (Bruszt et al. 2015; Langbein forthcoming).

Since these countries would stay outside the EU in the foreseeable future, the EU did not have to fear that such selective integration would endanger the integrity of the EU Internal Market or force the EU to use fiscal transfers in order to mitigate high political, social or economic costs caused by fast liberalization (Langbein 2015). While sluggish domestic reforms and comparatively bad investment conditions in the Eastern neighborhood countries prevented EU MNCs to gain from integration, the latter did not have to bother too much about the lost opportunity of market expansion since their US or Japanese competitors faced similar challenges in the region. Also, the EU had very low stakes in the developmental externalities of rule transfer.

At best, EU assistance under the shallow mode of integration targeted state actors in order to help them play by EU rules. The EU-financed Twinning and technical assistance programs to support state restructuring, but 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 forthcoming). Moreover, as Langbein (2015) has shown for Ukraine, state restructuring efforts were not flanked by corresponding firm-level assistance to support local industries with the adjustment.

3.3. Eastern Partnership (EaP) (2009-today): management under the deep-light mode of integration

From 2009 onwards, the EU approach vis-à-vis the ENC gradually shifted towards a deep-light mode of integration. The Deep and Comprehensive Free Trade Agreements (DCFTA), which form the core of the Association Agreements that the EU began to negotiate with Armenia, Georgia, Moldova and Ukraine in 2009, go beyond normal free trade agreements that are based on the reduction of tariff and non-tariff barriers to trade. In the context of the DCFTA with Ukraine, for example, which was enforced provisionally on 1 January 2016, both parties committed to an almost complete lifting of import tariffs. The DCFTA's *finalité* is full convergence with the *acquis* governing the EU internal market. In contrast to the former Partnership and Cooperation Agreements (PCAs), which the EU had concluded with a number of ENC throughout the 1990s, the DCFTAs are legally binding and do not leave much room for 'pick and choose'. More importantly, – unlike the PCAs and many preferential agreements the EU is concluding with third countries in Africa or Latin America – the DCFTAs exclude equally deep integration with others, first and foremost with Russia-led integration regimes, such as the Customs Union.

Unsurprisingly, following the launch of the EaP, the Russian government under Vladimir Putin started a campaign to erode Ukraine's support for the Association Agreement with the EU, arguing that the DCFTA would have negative repercussions on both the Russian and Ukrainian economies (Delcour/Wolczuk 2013). To diminish domestic support in Ukraine for the conclusion of the DCFTA, Russia imposed sanctions on a number of Ukrainian imports directly affecting some of the Ukrainian oligarchs (Langbein 2015; Shumylo-Tapiola 2012).

The EU's ignorance of the potential consequences of its increasing engagement in the region is striking. Up to 2014, EU strategy papers related to the ENP and the EaP were completely silent about potential negative geopolitical and economic consequences of rule transfer to the Eastern neighbors, their repercussions for the EU and partner countries themselves as well as about possible strategies to alleviate these negative consequences (European Commission 2004; European Commission/High Representative 2011).

While the 'pick and choose' mentality, which the shallow mode allowed for, stabilized rent-seeking elites rather than helping improve conditions for large parts of the societies in the Eastern neighborhood countries, the deep-light mode of integration destabilized the region. The EU's 'take it or leave it' approach forced the Eastern neighbors to make a choice between closer integration with Russia or the EU. In the absence of comprehensive assistance for encompassing trade liberalization and regulatory integration the EU may, however, lose support for European integration in the three associated Eastern partner countries once citizens realize they cannot count on measures mitigating and/or compensating for present economic hardships.

In this section we have discussed how the three modes of integration – deep, shallow and deep-light – played out in the two Eastern peripheries of the EU. In the next section of the paper we turn to the question why the EU cared about the developmental externalities in the context of Eastern enlargement and did not consider managing such externalities in the case of the neighborhood countries.

4. Wherefore management of interdependence?

With regard to the deep integration of the CEEC, it might seem to be counter-intuitive to assume that, prior to accession, the EU should have cared about the developmental consequences of enlargement. The European Commission did not have any other formal obligations, except for controlling and assisting the flawless transfer of the existing mandatory rules of the EU internal market to the CEEC, and in fulfilling its tasks the Commission could rely on an unambiguously asymmetrical relation between the EU and the accession countries.

Considering that the relationship between EU insiders and applicant countries can be characterized as an asymmetric interdependence in favor of the EU (Moravcsik/Vachudova 2003; Vachudova 2005), EU insiders should have been sufficiently strong to defend themselves against potential negative developmental consequences of integration without any need to build capacities that help anticipate and alleviate them. The EU insiders could have simply excluded the applicants from full membership until market forces had wiped out the weaker, less competitive parts of the CEE economies. Alternatively, to shield themselves from potential negative spill-overs, the EU insiders could have advanced so-called 'constitutional differentiated integration' to a greater extent by granting applicant countries opt-outs from entire policy fields and/or sectors (Schimmelfennig/Winzen 2014).

However, the EU insiders did not pursue any of these strategies. Instead, the EU urged the applicants to take on all pre-existing mandatory EU rules and policies from more than 30 different policy fields prior to accession (Schimmelfennig/Sedelmeier 2005) and only advanced instrumental differentiation in the form of transitory arrangements that are more temporary and short-term (Schimmelfennig/Winzen 2014).

The existing literature on the Eastern enlargement provides two reasons as to why the then EU-15 accepted the CEEC as full members in the first place: as Schimmelfennig (2001) has argued, the post-Cold War commitment of the EU insiders to the CEEC's 'return to Europe' increased the bargaining power of the applicant countries and explains why the EU insiders could not exclude the CEEC from full membership. By contrast, rationalist accounts underline that full membership rather than exclusion was in the long-term economic and geopolitical interest of both EU insiders and applicants (Moravcsik/Vachudova 2003). Either way, once the EU had decided to push for the deep integration of these countries it faced the growing need to pro-actively manage the potential large-scale negative developmental externalities of integration in the accession countries if it wanted to safeguard the interests of the EU insiders.

As we have elaborated elsewhere (Bruszt/Langbein 2015), three mechanisms forced the EU insiders to develop capacities to ensure that the new members were able to play by and live by EU rules. It needs to be noted that none of these mechanisms is linked to the increased bargaining power of the rule-takers that presumably forced the EU insiders to take into account the interests of the applicant countries as the legitimacy of the Eastern enlargement increased.

First, there was a clear and growing perception within the EU that the costs and gains of enlargement for the EU insiders were the main factor for how integration would be managed. The early 1990s experience of the collapse of the former GDR economy as a result of misplaced monetary and economic integration increased the fear of a similar economic collapse, eventual political turmoil, or a large-scale migratory wave of displaced people from the CEEC. This would have meant increased costs for economic integration that EU insiders could not externalize due to geopolitical closeness and economic intertwining.

Added to the fears of the uncontrollable costs of integration were considerations of missing out on potential gains. Whereas in the early 1990s the potential contribution of the CEE economies to growth and development in the Western part of Europe was thought to be negligible, by the end of the decade the same economies had turned into important platforms on which intra-EU MNCs could expand their exports and/or profit from the abundance of cheap and highly skilled labor. Clearly, economic interdependence grew considerably during the 1990s between the two parts of Europe. Not only has the share of German FDI to the CEEC increased significantly since the 1990s, the latter's' share in total German FDI has even outweighed the share of France since the 2000s (Figure 1). The abundance of highly skilled and cheap labor came as an unexpected gift to the major Western European manufacturing multinationals struggling tooth and nail with their American and Japanese competitors. The share of CEEC in car production, for example, went up from less than ten percent in the mid-1990s to around 25 percent by the early 2000s (Figure 2).

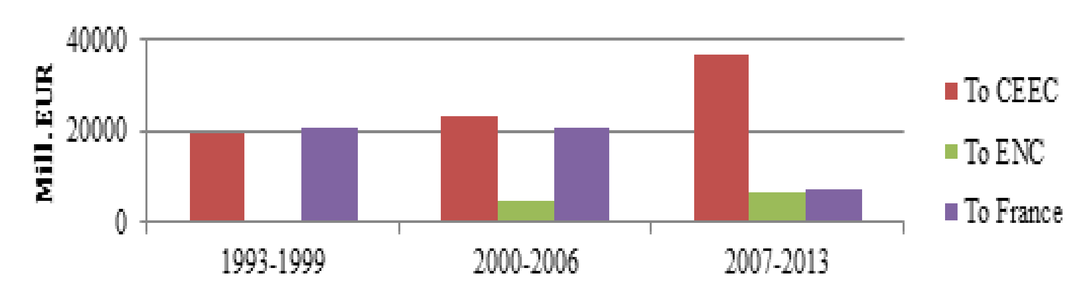
Whereas German exports to the transition countries were negligible in the early 1990s, by the 2000s the share of CEE markets in total German exports surpassed that of France or the US (Figure 3).

Second, as clearly elaborated in official EU documents describing the strategy of Eastern enlargement, such as the 'Agenda 2000' (European Commission 1997), there was a fear that eventual large-scale non-compliance in the new EU member states could decrease the competitiveness of economic actors in the old member states. This might have resulted in a massive transfer of firms to the new member states, inducing a race to the bottom in the old member states and, as a result, could have undermined the integrity of the internal market.

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

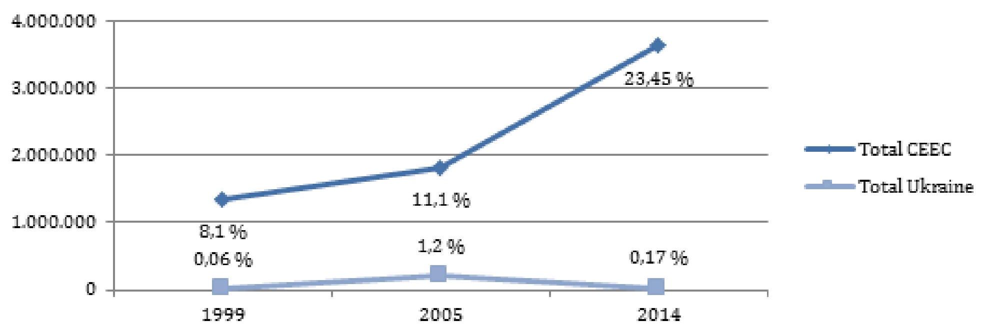
Summing up, the promise of membership has dramatically increased economic ties and, with it, economic interdependence between the two parts of Europe. If the EU wanted to defend the integrity of its market, ensure that its rule was implemented in the new member states, control the costs and increase potential gains of enlargement, it would have had to worry about the developmental consequences of economic integration in the accession countries.

Figure 1: German FDI outflow to selected destinations in million EUR, 1993-2014



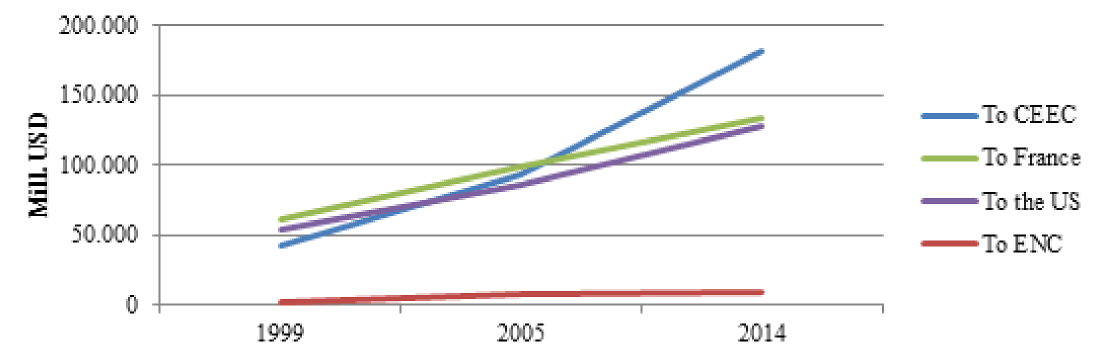
Source: OECD

Figure 2: Passenger car production in CEEC and Ukraine absolute and relative to total EU production



Source: www.oica.net; www.acea.be

Figure 3: German exports, 1999-2014, selected destinations



Source: http://comtrade.un.org/data/

4.1. Why the EU doesn't care in the context of the ENP/EaP

Knowing that the ENC will remain outside the club for the foreseeable future they always represented a much smaller challenge to integration.

Under the shallow mode of integration, the EU insiders did not conceive of selective or partial economic and regulatory integration as a threat to the integrity of the common market (Langbein 2014). Compared to the CEEC, economic interdependence between the EU and the ENC was marginal. Germany's foreign investments in the CEEC made up roughly 6.5 percent of the total German FDI spent between 1990 and 1999, while the share of the ENP-East was at 0.14 percent during the same time period. Until today, the German FDI in the CEEC largely outweighs the German FDI in the ENC (Figure 1). A similar picture evolves once we compare the trade patterns between Germany and the two regions (Figure 2). Hence, it is not surprising that even under the deep-light mode the EU insiders still do not seem to fear being forced to assume responsibility for coping with negative consequences of economic integration in the context of the Eastern neighborhood: the EU began to negotiate comprehensive trade liberalization and regulatory integration with at least some Eastern neighbors in the form of Association Agreements. Nevertheless, the amount of assistance that the EU is offering the neighbors to meet common market rules and to alleviate negative consequences of rule transfer is still limited if compared to the assistance it provided in the context of the Eastern enlargement.[5] This suggests that the EU's perceived political and economic interdependence with the ENC is still low, which makes Brussels believe that it can externalize the negative consequences of deeper economic integration of the neighbors.

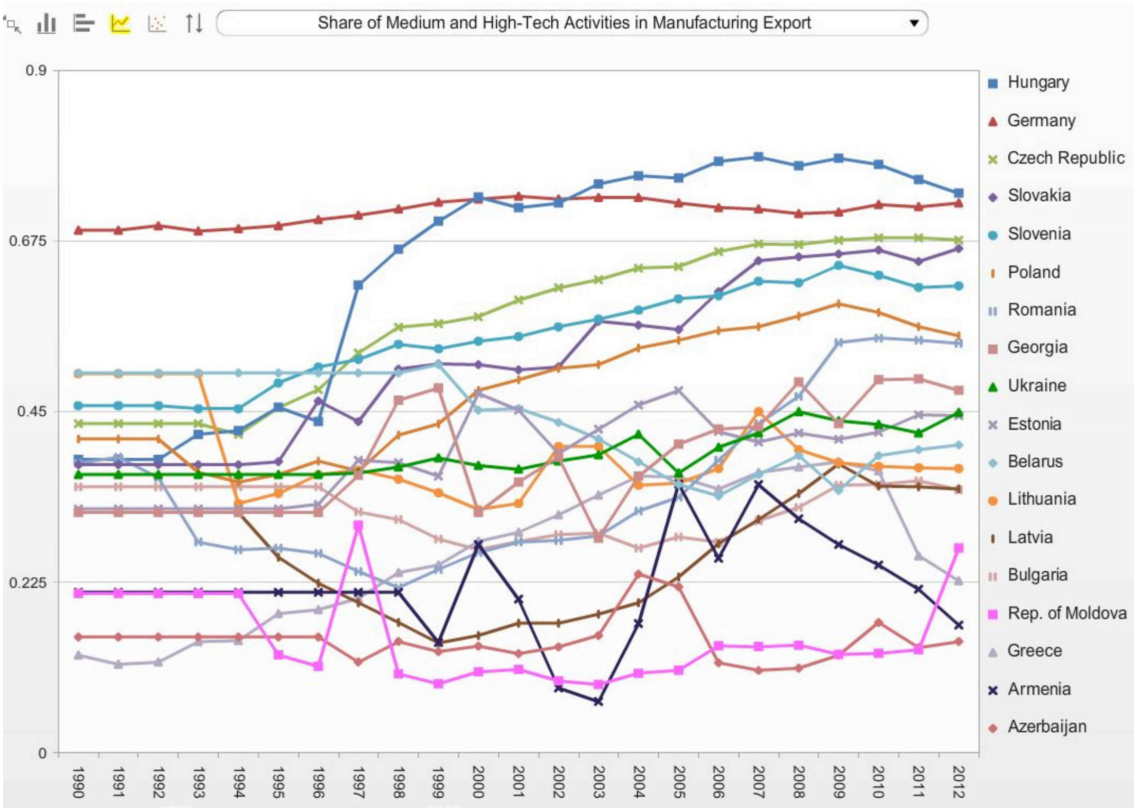
5 The EU support to the Eastern neighbors including the bilateral ENI, regional programs, cross-border programs and ENP-wide programs from 2007-2013 made up 0.25 percent of the regional GDP. By contrast, EU support to CEEC from 1990-2006 (PHARE, SAPARD, ISPA) made up 0.55 percent of their regional GDP. Source: own calculations.

5. Deep vs shallow - different outcomes of integration

How did the above strategies contribute to the developmental pathways away from the periphery in Eastern Europe? With regard to production profiles, a measure used to describe movement away from the periphery, the two peripheries record substantive differences in the structure of their manufacturing export (see Figure 4 below). Despite the considerable internal variation, the fastest developing CEE economies have converged to the production profile of Germany. All ENC have remained in the periphery from this perspective.

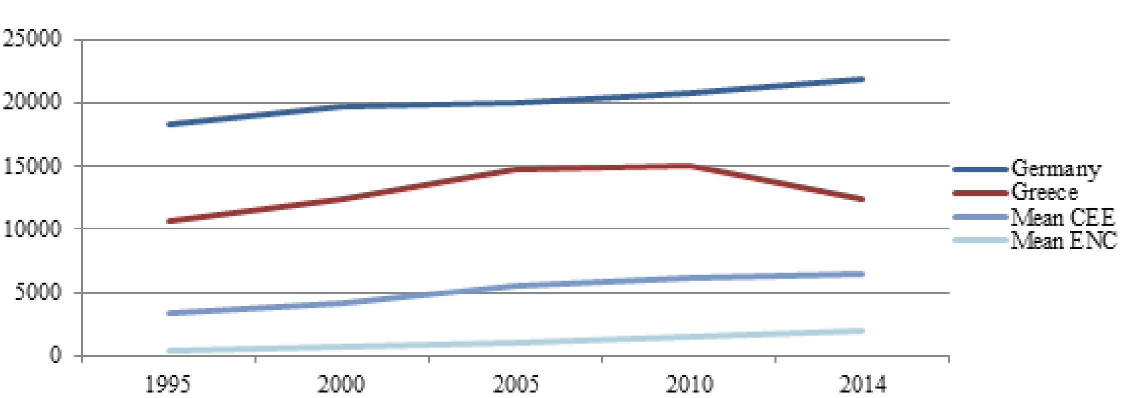
In a similar way, our proxy for social convergence, household final consumption expenditure per capita, demonstrates the gap between the CEEC and the countries left outside and behind. At the same time the numbers clearly underline the persistence of extreme inter-state social disparities within the EU. This suggests that the improved position of the CEE economies in transnational markets has only brought benefits for a relatively small part of the population.

Figure 4: Share of medium and high-tech activities in manufacturing export, 1990-2012



Source: UNIDO

Figure 5: Household final consumption expenditure per capita (constant 2005 US$)



Source: World Bank.

6. Conclusion

In this paper we have argued that the EU has managed market integration in its two Eastern peripheries in dramatically different ways. During the deep integration of the CEEC the EU was forced to internalize at least the major potential developmental consequences of market integration. In contrast, in the shallow integration of the neighborhood countries the EU has so far clearly sought to externalize the developmental consequences of integration.

The two strategies have yielded very different levels of progress in integration and have affected domestic developmental pathways in dramatically different ways. While the CEE countries greatly benefitted from the pro-active integration strategy during the pre-accession period, these modes of managing core-periphery relations have left these two peripheries burdened with different developmental problems.

The dilemma for the leading CEE countries is the question of how to widen the circle of beneficiaries of their FDI-led growth and increase the benefits of domestic actors while maintaining and increasing the competitiveness of their economies. Achieving both tasks in the framework of implementing the uniform rules of the single market proves a major challenge to these countries (Bruszt/Vukov forthcoming). The developmental problems linked to economic disparities did not disappear after May 1 2004, the date of accession of the CEEC. The uniform rules of the single European market leave little room for states of the lesser-developed members to manage the specific developmental problems of catch-up growth. Unlike in the golden age of embedded liberalism, under the new regional regime nation states have limited powers to negotiate more inclusive deals with multinational companies or use discriminatory strategies to aggressively promote domestic firms. Meanwhile, the post-accession assistance programs, despite the reduction of social and economic disparities are among their goals, have limited actual effects (Medve-Balint forthcoming). The problem is not the amount spent on reducing developmental disparities within the EU but that Brussels has only limited control over the spending of these moneys. Under the regime of dis-embedded liberalism the EU as a supranational institution works primarily as the guardian of the single market's uniform rules, while nation states in the Eastern peripheries have a great interest in keeping development largely a member state business – an arrangement that allows national governments in these countries to control EU moneys amounting to 5 to 8 percent of their GDP per year. These moneys thus work more as rents lowering the pressure to care about upgrading the tax bases of these states and increasing competitiveness. This situation provides a highly rewarding framework for economic nationalism in the CEEC.

The dilemma for the associated Eastern neighbors like Georgia, Moldova and Ukraine, in particular, is that both the Russian aggression and the increasing bottom-up pressures for domestic reforms limit the opportunities for domestic elites to advance à la carte integration. At the same time, full trade liberalization and regulatory integration with the EU, as foreseen by the Association Agreements, may impose costs on domestic actors that are not remedied by encompassing EU assistance. This is likely to increase resistance to further integration once citizens in the neighborhood countries realize they cannot count on the intertemporal trade-off of getting future membership in the club of the rich as a reward for tolerating present economic hardships.

The EU has so far not perceived neighboring countries as a danger for the core. While the present Ukrainian crisis represents a fundamental challenge to this perception, up until the present neighboring countries are seen to be neither in a position to hinder further market integration within the EU, nor as recipients entitled to transfers from the EU should integration result in dire economic consequences. The Ukrainian crisis and ongoing conflict in Eastern Ukraine question the viability of this approach and clearly shows that the EU is not protected against the political and economic collapse of its neighborhood countries.

From the perspective of maximizing the integration capacity of the EU the lesson is thus that encompassing deep integration may not only yield the superior developmental results but might also increase the potential for further integration. Such beneficial effects will, however, be sustainable only to the extent that the EU can create effective institutional capacities to manage the specific developmental problems of its peripheral economies. With regard to the economic integration of countries without the promise of membership we argue that, if the EU does not want to contribute to further economic and political destabilization in these countries, it has to consider moving towards the deeper mode of integration and develop mechanisms to anticipate and alleviate negative consequences of rule transfer. In countries with weak and captured states this might be a non-trivial task, as the experience of integrating the countries of the Western Balkans has demonstrated thus far.

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

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