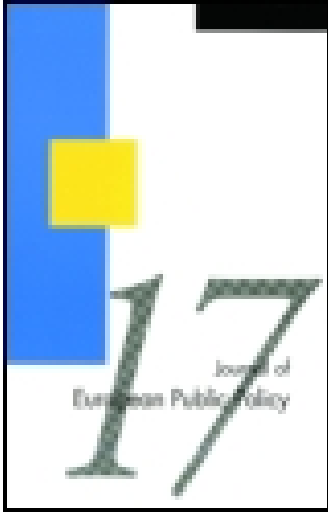


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Wade Jacoby

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Managing globalization by managing Central and Eastern Europe: the EU's backyard as threat and opportunity

Wade Jacoby

ABSTRACT As European voters and politicians increasingly demanded in the 1990s that the European Union (EU) 'manage' globalization, managing the new member states of Central and Eastern Europe (CE) emerged as an important precursor. To richer areas like the old EU-15, poor areas next door often appear as both threat and opportunity. Some EU-15 actors – mostly corporations, but also many European liberals – saw in CE a chance for new markets, new workers and new investment opportunities for the core EU-15 economies. They tried to codify new conditions of production and sale that they thought beneficial, but other EU-15 actors worried about competition from CE on capital, labor and product markets. The fearful – mostly EU-15 states and the EU itself but sometimes firms headquartered in the EU-15 – acted to try to minimize these potential threats. I show that, as a broad proposition, actors motivated by the threats seem to have shaped conditions more than those motivated by opportunity. Data from financial flows, trade in goods and services, and labor migration illustrate this central point. I conclude with speculations on how this pattern is affected by the economic downturn after 2008.

KEY WORDS Central and Eastern Europe; European Union; foreign direct investment; globalization; immigration; trade.

Southeast Asia begins 70 kilometers east of Berlin.

–German trade union official, 1993

You think we don't know what you say? East Europe...where you pick up masterpiece for string of beads... And what we spend on meal for you is tip. And you can buy our whole machine tool industry for thirty second ad on NBC.

–David Edgar, 'Pentecost'

INTRODUCTION

How did the Eastern enlargements of the European Union (EU) in 2004 and 2007 fit with Europe's broader efforts to manage globalization? A substantial literature focuses on EU efforts to manage the behavior of economic rivals,

but how does the EU manage *prospective* members who are not yet major economic rivals? Managing Central and Eastern Europe (CE) seems a prerequisite for managing globalization, and it is also an important issue in its own right. As the two epigraphs above suggest, poor areas next door often inspire both feelings of threat and opportunity in rich areas (and the EU-15 are very rich indeed). The threat notion captures the worry (often on the part of the very same actors in the old EU-15) that competition from the region might actually threaten them.

One core question about CE mirrors Europe's core question about globalization: are potential new economic partners more of an opportunity or more of a threat to us? I argue that the CE states have emerged as a clear opportunity for the EU, and one reason is that the EU and its then 15 member states took them seriously as a potential economic threat almost from the very outset. I show that emerging potential threats were attenuated, weakened and managed, often in ways that put the EU at the very center of the politics between the Western and Eastern parts of Europe. I also show that actors from the old EU-15 often used the EU to increase their business opportunities in CE.

My main goal here is to flesh out the point that 'enlarging the sphere of EU influence' is an important mechanism for managing globalization (Jacoby and Meunier 2010). This is a novel claim, and it may have broader relevance since several authors – many among those optimistic about the EU as a rising power – have made the claim that the EU will increasingly impact upon a very large sphere of geographically proximate countries (McCormick 2006; Reid 2004; Schnabel 2005).¹ It seems useful, then, to look back on the EU's engagement with CE as a source of clues about how the EU deals with economically weaker states whose proximity can be both an opportunity and a threat to its member states.

To do so, I investigate the three most commonly cited areas of globalization, namely flows of capital, labor, and goods and services. In my account, actors from the EU's 15 pre-2004 'old member states' plus EU officials are the managers, while the 10 CE new member states are the managed.² I focus my attention on the period from the collapse of communism to the onset of the financial crisis in late 2008, the effects of which are too new for inclusion here. My core intuition is that managing global challenges begins by managing one's own backyard. To the extent that there is a perception that much lower costs lie in close geographic proximity, this should induce some actors to try to exploit that and some to restrict it. I show that this is exactly what has happened since 1990.

CE sparked two primary responses among West European economic and political actors: a feeling of threat and one of opportunity. Some actors – mostly corporations, but also many European liberals – saw a chance for new markets, new workers and new investment possibilities for the core EU-15 economies. The underlying logic was that these actors could use the physical, human and legal assets of the CE region to diversify (generally not abandon) their own economic model.³ On the other hand, many EU-15 firms, labor unions and

many politicians worried openly about competition from CE on capital, labor and product markets or the cost of fiscal transfers to the much poorer region. They sought to defend their economies against threats emanating from CE by proposing barriers to immigration and trade and measures to moderate the amount of investment that flowed from EU-15 to CE sites.

Broadly, I argue that EU-15 actors exercised remarkable control over the economic transformation in CE. That is, EU-15 actors used the EU to manage the CE states. They have done so in ways that provided new opportunities while carefully managing threats. Sometimes, this has involved very conventional EU tools – such as trade agreements – so that the outcome is not surprising. In other cases, however, the EU has acted creatively to manage flows of both capital and labor with new instruments. None of this is to deny that CE actors – including national governments – were crucial to the economic reforms of post-communism, a prominent theme in my other work (Jacoby 2004, 2006). But in a collection devoted to EU efforts to manage globalization, it seems important to focus more light on some of the EU's less understood policies towards CE.⁴ In the interest of space, it is also regrettably necessary to downplay the very important national and subnational differences among these 10 states (Bohle and Greskovits 2007) in an effort to give a general account of such diverse policy reforms.

I show that private actors from the EU-15 hit the ground early in CE, and their effects have generally pre-dated an active interest by the EU in the regulatory system of CE economies. But where private actors have provoked relatively decentralized policies, the EU, while coming late to the table, enjoyed substantial leverage, especially during the run-up to enlargement. In broad terms, the EU (and some of its member states) sought to displace private practices geared towards exploiting new opportunities with more defensive 'fear-driven' policies as the dominant management approach in the region. I elaborate this central point through materials drawn from a growing secondary literature and from my own decade of research into these issues. I begin with an account of FDI, followed by immigration and trade.

CAPITAL INVESTMENT: PROMOTING OPPORTUNITY, ATTENUATING THREATS

In capital, the EU was fairly quiet in the face of early post-communist investment debates but asserted key EU-15 interests against perceived threats that arose later in the transformation. Immediately after communism collapsed, many Western corporate managers saw investment in CE as a chance to build a low-wage platform to complement or replace high-cost home production, exploiting new conditions that would make their firms more fit for global competition. The first epigraph – that Southeast Asia begins 70 kilometers east of Berlin – captures the sense of many actors that CE was a natural low-cost region no matter what political actions were taken there. Yet it is incorrect to imagine that capital flowed East quickly and easily. Almost all CE states started out

strongly protective of their national capital stock, partly for reasons crystallized in the second epigraph, taken from a character in David Edgar's brilliant 1995 stage play, 'Pentecost'.

Ironically, just as Edgar was writing foreign direct investment (FDI) saw its first real surge into the region. Even at that time, however, more than twice as many CE respondents told pollsters that 'Foreigners should not be allowed to own land in (respondent's country)' as in the Organization for Economic and Co-operative Development (OECD) states (69 per cent versus 33 per cent) (Bandelj 2008: 55). Yet by 2004 FDI as a percentage of gross domestic product (GDP) was 39 per cent in CE – almost twice the world average. In banking, the picture was even starker, as more than half the CE financial sector was in foreign hands by the end of 2004, as opposed to an OECD average closer to 20 per cent (Epstein 2008: 70–2). Clearly, something had overcome these sceptical attitudes.

This market did not emerge spontaneously but was fostered by three sets of policies driven by, respectively, the international financial institutions (IFIs), transnational corporations (TNCs), and the CE states themselves. First, when CE governments had initial reservations about selling state firms to Western investors, the Western-dominated IFIs that played a role in encouraging privatization could point to the EU's 'free movement of capital' as a component of eventual membership (Kaminski 2000). So while the EU itself had little involvement in the basic design of privatization programs, its famous Annual Reports often mentioned specific targets of privatization and encouraged the various CE governments to sell properties for whom the most plausible buyers were generally from the EU-15. Even Czech 'voucher privatization' came only *after* the conservative Czech government initially resisted selling the perceived jewels of the Czech economy into foreign hands (Appel 2006). Drahokoupil shows that the EU 'narrowed the space for attempts at promoting domestic accumulation' (2008a: 26), and multivariate regressions of the determinants of openings to FDI flows across all post-communist states show large and significant 'EU effects' (Bandelj 2008: 84–5).⁵ Although hardly the central actor in privatization, the EU thus broadly sought to increase investment opportunities in CE.

TNCs were a second source of policy innovation. Far from merely responding to CE states' privatization tenders to buy and revitalize aging communist firms, many TNCs were willing to make expensive greenfield (i.e., brand new) investments. A detailed study of seven major greenfield projects – six from EU-15 firms and a seventh from Kia – confirms that far from taking conditions as given, TNCs launched structured bidding wars among potential investment locations. When BMW announced plans to build a major car plant, it called upon officials in prospective locations to answer over 70 questions about the conditions of investment there. It received proposals from about 150 locations in CE. BMW also hired a CE-based consulting firm, Svoboda & Partner, to encourage localities to put their best fiscal foot forward. One Svoboda official recalled, 'We would knock on the closed doors of various [Czech] authorities, trying to persuade them that the state had to make a real effort. It was not

enough to offer land; it was necessary to fulfill even the unexpressed wishes and expectations of the car-maker' (quoted in Drahokoupil 2008b: 204). While such demands have become standard global practice for TNCs, in CE the TNCs could help set the broad initial rules of the game, rather than the more general pattern of seeking exceptions to those rules.

The third source of policy innovation has been the CE states. In the hunt for investment capital, they have often offered very lucrative investment incentives targeted at foreign investors (Drahokoupil 2008a, 2008b; Ellison 2007; O'Dwyer and Kovalcik 2007). Where large car firms are arguably policy 'makers',⁶ smaller Western investors are policy 'takers', and good general conditions are meant to lure them East. In that sense, we can imagine CE policy-makers solving the collective action problems of smaller foreign investors, who may be too dispersed to effectively lobby CE states. The basket of policies includes tax cuts for foreign investors, a simplified tax code, tax holidays, land grants, loose restrictions on labor relations, and even long-term commitments to reduced social spending as a credible commitment to sustained low taxes. Clearly a function of aggressive governments seeking to lure hard-to-identify potential investors, these policies have proliferated more in some CE states than in others.

These policies were coterminous with a second boom in FDI in the early part of the 2000s, but then a backlash ensued against hyper-liberal policies ensued.⁷ The backlash was led by actors worried about EU-15 competitive disadvantage and by EU officials keen to prevent behavior that might undermine the legitimacy of the single market. Some sought to prevent capital from flowing from the EU-15 by pressuring CE states to raise standards quickly so that CE tax rates soon approximated those on capital in the EU-15 and to end very attractive tax holidays. This reaction came despite the fact that EU-15 states did not see major capital outflows to CE (except, perhaps, from Austria and, even then, major Austrian banks were reaping well over half of their profits in CE markets by 2005 (Epstein 2008: 70)).

In this reaction, the leading instrument of EU-15 actors has been the EU, with its detailed single market *acquis* and enforcement mechanisms.⁸ As a leading target of FDI, Hungary's policies have come in for particular scrutiny.⁹ EU-15 corporate tax rates have come down markedly in recent years, at least partly in response to CE tax competition, a development generally welcomed by managers.¹⁰ On the other hand, the EU screening process stripped CE states of some potentially useful national tools for managing the political economy – tools that were judged by the Commission to be in contradiction to the *acquis* (Appel 2006; Ellison 2007; Gabrisch and Werner 1999). Some tax tools were outlawed altogether as violations of the state aids section of the *acquis*; others were trimmed substantially, such as the length and extent of tax holidays. When the EU tried to void favorable conditions between Slovakia and US Steel, the American company resisted, and the EU wrote an exception into the Slovakian accession treaty. In most cases, however, the EU was pushing to remove or limit concessions won by EU-15-based actors in CE.¹¹

CE states know that the EU has relatively few tools to constrain the corporate tax policies of CE states and are often allied with well-informed and powerful Western firms poised to defend their policy discretion.¹² That said, with the controversial ‘flat taxes’ in six EU members (Estonia, Latvia, Lithuania, Slovakia, Romania and Bulgaria), only the Bulgarian choice for the flat tax came after EU membership, with the Baltic States moving already in the mid-1990s. Smaller and poorer CE countries were attracted to the flat tax to draw FDI flowing to Poland, the Czech Republic and Hungary, and the EU-15 could do little to stop them.¹³

At the same time, FDI allows EU-15 states new options, including some that leave them better prepared to face globalization pressures. Without fundamentally changing their own national models of capitalism – a deeply contentious process with uncertain results – many large and small EU-15 firms are able to do things complementary to (not alternative to) production at home. Suzanne Berger notes that some EU-15 firms (her examples are drawn from Italian textiles) tend to use CE investment for new business and expansion while their core business stays in the home location.¹⁴ Becker and Muendler (2008) use a German dataset to show that job separation at TNCs who invested abroad was substantially lower than with comparable jobs at non-TNCs. Among other things, this may be because FDI allows better matching of worker to comparative advantage, thus increasing overall firm efficiency and perhaps global market share. Bandelj (2008) shows that investment opportunities in CE allow EU-15 firms to alter the ‘make versus buy’ decision in many cases.

In short, CE is both a platform for EU-15 business expansion and also a pressure valve to diminish tension over domestic regulations on the grounds that investors can escape some regulations by going to CE. CE politicians play to both sides of this: they offer preferential terms for foreign investment, defend those deals against skeptical EU Commission officials, and hope to use the resulting investment to catch up to EU-15 standards.

LABOR MIGRATION: VARIETIES OF ANXIETIES

If the capital movement case revealed a structural advantage for EU-15 actors who saw opportunity in CE, the labor case reveals an advantage for those who felt threatened. Moreover, the capital side showed substantial diversity across the region, suggesting that CE states clearly are not all responding in the same way to EU-15 management efforts. The labor case adds the important dimension that the EU-15 vary significantly in *what they want from CE*. In explaining this variation, geography clearly matters in the case of labor. Germany and Austria had quite poor CE states on their immediate border while none of the other EU-15 did.¹⁵ Their politicians judged the potential for migration flows very differently than did politicians in, say, the UK.

Broadly, the EU-15 have both a tradition of very low labor mobility internally and a de facto ‘low-skill bias’ in their immigration policies. This combination

brings somewhat fewer economic benefits than would high mobility and a high-skill immigration bias, but it also exacerbates the political tensions that surround immigration. In comparative perspective, moreover, Europe is more skeptical towards low-skilled immigrants than is the US since it has a more generous welfare state (Brücker and von Weizsäcker 2007: 248).

While some EU-15 actors placed priority on getting access to labor (especially skilled labor) from CE, others focused on walling off immigration from CE. Initially, it seemed as if the primary management here would involve the Commission walking the CE states through a welter of well-established (if patchwork) regulations regarding free movement of persons, which had become a core principle of the single market in both theory and deed by the 1990s (Grabbe 2006: chs 6 and 7). But technocratic debate over mutual recognition of things like professional certificates was soon swamped in the late 1990s by the high politics of member states. Germany and Austria, in particular, raised strong objections to immediate free movement of CE workers. In Austria, the temporary work of CE migrants was often likened in the coarse public debate to prostitution. Indeed, the places where day laborers waited for work in Vienna were called the *'Arbeitsstrich'* – roughly the 'work brothel'. Between 2000 and 2004, the number of residents of the accession states living in the EU-15 increased from 700,000 to over 900,000. At that stage, gross monthly wages in the immediately acceding CE countries generally ranged from less than 15 per cent of German wages (Latvia and Lithuania) to about 30 per cent (Hungary and the Czech Republic) (Zimmerman 2007).¹⁶

Faced with severe pressure from Germany and Austria, the EU was ultimately obliged to negotiate the right of individual EU-15 states to limit entry of workers from CEE states for up to seven years after membership. Once the possibility was opened, 12 of the 15 took advantage of it – all but the UK, Ireland and Sweden. To many observers this majority position seemed politically comprehensible, but economically (and morally) shortsighted.¹⁷ The Commission unsuccessfully advocated more openness to CE immigration. Frits Bolkestein, Internal Market Commissioner, was blunt about the defensiveness of these walls: 'In a healthy economy it is better to prepare for competition than to draw up new barriers' (Grabbe 2006: 146). In the event, Polish immigration to Germany barely budged with enlargement, though there seems little doubt that many Poles who emigrated to the UK might otherwise have gone to Germany.¹⁸

Yet despite their significant miscalculation in the number of arriving immigrants, there was, up until the time of the downturn in 2008, no evidence of declining native wages in the UK, Ireland or Sweden 'even in the sectors with the largest share of new immigrants' (Zimmerman 2007). There has also been little evidence of a growth in 'welfare tourism' (Kvist 2004). Zimmerman's 2007 data show that after enlargement, Irish unemployment trended very slightly downward while UK and Swedish unemployment trended slightly upward until, with the financial crisis of 2008, it rose sharply everywhere in Europe. Interestingly, the public perception of immigration (share who agree that 'immigration is good for the country's economy') long tracked these

disparate political decisions. In both the UK and Ireland, the share of respondents who agreed with the statement rose in the wake of enlargement. In both Germany and Austria, the share fell (Zimmerman 2007).

In keeping with these heightened anxieties, Austria and Germany announced their intention to sustain migration bans through 2009 (Austria) and 2011 (Germany). Meanwhile, Greece, Spain, Portugal and Finland lifted the bans entirely after the first period, while Belgium, Denmark, France, Italy, the Netherlands and Luxembourg modified the restrictions, especially in sectors with tight labor markets. In short, anxiety over immigration has varied substantially across the EU-15, but the broad picture is that most used the EU to legitimate time-limited immigration bans on citizens of fellow member states in order to buy time for adjustment to challenges from CE.

TRADE PATTERNS: BUYING MORE TIME

In trade, the EU initially used protectionism, treating the post-communist states as it would other non-members. Controlling access to its market is, of course, one of the key EU assets for managing globalization on behalf of its members (Drezner 2007). Soon, however, the EU began negotiating the so-called Europe Agreements (EAs) with the CE states. While most observers saw the EAs as a substitute for offering the CEs any perspective on quick membership, the EAs did contain much more favorable trade provisions than were available otherwise.¹⁹ Giving up on pure protectionism, however, meant moving to a more subtle mix of management strategies.

As protectionism gave way to the managed trade of the EAs, the EU-15 determination to avoid competition in sensitive sectors was evident from the outset. On the surface, the bilateral deals between the EU and the CE states seemed tilted towards the latter: Europe would remove its trade barriers within five years, while the CE states would get ten years. The fine print, however, contained exclusions for many products where CE states were most competitive, including iron, steel, some chemicals and several agricultural products (Mayhew 1998: 62–71). This asymmetry bought the EU-15 time to respond to areas of CE comparative advantage, and an obvious response was to buy heavily in those areas. By the time general openness arrived, a surge in EU-15 FDI after 1995 (described above) left many key assets in foreign hands.

The point is that trade deepened in ways that substantially softened the blow to EU-15 economies. Recent scholarship paints a vivid picture of trade developments up to enlargement in which the CE economies grew deeply dependent on that of the EU-15. For example, Baldone *et al.* (2007) show that CE states' revealed comparative advantage is likely much lower than previously thought. Using EU data on firm registration of intermediate goods flows, the authors decompose trade statistics in a way that takes account of two facts: first, that many products that originate in non-EU countries go through at least one phase of their production in the EU (called 'inward processing trade' (IPT)); and second, that many products that originate in the EU undergo a phase of

production outside the EU ('outward processing trade' (OPT)). For example, German and Austrian firms often temporarily exported to CE and then re-imported the goods for final finishing.²⁰ EU countries' OPT shares were virtually always highest with the CE states, rather than with American or Asian states who were their leading trade partners and with whom their IPT shares were highest. Yet CE states had a trivial position as temporary exporters to the EU, accounting for about 2 per cent of total IPT in the EU. Thus trade in semi-finished goods was essentially a one-way street. The data also show that apparent CE strength in exports was, in some sectors, derivative of German and Austrian production that conventional trade statistics counted as CE trade, even though most of its value added occurred elsewhere. This means that CE comparative advantage is overstated in most existing trade datasets.

Another indicator of dependency in CE economies takes off from the distinction between two basic forms of intra-industry trade (IIT). Vertical IIT occurs when developed countries control all the highest value added parts of the product cycle, while horizontal IIT characterizes peer-to-peer trading regimes of differentiated products of roughly equivalent value added. Gabrisch and Werner (1999) showed that Visegrad (e.g. Poland, Hungary, the Czech Republic and Slovakia) IIT did rise during the 1990s, but that it tended to have much higher vertical levels than in EU-15 states (1999: 147). The same data also showed that relative unit values (essentially, within sector variation in price-quality measures for EU-15 and Visegrad production) showed that consistently large gaps in favor of EU-15 producers in most sectors liberalized quickly. In only six of the 30 sectors measured were Visegrad producers more competitive (146–7). Finally, in the few cases of CE advantage in price-quality ratios, fewer than 10 per cent are in 'high-quality' imports.²¹ Broadly, the Visegrad states are specializing in areas of 'standard goods of labor- and scale-intensive production' (148). This certainly can raise incomes but in a way less likely to fundamentally challenge EU-15 models of production, which I have argued is the essence of managed globalization in the context of enlargement.

My interpretation of these results is that the EU-15 have managed the trade aspects of integration with CE successfully from their perspective. They have diversified EU-15 production by investing in CE but without (so far) provoking any major backlash against enlargement.²² As noted above, EU-15 firms could insist on steps to open CE markets while protecting themselves from competition from there. For example, though illegal under EU law, many investors imposed 'vertical restraint agreements' prohibiting their own CE affiliates from using technology transferred to them for any production activities outside the framework of their joint-venture agreement with their Western partners (Lorentzen and Mollgard 2000). Moreover, Volkswagen (legally) limited reimports to the EU-15 of its Skoda products out of fear of cannibalizing its VW brands there.²³ This management strategy dampened the potential for unwanted competition that did occur.

So far, CE producers have posed few really stiff competitive challenges to EU-15 producers. There are two factors behind this pattern. First, the trade strategy

described above meant that potential direct competitive challenges from CE could be largely managed by EU rules and policies. The EU allowed access to its market only on its own terms and at its own pace. Second, global liquidity was so high since the second wave of FDI that ample investment capital could flow to CE without thinning the capital base of the EU-15. This 'win-win' pattern is easiest to see in the auto sector, where very clear upgrading did take place in CE (already by 1999, CE producers had caught up with EU-15 producers in unit values in autos) (Scepanovic 2009: 6). Even as CE producers increased employment and exports of both high- and low-value-added production in the auto sector, the sector also showed stable or growing production in Southern Europe (especially Spain) and Germany (Scepanovic 2009).

While the first factor – limits to market access – dampened CE growth into high value-added markets, the second – high liquidity – promoted such growth. Both of these factors have changed, however. First, the EU-15 regulatory strategy depended very heavily on the CEs' non-member status, which ended in 2004. Should CE-based firms – aided by propitious tax, investment and labor market policies in CE – launch new challenges, it is harder to see how this pattern could be repeated.

Second, the financial crisis has manifested, in part, as a liquidity crisis, and lending is down substantially since 2008. FDI inflows to the CE member states fell 9 per cent in 2008, and FDI inflows for 2009 may be an estimated 50 per cent lower than in 2008 (Hunya 2009). CE exports have been devastated, falling around 30 per cent year-on-year in several CE economies in 2009. Industrial production is down. Year-on-year growth reversals between 2008 and 2009 ranged from a low of –5 per cent (Poland) to –28 per cent (Latvia), and Poland was the only CE member to register positive growth in 2009 (0.8 per cent). Poland's relatively favorable growth reversal numbers are equal to that of the EU-15 average, so all other CE states are doing worse than the EU-15 and some far worse. Still, growth reversals are lower in CE states that trade heavily with the EU-15 than in states like Russia and Ukraine, suggesting some buffering role for intra-European trade (WIIW 2009: 4). While a fragile recovery is forecast for some states, most predictions see growth remaining below 3 per cent in even the best performers through 2011 (WIIW 2009: 11–12).

CONCLUSION: FOUR PARADOXES OF FRAGILE ECONOMIES

'Enlarging the sphere of EU influence' is one of five mechanisms that this collection puts at the core of managed globalization. I argue that the EU-15 have been highly risk-averse during this enlargement. Their management efforts allowed EU-15 actors to exploit investment opportunities in CE but without immediately exposing EU-15 economies to large increases in migration or trade pressure in sectors where CE had comparative advantage. Slowly, CE states shifted from a domestic growth strategy to one based more on attracting FDI and boosting exports. This transformation was aided, abetted and channeled by the EU-15. In finance, the EU eventually stripped CE states of

some of the tools they had been using to attract foreign capital, and the EU paved the way for the EU-15 to delay trade opening in sensitive sectors until FDI patterns increased EU-15 influence and, later, to put up barriers to labor mobility. Emphasizing that the EU-15 bought time to adjust, the CE states also played important (and quite understandable) roles in promoting FDI. The result was neither a neoliberal invasion (Aligica and Evans 2009) nor a pure 'manager's paradise' (Bluhm 2007), but a carefully managed economy closely tied to those in Western Europe.

Four paradoxes emerge. First, even though CE states have been thoroughly managed by the EU-15, the result has still been broadly perceived as a win-win situation, at least until recently. Even though the EU-15 states won all the key disagreements prior to enlargement – over issues like agriculture funding, the size of the structural funds, the time to membership, the stretching of the *acquis* to novel areas – the wide gap in living standards between EU-15 and CE states means that even small concessions were meaningful in CE. Moreover, their status as potential and then actual EU members has helped lower CE borrowing costs, which stimulated a long consumption boom. In most places, between 2000 and 2008, employment, growth and investment were up while inflation was down. The financial crisis that began in 2008 may only further cement CE interest in joint EU policies even if costs are asymmetric. For example, while most CE states have taken a cautious approach to future eurozone membership, it has not escaped notice that those states that did join – Slovenia, Slovakia, Malta and Cyprus – enjoyed a certain insulation from the currency fluctuations that roiled markets in late 2008, hammering even states like Iceland, let alone Hungary and Latvia.²⁴

A second relevant paradox is that where Abdelal and Meunier (2010) show that the EU was more able to manage globalization in capital than in trade, the CE cases show roughly the opposite pattern: EU-15 governments more easily managed the trade aspects of enlargement than the FDI aspect, where they often resented the hyper-liberal policies designed to attract investment. These liberal policies emerged from an implicit coalition between CE reformers and EU-15 investors (Jacoby 2006). This coalition around finance was much harder for the EU-15 to control, but it also generated conditions under which the later move to free trade would be much less disruptive, since EU-15 actors soon came to own the CE firms exporting (or reimporting as in the above data) to the EU-15. Broadly, this pattern underscores again how powerful is the EU's gatekeeping leverage granted by virtue of the large internal market to which it controls access. By contrast, the EU has far fewer instruments to limit the outflow of capital from the EU-15.

The question is how well the EU deploys this leverage. Sbragia (2010) shows that the EU has often fared poorly, seemingly handcuffed by its commitment to multilateralism. In the current banking crisis, the EU seems often to have failed to exploit widespread disenchantment with American finance practices to play a central role in developing new global financial regulations (or even get its own house remotely in order) (Newman 2009; Véron 2009). Even in its own

neighborhood policy, the EU has struggled to use economic leverage alone (without membership conditionality) to prompt radical reforms in 'deep' Eastern Europe or the wider Mediterranean areas (Vachudova 2008). However, in CE the EU did play its trade cards adroitly and to the clear benefit of EU-15 actors. Now that the CE states are full members (a situation that often improved conditions for previous waves of EU entrants), they can defend themselves far better. Yet what if access to consumption financing narrows dramatically and investment capital flows out of CE during a protracted economic downturn? Will the CE states, even as full members, find that they have left behind their status as geo-strategic buffer states for the USSR only to emerge as economic buffer states for the old EU?

A third paradox is that some level of liberal 'threat' from CE may actually be welcomed by generally conservative and risk-averse EU-15 governments. Initially, West European firms' efforts to attract generous investment subsidies seemed to empower CE states with whom these firms often worked very closely. EU-15 states often protested about the potential for social dumping and unfair tax competition. These complaints have grown quieter however, and part of the reason for this may be because CE liberalism both helps solve a collective action problem of West European firms and provides them with favorable conditions that reduce their demands on EU-15 governments. Many such corporations – not least large German firms – chafe at domestic regulations and are genuinely interested in using production abroad not just to cut costs but to put reform pressure on their home governments. Yet the ability to lower their costs in the short run by investing in CE may rather dampen their fervor for reforms that might lower their home costs in the long run. In that sense, CE investment seems to have functioned as a 'pressure valve' that, when released, somewhat deflates the pressure for domestic reform, something that might, for example, have threatened to tear apart the CDU–SPD grand coalition that governed Germany until the autumn of 2009. Post-election interviews in the German Ministry for Economics suggest no enthusiasm for reopening the contentious debate over 'tax dumping' in CE.²⁵

A fourth paradox is that when EU membership was achieved, the resulting 'safety' seems to have led CE states to adopt some very risky new behaviors. This behavior is the subject of another paper, but some of its roots seem already to be clear enough. On the one hand, the very fact of prospective and then actual EU membership dramatically lowered borrowing costs for CE actors, but this was especially true to the extent that borrowing was denominated in foreign currencies like the euro or Swiss franc. Some of this debt was no doubt justifiable in the context of consumer prices that were converging on EU-15 levels quite a lot faster than were wages. Nevertheless, when domestic currencies came under severe pressure in the autumn of 2007, debt service became a crushing burden for both private and public actors. To this economic logic, we must also add an important note about politics that may well lie at the heart of this risky behavior: CE politicians of all stripes have been faced with relentlessly dissatisfied electorates, resulting

in high electoral volatility, party death and exit, and high government turnover. In this context, the incentives are hard to resist for politicians to pursue policies with benefits in the here and now and costs that will be borne by the next government, almost certainly not by them.

What lies ahead? With the global economy in turmoil, it is exceedingly difficult to say. One hunch is that variations across European economic systems will become even more important. We already know that even the Europe of the EU-15 contained up to four fairly coherent economic models: (1) Nordic Coordinated Market Economies (CMEs); (2) Continental CMEs; (3) Liberal Market Economies (LMEs); and (4) a Southern European model (Pontusson 2005; Fioretos, this issue). A useful line of future research would ask the extent to which countries from each part of the typology have and sustain a distinct relationship with CE. For example, Germany is, by some distance, the largest investor in CE. On the other hand, the UK – well ahead of Germany and second only to the US in global FDI outflows – has been only a bit player in CE, accounting for less than 5 per cent of total FDI, except in Bulgaria (11 per cent) and Lithuania (7 per cent) (Bandelj 2008: 106–10). One hypothesis consistent with this data would be that LMEs have least to gain from CE (since their economies are already more liberal) and that they therefore invest less in CE. A corollary might, however, be that LMEs have allowed more immigration from CE, suggesting that they want something different, but not that they are less interested in CE. In other words, the EU-15 may use regionalization differently: Britain hosts CE workers, while Germany prefers to invest there instead.²⁶

Variation in EU-15 objectives must also be matched analytically with substantial variation in CE capacities, a crucial theme that space limitations have obviously precluded here. Greskovits (2006) shows that behind broadly liberal policy regimes very different economic structures are still being reproduced. Distinguishing capital-intensive and non-intensive production regimes as well as skilled versus less skilled production produces a typology with four combinations: capital-intensive-low skilled (e.g. mining, Bulgaria), capital intensive-high skilled (e.g. autos, Slovakia), non-capital intensive-low skilled (e.g. textiles, Romania), and non-capital intensive-high skilled (e.g. electronics, Hungary). Surely, these sectors will respond differently to the ongoing turmoil, with the auto sector in especially difficult times. It is far from certain that the EU-15 can still use EU instruments to manage CE states now that they are all members, but given the history outlined above and the rough times ahead, it seems beyond a doubt that they will give it a try.

Biographical note: Wade Jacoby is Professor of Political Science and Director of the Center for the Study of Europe at Brigham Young University, USA.

Address for correspondence: Wade Jacoby, BYU Department of Political Science, 745 SWKT, Provo, UT 84604, USA. email: wade.jacoby@byu.edu

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NOTES

- 1 For example, Leonard (2006: 145–6) lists 82 non-member European, African and Asian, states in an emerging ‘Eurosphere’.
- 2 This article does not treat Malta and Cyprus, which also joined in 2004.
- 3 This logic applies both to firms – which have a model of production – and to nations in the sense of national models of capitalism.
- 4 For important exceptions, see Gowan 1995; Zielonka 2006; Böröcz 2010.
- 5 This finding is based on a dummy for prospective membership. On the other hand, formal EU investment treaties seem not to explain much variation (Bandelj 2008: 123).
- 6 Audi resisted Hungarian efforts to impose a 4 per cent ‘solidarity tax’ on foreign capital and helped scuttled the whole measure (Ellison 2007: 25).
- 7 To be clear, my claim is not that liberal policies definitely attracted investment capital and jobs. Even when the Baltic states moved to the kind of hyper-liberalism just described, this did not redirect FDI away from the four ‘Visegrad’ states that had already been the main beneficiaries of the first FDI boom (see Bohle and Greskovits 2007: 457–9). My point is that the policy basket under discussion scared key EU-15 actors with visions of the proverbial ‘race-to-the-bottom’.
- 8 The CE states appear to have been conscientious about passing EU legislation and resolving disputes with the EU subsequent to membership (Sedelmeier 2008).
- 9 For example, Volkswagen accounted for about 15 per cent of both Czech and Slovakian exports in the years leading up to enlargement (Pavlínek 2004).
- 10 A 2006 EU report found that corporate tax rates declined in 22 out of 25 EU states between 1995 and 2004. Weighted for country size, the average rate drop was from 43 per cent to 33 per cent (European Commission 2006: 82–4).
- 11 Van Aken (2008) shows that foreign investors provided a clear advantage when CE states sought temporary ‘derogations’ to set aside parts of the *acquis* for a limited time.
- 12 Former Estonian Prime Minister Juhan Parts spoke for many when he said, ‘Estonia views any move to QMV on tax and social security as not acceptable.’ *BBN Estonia*, 6 October 2003.
- 13 For a subtle but inconclusive analysis along these lines, see Aligica and Evans (2009: 185–203).
- 14 Even here, however, Berger (2005) stresses the low productivity in CE sites like Romania, while noting that firms there are often obliged to build much of their own infrastructure. Such hidden costs cut heavily into anticipated benefits. See also Sammarra and Belussi (2006).
- 15 Greece did by 2007, but not 2004 when the core policy space was contested. Italy was bordered by relatively well-off Slovenia.
- 16 Slovenia was an outlier at just over 50 per cent. Bulgaria and Romania (2007 accession) were under 10 per cent of German wages.
- 17 To be sure, Germany and Austria have the highest shares of non-nationals among their working-age populations (about 10 per cent – though few from CE states).

- 18 The UK received far more immigrants than anticipated (according to the BBC, 600,000 total rather than the Home Office's estimate of 13,000 per year (e.g. approximately 50,000 per year since May 2004), with Poland by far the biggest sender).
- 19 For the EAs, see Sedelmeier (2005). A more positive view is Kaminski (2000), who notes that many potentially protectionist measures were limited in practice. Still, Eurostat data show that aggregate CE trade deficits with the EU-15 jumped from just under €5 billion in 1994 to nearly €13 billion in 1996. Vachudova (2005: ch. 4) shows that stingy EU trade concessions in the EAs increased CE determination to seek full EU membership.
- 20 In the years the study was conducted – 1990 to 2003 – the CEs were non-EU countries.
- 21 In a later study, Mykhnenko (2007: 373) found that CE states (even those with very different growth levels) still showed similar comparative advantages in global markets, namely low and medium technology exports and resource-based manufacturing exports.
- 22 This claim is easier with the Lisbon Treaty finally ratified. That said, I am not aware of solid data linking prior French, Dutch or Irish rejection of the Constitutional or Lisbon treaties to frustration over enlargement.
- 23 I thank Bob Hancké for this information.
- 24 For the Hungarian case, see Szlanko (2008); for the Latvian case, see Raudseps (2008).
- 25 Interview with Hansjög Schaal, German Ministry of Economics, Berlin, September 2009.
- 26 Consistent with this proposition, Ireland has virtually no CE investment. On the other hand, Sweden – which also opened its labor markets from the start of enlargement – was actually the fifth largest investor in CE.

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