

Managing globalization by managing Central and Eastern Europe:

Two out of three ain't bad?¹

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Southeast Asia begins 70 kilometers east of Berlin

--German trade union official, 1993

My paper is concerned with the Eastern enlargements of the EU in 2004 (by ten states) and 2007 (two more) and how these enlargements fit with notions of managed globalization.² 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 CEE seems a prerequisite for managing globalization, and it is also an important issue in its own right. Poor areas next door often inspire both greed and fear in rich areas (and the EU-15 are very rich indeed). And the core question about Central and Eastern Europe (CEE) mirrors Europe's core question about globalization: are these potential new partners more of an opportunity or more of a threat to us?

¹ Thanks to Grigor Pop-Eleces, Scott Cooper, Rachel Epstein and the Princeton Workshop participants for comments on an earlier draft.

² The new members in 2004 were Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia; in 2007, they were joined by Bulgaria and Romania.

The paper's main function is to flesh out the introductory paper's point that "enlarging the sphere of EU influence" is an important mechanism for managing globalization. Several authors – many among those optimistic about the EU as a rising power – have made the claim that the EU will increasingly impact a very large sphere of geographically proximate countries (McCormick 2006; Schnabel 2005; Reid 2004). Leonard (2006: 145-6) lists 82 non-member states in an emerging "Eurosphere"! It seems useful, then, to look back on the EU's engagement with CEE 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" (OMS) plus EU officials are the managers, while the 12 new member states (NMS) are the managed. Where many of the papers in this workshop look at EU efforts to manage globalization by managing relatively distant practices, this paper looks at management of an area on the EU's immediate geographic periphery.³ What this has to do with globalization is that the particular form that regionalization has taken is, arguably, a technique for coping with globalization. That is, Hungarian products exported to Germany are not "globalization," but a leaner and more cost-effective Volkswagen with plants in CEE arguably poses a different competitor to Japanese car companies wherever they compete. Thus, my core proposition is that managing global challenges begins by managing your own backyard. To the extent there

³ Obviously, CEE actors are often partners in both offensive and defensive forms of management. I play this theme up even more in (Jacoby 2006).

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. This is exactly what happened since 1990. Crudely, the main offensive actors were OMS-based firms, while the main defensive actors were various OMS, sometimes using the EU itself and sometimes intervening directly.⁴

Exaggerating a bit for effect, CEE sparked three responses among West Europeans: greed, fear, and indifference. Some actors – mostly corporations, but also many European liberals – saw a chance for new markets, new workers, and new investment possibilities for the core OMS economies.⁵ But for most people, fear of losing what they have is stronger than the hope of getting what they do not have. Many actors worried openly about competition from CEE on capital, labor, and product markets. Others worried about the cost of fiscal transfers to the much poorer peoples of the region. The fearful – mostly states and the EU itself but sometimes OMS firms – then acted defensively. And yet the dominant emotion still was probably indifference. Most citizens of EU-15 states appear to have thought relatively little about the effects of enlargement (but to have been generally positively disposed when they did think about it). This is only natural. The bulk of politics is still national politics, and it was hard for ordinary citizens

⁴ And I mean “crudely.” Below, I list several instances where OMS firms were defensive, and the EU acted offensively.

⁵ Analogously, some OMS workers saw potential benefits from new markets for their companies. Some OMS consumers saw the prospect of lower prices as a result of a more efficient internal market. But the main actors are OMS firms and states.

to muster much energy to evaluate such opaque choices. This indifference was a necessary condition for the dominance of firms and state and EU officials that I describe.⁶

There are a growing number of fine accounts of the political economy of CEE. These works skillfully mine and mix the legacies of communism, the initial policy choices of postcommunist reformers, and the actions of domestic and international investors to explain the emerging economic patterns of the wider region. The EU plays a generally peripheral role in these accounts and for understandable reasons. While few dispute the importance of the EU in preparing these countries for membership, the basic regulatory framework of the internal market is uniform and so gives relatively little leverage in explaining variation across the region. Moreover, while the EU's decisions on membership weighed heavily on the minds of CEE citizens and policymakers alike, the EU does not control much of the microeconomic order of its member states (or prospective member states). Thus, there is something odd about telling the story of the CEE political economies from an EU perspective. And yet sometimes we see interesting things in our peripheral vision, and I think that is the case here.

This paper starts with an analytical continuum. The two extremes are marked by what the introductory paper called ad hoc globalization – the effort to cope with increased global flows by producing more efficiently but without making any effort to shape the conditions of production – to outright protectionism. For pure market liberals, ad hoc globalization is an opportunity, and CEE producers put welcome pressure on conservative OMS economies. For pure protectionists, CEE adds intolerable new pressure to existing OMS structural problems. And yet most people lie in between these

⁶ ...often matched by similar popular indifference on the CEE side.

extremes, advocating a mix of offensive and defensive practices that, at some point, clearly begin to overlap. While retaining the broader offense and defense categories, I want to suggest two mechanisms that seem particularly important in relation to enlargement. I call them “diversification” and “ordering.” Each is driven primarily by EU-15 actors, though CEE actors will play important roles in each mechanism.⁷

The rest of this paper lays out diversification and ordering as variants of offensive and defensive management, respectively and sketches the utility of these ideas for describing the basic contours of policy about capital, labor, and trade. The key questions were: how much policy diversity is appropriate in CEE efforts to attract capital? How much freedom should CEE citizens have to seek work in the OMS? And how much should OMS-NMS trade be driven by each sector’s relative comparative advantage alone? The paper concludes that, on balance, the advocates of defensive ordering not only “won” two out of these three battles, they also found a way to salvage many of their aims in the one area – capital – where they “lost.”

⁷ The diversity and durability of European national models of capitalism suggests to me that, like them, the CEE states must find their own comparative advantage. The difficulty is that CEE states must grope for their comparative advantage under the partial influence of TNCs trying to stabilize their own models. With so much in flux, the groping is difficult. Looking at some of the TNC strategies in the capital section below one wonders how these states will achieve fiscal balance in the long run with such low tax rates.

Offensive diversification and defensive ordering

Most scholars have looked at CEE as a target of regionalization.⁸ But my intuition here takes off from the idea of the EU as an agent of management in CEE. If the EU can be a tool wielded by the OMS to manage globalization, then we ought to see them using enlargement to prepare the CEE region to help the OMS area compete globally (and not merely to help CEE states prepare to be good EU members). To the extent the EU succeeds/fails in managing the NMS, we might also gain important clues as to its strengths/limitations in managing more distant economic competitors.

Ad hoc globalization – defined as exploiting conditions while making no effort to shape them more generally – was fairly unattractive in CEE because communism had left a fairly decrepit economic legacy. As a result, very little FDI flowed to CEE from the OMS in the early period of the “transition.” Offensive strategies came in two very different packages. The first was uncontroversial. The EU-15 states, EU officials, and virtually all OMS firms with a potential interest in investing in CEE agreed that the initial management measures needed were to privatize firms, develop adequate payment systems to enable commerce, secure provisions for contract enforcement, and introduce measures for repatriating profits.⁹ In that fairly minimal sense, the basics of “doing business” would require “doing governance” as well. Besides the mechanism of

⁸ A partial list of books from just the past three years would include (Epstein forthcoming; Grabbe 2006; Pevehouse 2005; Pridham 2005; Schimmelfennig and Sedelmeier 2005; Vachudova 2005). For my take, see (Jacoby 2004).

⁹ These OMS exhortations were largely uncontroversial in CEE with the exception of some privatizations (e.g. banks) and perhaps the repatriation of profits.

“enlarging the sphere of EU influence,” two other mechanisms were widely used: exercising regulatory influence and empowering other IOs (often the IMF or the OECD) (Appel 1994; Stone 2002).

A second variant of offensive management was, however, quite controversial and will be my focus below. OMS actors strongly disagree about what would most help the OMS compete globally. But one important strain of thought is that offensive management could bolster OMS efforts to organize an economic region in CEE that would bring OMS producers new advantages in global competition. This meant gaining access to tens of millions of new consumers, which along with access to lower costs in CEE, could improve their competitive position on extra-regional markets as well.¹⁰ The underlying logic is that OMS actors could use the physical, human, and legal assets of the CEE region to diversify (not abandon) their own economic model.¹¹ As noted, this idea was more controversial than ideas about helping CEE states establish the basics of a market economy. OMS private entities – mostly large Western firms – thus often sought to enlist CEE policymakers in reforms that went beyond the ad hoc by, for example, seeking propitious rules for FDI and a favorable tax environment. Below I describe three faces of offensive management through the “diversification” of existing practices and models.

¹⁰ These firm-level motives hold even if enlargement were shown to be a net economic drain on OMS economies since individual firms could still benefit enormously. Most early analyses suggest modest net gains for OMS economies as a result of enlargement.

¹¹ This logic applies both to firms – which have a model of production – and to nations in the sense of national models of capitalism.

Defensive management, by contrast, emphasizes organizing CEE to solidify it as a barrier against extra-European competitive pressures while also minimizing its comparative advantages vis-à-vis the OMS. Rather than diversifying the production conditions of OMS-based firms, the core idea is to protect those OMS firms against challenges that emanate directly from CEE (perhaps taking advantage of lower costs there) or that move through CEE (particularly the flow of illegal goods and people across lightly-guarded frontiers). Techniques here include strict bars against immigration, trade barriers, and measures to ensure that investment does not move from OMS to NMS sites. As CEE states gained momentum towards EU membership, OMS actors found opportunities to deploy some of these extreme defensive strategies.

Though at its limit, defensive management shades into simple protectionism, I am interested in some OMS defensive management vis-à-vis CEE that had a different character, which I call “ordering.” Just as offensive management goes beyond ad hoc deregulation, defensive management means more than building higher walls against external competition. The central idea behind ordering as a defensive strategy is that CEE is both an opportunity and a threat and that it requires OMS/EU management to get the balance right. More concretely, the intuition behind ordering is that some firms (and the jobs they create) are not worth having in a modern economy. Defensive ordering becomes a matter of using rules to make the distinction between commercial practices that ought to exist and those that ought not exist, at least not in modern Europe. The ordering approach would then use management tools to promote and/or defend the former but not the latter. Rather than “picking winners” among individual firms or sectors, this approach tries to nurture specific economic capacities, such as the ability to pay wages with regular

productivity gains plus cost of living increases. Such actors were keen to see that CEE producers – including OMS firms invested there – would not be able to boost their competitive position by abusing their workers, their customers, or the environment.

Just as diversification can be seen an extension of the restless search for lower costs, ordering can be seen an extension of the restless search for higher efficiency. Though it sometimes appeared to CEE actors as disguised protectionism, in fact, arguments about order are a staple of the comparative political economy of Northern Europe. Take national labor markets, for example. In the labor market, the central objective of ordering is to boost average economic productivity (thus the justification for overall wage growth) by “selectively squeezing corporate profits” through pressure on the lowest productivity firms, either forcing them to rationalize production or exit the market (Pontusson 2005: 63). In this approach, low wages are seen as an (ill-advised) subsidy to inefficient firms. Different metaphors capture the reality: some refer to the German wage floor system as a form of industrial “hygiene” because it “cleans up” perceived bad practices while German collective bargaining partners often describe their rigid minimum wage system as a “modernization whip” in reference to the fear of stagnation that drives both employers and employees in such a system.

Though the idea of ordering a national economy is thus an old one in several European states, it is a reflection of the domestic preferences and traditions of those states.¹² The EU has few, if any, levers to influence the wage policies of prospective member states, so it could not foist this particular kind of ordering on CEE even it wanted

¹² And indeed it is quite contested since it diminishes the prospects for a large low-wage service sector for low-productivity workers.

to. But while it is not the prerogative of the EU to determine the microeconomic order of its member states, the strong desire of CEE states to become EU members has allowed the EU to exercise substantial control over their economies, often stretching the *acquis communautaire* in order to do so (Grabbe 2006). Below, I develop some examples of EU ordering in areas of tax law, state aid, immigration control, and trade agreements.

As a broad generalization, OMS private actors (who moved quickly) pursued offensive management through diversification, while the EU actions (which came later) tended to look more like defensive management through ordering.¹³ Each of them, it goes without saying, sought to solidify their preferences in public policy passed by CEE states.

Diversification and ordering in capital, labor, and trade.

OMS private actors hit the ground running in CEE, and their effects have generally predated an active interest by the EU in the regulatory system of CEE economies. But where private actors have had relatively decentralized policies, the EU, while coming late to the table, has enjoyed some leverage. Thus, one important question is whether the EU (and at least some of its member states) have sought to displace private offensive diversification strategies with defensive ordering as the dominant management approach in the region. My main finding is that this is indeed what happened.

¹³ This happened in German unification as well: the public authority strove to implement minimum standards (often at the behest of private *collective* actors) while *individual* private actors probed for new opportunities, some of which presumed a weakening or hollowing out of those minimum standards.

Consistent with the introductory paper, in this section I note the behavior of actors who prefer offensive management and those who prefer defensive management. The former seek to use regionalization as a tool to promote globalization by diversifying European strategies. The latter seek to manage regionalism through ordering so that it generally aids in defending current arrangements against globalization pressures, even if it also containing elements of selective modernization. How do these strategies play out in debates about the three leading areas of globalization (capital, labor, and trade)?

Capital and FDI Questions: Postcommunist Junkyard or Greenfield of Dreams?

In capital, many OMS corporate managers saw investment in CEE as a chance to build a low-wage platform to complement high-cost OMS production. Ad hoc globalization occurred whenever OMS firms sought simply to exploit new conditions that would make them more “fit for global competition” without trying to shape those conditions more generally. This paper’s epigraph – that Southeast Asia begins 70 kilometers east of Berlin – captures the sense of many actors that CEE was a natural low cost region no matter what political actions were taken there. Yet, it is incorrect to imagine that capital flowed quickly and easily into CEE. Almost all CEE states started out strongly protective of their national capital stock, and FDI first surged into the region only after about 1995. Even at that time more than twice as many CEE respondents told pollsters that “Foreigners should not be allowed to own land in (respondent’s country)” as in the OECD states (69% versus 33%) (Bandelj 2006: 55). By 2004, however, FDI as a percentage of GDP was 39% in CEE – almost twice the world average. Clearly, something changed.

There is strong evidence that this market did not emerge spontaneously. In addition to ad hoc opportunism by OMS firms, active diversification took at least three forms. First, to the extent that CEE governments had initial reservations about selling state firms to OMS 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. So while the EU itself had very little active leverage over or involvement in the basic design of privatization programs, its famous Annual Reports often mentioned specific targets of privatization and encouraged the various CEE governments to sell properties for whom the most plausible buyers were generally from the OMS. Given the fame and later influence of Czech "voucher privatization," it is worth remembering that the conservative ODS government initially strongly resisted selling the perceived jewels of the Czech economy into foreign hands (Apple 2004). Drahekoupil argues that the EU "narrowed the space for attempts at promoting domestic accumulation" (2008a: 26). Multivariate regressions of the determinants of openings to FDI flows across all postcommunist states show large and significant "EU effects" (Bandelj 2006: 84-85).¹⁴ Here is an initial clue that while the EU acted in a broadly defensive way in CEE, it could and often did help shape openings for the diversification of OMS political economies.

A second major diversification strategy was driven by TNCs from the EU-15. Far from merely responding to CEE states' privatization tenders to buy and revitalize aging communist firms, many TNCs were willing to make expensive greenfield investments. A

¹⁴ 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 2006: 123).

detailed study of seven major greenfield projects – six from OMS 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 prospective locations to answer over seventy questions about the conditions of investment there. It received proposals from about 150 locations in CEE. It also hired a CEE-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 Drahekoupil 2008b: 204).

While this is a clear illustration, many FDI decisions are far from hyper-rational exercises in venue shopping. Managed globalization, however, should not require perfect foresight. Rather, it should also include the many cases in which OMS firms vaguely expected to improve production conditions but had little knowledge of specific CEE possibilities and hence largely muddled through with informal contacts and educated guesses (Bandelj 2006).¹⁵ In the search for diversified production conditions, OMS firms also display a range of tolerances. A large Dutch electronics firm invested in both Poland and Hungary confronted so large a gap between OMS and NMS conditions that the firm could comfortably pay wages a bit higher than local norms and also offer CEE workers more participation and fringe benefits and still relax pay, participation, and benefits

¹⁵ As I show below, however, when OMS firms don’t know exactly what they want, CEE policymakers have often been willing to guess.

considerably over their OMS costs (Kahancova 2008).¹⁶ On the other hand, Bohle and Greskovits characterize the floundering industrial sphere of the Baltics as the “low cost assembly sweatshops of the EU” (2007: 461).

The third agent of the diversification of OMS economies has been the states of CEE. In the hunt for investment capital, they have often offered very lucrative investment incentives targeted at foreign investors. Where large car firms are arguably policymakers¹⁷, many smaller OMS investors are policy takers, and good general conditions are meant to lure them east. In that sense, we can imagine CEE policymakers solving the collective action problems of small OMS investors, who are the ultimate managers in this scenario even if they are too dispersed to press their case. 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 in some CEE states and not others. While some case studies emphasize the effects of a “comarador service sector” of western consulting firms, their local allies, and EU officials (Drahokoupil 2008), more systematic accounts locate the initiatives in

¹⁶ A similar dynamic marks globalization. Pogge shows that while globalization improved conditions in some developing countries, one can still ask whether it was legitimate that the preponderant share of the benefits went to developed economies.

¹⁷ Audi recently was able to resist Hungarian efforts to impose a 4% “solidarity tax” on foreign capital and ultimately to scuttle the whole measure (Ellison 2007: 25).

conservative political parties – often under the advice of the IMF and OECD (O’Dwyer and Kovalcik 2007: 6-7).¹⁸

Analogous to the wage compression example given earlier, tax incentives to the most productive firms could encourage growth in the most efficient areas of the economy and thus, over time, raise the overall efficiency of the economy.¹⁹ This rationale might then be used to justify tax subsidies to highly efficient firms on the grounds that these are exactly the kinds of firms CEE governments want to encourage. Of course, these ideas have a strong ideological valence as well, as witnessed by the advocacy role of American NGOs like the Heritage Foundation or Hoover Institution. Where conservative parties face “institutionalized” left opposition – mainly Hungary and the Czech Republic – they fail to pass this basket of policies (though Hungary granted ten-year “tax holidays” to several specific firms (O’Dwyer and Kovalcik 2007; Ellison 2007)). Where recurrent ethnic tensions leave the party system unsettled – Slovakia, Estonia, and Romania are prominent examples – the opposition is too weak or fragmented to block these general policies. These policies were coterminous with a second boom in FDI in the early part of this decade. Thus, after the EU and OMS entrepreneurs, CEE states are a third source of diversification practices that might help OMS firms better adapt to global pressures.

Though to my knowledge, no systematic study has yet tied the big increase in FDI directly to the new policies, it is evident that a broadly defensive backlash has grown in

¹⁸ Left governments often initiated or sustained the shift of relative tax burdens from corporations to labor earlier in the postcommunist period (Appel 2006).

¹⁹ Average labor productivity has risen dramatically in CEE since the onset of major FDI around 1995. Need updated figures.

opposition to these practices.²⁰ The backlash seems to me a form of ordering as defined above. It is led by actors worried about an OMS competitive disadvantage and by EU officials keen to prevent behavior that might undermine the legitimacy of the single market project. Defensive managers should seek to prevent capital from flowing from the OMS to the NMS by pressuring CEE states to raise standards quickly (“hygiene”) so that CEE tax rates soon approximated those on capital in the OMS and to end or reduce very attractive tax holidays. Purely defensive actors – e.g. ones who would prefer simple old-style protectionism if it were legitimate – have so few tools for preventing capital movement (c.f. Abdelal and Meunier) that they have gravitated to the ordering technique, in part, because it legitimates some restrictions on policies to induce capital movement.

Ordering has entailed an OMS push back against perceived overly aggressive CEE policies and private deals. These defensive moves came despite the fact that relative to their own capital depth, OMS states have not seen major capital outflows to CEE (except, perhaps, Austria).²¹ The leading instrument of OMS actors has been the EU, with

²⁰ My claim is not that the policies definitely attracted investment capital and jobs. It’s important to note, for example, that even when the Baltic states moved to the kind of hyperliberalism 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: 457-59). My point is simply that the policy basket under discussion definitely scared key OMS actors with visions of the proverbial “race to the bottom.”

²¹ Occasionally, CEEs states have pushed back. For example, Estonia has annoyed the EU by holding to a 0% tax on reinvested corporate profits (profits distributed as

its detailed single market *acquis* and reasonably well-developed enforcement mechanisms.²² As a leading target of FDI, Hungary's policies have come in for particular scrutiny.²³ OMS corporate tax rates have come down markedly in recent years, at least partly in response to CEE tax competition, a development welcomed by offensive managers. On the other hand, and more in keeping with the ordering notion, the EU screening process stripped the NMS 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* (Ellison 2007; Appel 2006; 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 – though not eliminated. The ordering backlash led to some very interesting dilemmas. For example, when the EU tried to void favorable conditions between Slovakia and US Steel, the American company successfully resisted, and the EU felt obliged to write the

dividends are taxed at 23%). The EU has been critical, but Estonia points out the policy contravenes no regulations.

²² Contrary to expectations of many (including me), the CEE states appear to have been conscientious about passing EU legislation and resolving disputes with the EU subsequent to membership (Sedelmeier 2008).

²³ For example, Volkswagen accounted for about 15% of both Czech and Slovakian exports in recent years (Pavlínek 2004).

exception into the Slovakian accession treaty. In most cases, however, the EU was pushing to remove or limit concessions won by OMS-based actors in CEE.²⁴

On balance, it seems to me that this ordering effort has been too little, too late. While they can clearly limit state aids to firms, the EU (and its member states) actually have relatively few tools to dramatically constrain the tax policies of CEE states. And the CEE states know this. While the general process of enlargement often allowed the EU “stretch” its conditions on CEE politicians not always well versed in the complex *acquis*, ordering strategies also now confront more confident CEE member states who are allied with well informed and powerful OMS firms to protect their offensive management prerogatives.²⁵

At the same time, OMS countries do seem to be using FDI to buy complementary strengths, just as the diversification idea would predict. This means that without fundamentally changing their own national model of capitalism – a deeply contentious process with uncertain economic results – many large and small firms are able to do things complementary to (not alternative to) production at home. Suzanne Berger notes that some OMS firms (her examples are drawn from Italian textiles) tend to use CEE investment for new business and expansion while their core business stays in the home

²⁴ Foreign ownership (usually by OMS-based investors) was a clear advantage when CEE states sought temporary “derogations” that allowed them to set aside parts of the *acquis* for a limited time (Van Aken 2008).

²⁵ 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*, October 6, 2003.

location.²⁶ Bandelj (2006) shows that investment opportunities in CEE allows OMS firms to alter the “make versus buy” decision in many cases.

For offensive actors, therefore, CEE is a platform for new business; and one reason efforts at ordering have had limited effect is that even for defensive actors, OMS investment in CEE has some virtues. Most importantly, it can be a pressure valve to diminish tension over OMS domestic regulations on the grounds that investors can escape some regulations by going to CEE. CEE politicians play to both sides of this: they try to attract the former with preferential terms for OMS investment, defend those deals against skeptical EU Commission officials, and hope to use the resulting investment to catch up to OMS standards. In at least some countries in the region, economic convergence is arguably occurring in states that have had very aggressive policies (e.g. Slovakia). However, the real brake to offensive strategies may well be that equal (and even better) outcomes have also accrued to states that have aimed towards more traditional central European corporatism (e.g. Slovenia). Even more, if Slovakia is the greenfield of dreams – if you build a liberal economy, the investors will come – then Latvia is stuck as a kind of postcommunist junkyard, having pursued a very liberal policy set that seems not to be sparking rapid economic gains.

²⁶ Even here, however, Berger stresses the low productivity in CEE sites like Romania, while noting that firms there are often obliged to build much of their own infrastructure (Berger 2005). She shows that offensive managers have often found such hidden costs cut heavily into their anticipated benefits.

Labor Migration: Varieties of Anxieties

If the capital movement case revealed a structural advantage for offensive diversification policies, the labor case reveals an advantage for defensive ordering. The capital side showed substantial diversity across the region, suggesting that if the CEE states are being managed, they are not all responding in the same way. The labor case adds the real possibility that OMS vary significantly in what they want from CEE. That is, while there is evidence for both diversification and ordering, differences among the varieties of European capitalism seem more openly manifest here than was true in capital movements.

Geography clearly matters in the case of labor. Germany and Austria had quite poor member states on their immediate border while none of the other OMS did.²⁷ Their politicians judged the potential for migration flows very differently than did politicians in, say, the UK. As a general matter, the OMS have both a tradition of very low labor mobility internally and a de facto “low-skill bias” in their immigration policy (put differently, the lack of a common immigration policy). This scenario obviously brings somewhat fewer economic benefits to the OMS than would high mobility and a high-skill 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).

²⁷ Greece did in 2007, but not 2004 when the core policy space was contested.

While a diversification strategy placed priority on getting access to labor (especially skilled labor) from CEE²⁸, defensive managers focused their ordering efforts on walling off “deep” Eastern Europe from CEE and erecting mobility barriers against NMS workers. Initially, it seemed as if the primary management would involve the Commission walking the CEE 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: chapters 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 CEE workers. In Austria, the temporary work of CEE migrants was often likened in the coarse public debate to prostitution, as the places where day laborers waited for work in Vienna was called the “Arbeitsstrich” – roughly the “work brothel.” Between 2000 and 2004, the number of residents of the accession states living in the OMS increased from 700,000 to over 900,000. At that stage, gross monthly wages in the immediately acceding CEE countries generally ranged from less than 15% of German wages (Latvia and Lithuania) to about 30% (Hungary and the Czech Republic).²⁹

²⁸ This stretches the concept of diversification a bit since the actual exchange happens inside the OMS as CEE migrants are hired to work in, say, Germany. CEE workers were thus initially analogous to the “guestworkers” of the 1960s and 1970s, also a substantial exogenous shock to German industry.

²⁹ Zimmerman 2007. Slovenia was an outlier at just over 50%. Bulgaria and Romania (2007 accession) were under 10% of German wages.

Faced with severe pressure from Germany and Austria, the EU was ultimately obliged to negotiate the right of individual OMS to limit entry for up to seven years after membership. Once the possibility was opened, twelve of the fifteen OMS 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.³⁰ The Commission unsuccessfully advocated more openness to CEE immigration. Frits Bolkestein, Internal Market Commissioner, was blunt about the defensiveness of the temporary 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 who Poles who emigrated to the UK might otherwise have gone to Germany.³¹

Among the handful of now-emerging empirical studies, Zimmerman (2007) reports that despite its significant miscalculation in the number of arriving immigrants, there is no evidence of declining native wages in the UK, Ireland, or Sweden “even in the sectors with the largest share of new immigrants.” There is also little evidence of a growth in “welfare tourism” (Bawer 2006). Since enlargement, Irish unemployment has trended very slightly downward while UK and Swedish unemployment has trended slightly upward (Zimmerman 2007). Interestingly, the public perception of immigration

³⁰ To be sure, Germany and Austria have the highest shares of non-nationals among their working age populations (about 10% – though few from the NMS).

³¹ The UK received far more immigrants than they anticipated (according to the BBC, 600,000 total rather than the Home Office’s estimate of 13,000 per year (e.g roughly 50,000 since May 2004), with Poland, by far, the biggest sender).

(share who agree that “immigration is good for the country’s economy”) has tracked these disparate political decisions. In both the UK and Ireland, the share of respondents who answer agree 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 have already renewed their immigration bans and announced their intention to sustain these 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 have modified the restrictions, especially in sectors with tight labor markets. In short, anxiety over immigration has varied substantially across OMS, but the clear balance is for ordering over diversification.

Trade Patterns: Using Ordering to Buy Time

In trade, the EU initially used protectionism, treating the postcommunist states like it would any other nonmembers. Controlling access to its market is, of course, one of the key assets enjoyed by the EU in efforts to manage globalization on behalf of its members. Not long into the postcommunist transformation, however, the EU began negotiating the so-called Europe Agreements (EAs) with the CEE states. While most observers saw the EAs as a substitute for offering the CEEs any perspective on quick membership, the EAs did contain much more favourable trade provisions than were

available otherwise.³² Giving up on pure protectionism, however, meant moving to a mix of the diversification and ordering strategies. As in the area of capital, the broad pattern was that private firms sought diversification – deepening trade integration rather than capital integration across the two parts of Europe³³ – while public authorities were the primary face of ordering.

Unlike in the area of capital, however, ordering was really coterminous with diversification in trade. Specifically, as outright protectionism gave way to the carefully managed trade of the EAs, the OMS determination to avoid competition in sensitive sectors was evident right from the outset.³⁴ On the surface, the series of bilateral deals between the EU and the CEE states seemed tilted towards the latter: Europe would remove its trade barriers within five years, while the CEE states would get ten years to comply. The fine print, however, contained exclusions for virtually every product where the CEE states were competitive, including iron, steel, some chemicals, and several agricultural products (Mayhew 1998). Ordering began early and bought the EU-15 time to respond to areas of CEE comparative advantage. An obvious OMS response was to buy heavily in those areas. By the time general openness arrived, a surge in EU-15 FDI left many key assets in OMS hands.

³² Indeed, according to Schimmelfennig (2004), it would have been preferable for many OMS actors to stop there and not move on to full membership. For the EAs, see (Sedelmeier 2005).

³³ A third alternative is licensing between firms, which I neglect here for lack of space.

³⁴ Again, it is far easier to mobilize actors to defend current benefits (market shares) than to pursue new rewards (through FDI).

Diversification strategies proceeded, but in ways that attenuated their potential to fundamentally challenge OMS models. For offensive managers, especially those looking to send parts of the production chain with higher labor costs to CEE, it was important that CEE states have a perspective on free trade with the OMS. With the EAs, this threshold was reached quickly while the exceptions to the EAs clearly signaled that an aggressive diversification strategy would not be tolerated. If OMS actors could convince CEE states to privatize in sensitive sectors, they still faced huge barriers in selling back to OMS markets. Thus, a pattern developed in which diversification initially was attenuated.

Trade did deepen, but in ways that substantially softened the blow to EU-15 economies. While it is still too soon to say much about trade effects post enlargement, a series of recent econometric studies paint a fairly vivid picture of developments up to 2004. A study by Badlone, Sdogati, and Tajoli (2007) on the increasing fragmentation of production shows that CEEs revealed comparative advantage is likely much lower than previously thought. Using an EU data set based on firm registration of intermediate goods flows (the firms received tax breaks in exchange for registering these transactions), 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 (this is called “inward processing trade” or IPT); and second, that many products that originate in the EU undergo a phase of production outside the EU (“outward processing trade” or OPT). In the years the study was conducted – 1990-2003 – the CEEs were non-EU countries, so we can use this analytical leverage to distill some key implications.

As a baseline, while the EU has countries where inward trade (IPT) dominates (e.g. Ireland) and countries where outward trade (OPT) dominates (e.g. Germany), overall, the EU states do far more IPT than OPT. Regarding CEE, it is clear that German and Austrian firms often temporarily export to CEE and then “re-import” the goods for final finishing. Where EU countries’ IPT shares are very high with the Americas and, to a lesser extent, Asia, their OPT share are virtually always highest with the CEE states.³⁵ On the other hand, CEE states have a fairly trivial position as temporary exporters to the EU, accounting for only about 2% of total IPT in the EU. This means that trade in semi-finished goods is a one-way street. Moreover, apparent CEE strength in exports is, in some sectors, derivative of German and Austrian production that conventional trade statistics count as CEE trade even though most of its value added occurred elsewhere. Finally, the EU’s outbound trade with CEE is, by definition, inbound trade for CEE. As in the Irish case, high levels of IPT are associated with higher levels of growth, but the implications for CEE comparative advantage are that is generally overstated in most trade data.

³⁵ Except 2003, when OPT to the US barely edged out OPT to CEE. Note further that OPT to the CEE states is undoubtedly higher than these figures suggest because after 1997, EU trade agreements with the CEEs removed most of the tariffs and other barriers that led firms to register intermediate goods trade. Since this change mostly affected CEE states, the drop in relative shares of total OPT (from 40% to 30% of the EU total) is very likely an artifact of this rule change and not a decrease in the use of CEE for OPT purposes (p. 1738).

A slightly different form of skepticism about CEE economies takes off from the distinction between two forms of intra-industry trade (IIT) (Gabrisch and Werner 1999). 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. Concerned that the CEEs will be on the tail end of a vertical regime, the authors wonder how Visegrad locations can achieve more horizontal IIT relationships. Their pre-enlargement data showed that while IIT was on rise in CEE, it was towards mass-production goods (142-43). Vertical (“bad”) IIT as a percentage of total IIT was between 89-95% in 1993 and actually rose in the Czech case up to 1996 (it did drop in the other three Visegrad states). Gabrisch and Werner’s comparison figures show that VIIT is substantially higher 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) show consistently large gaps in favour of the EU-15 in most of the 30 sectors that were liberalized most quickly. In only six of the 30 sectors were Visegrad producers more competitive (146-47). Finally, in the few cases of CEE advantage in price-quality ratios, less than 10% are in “high-quality” imports.³⁶ The bottom line is that even growing IIT involving CEE has not really produced any economic convergence. Visegrad states are specializing in areas of “standard goods of labor- and scale-intensive production” (148).

³⁶ Using 2001-2002 data, Mykhnenko (2007: 373) found that CEE states with very different growth levels still showed similar comparative advantages in global markets, namely, low and medium technology exports and resource-based manufacturing exports.

Again, this can raise CEE incomes, but it seems less likely to pose a fundamental challenge to OMS models of production.

My tentative interpretation of these results is that the OMS have managed the trade aspects of integration with CEE pretty successfully. They have diversified OMS production but without provoking any major backlash against enlargement. Recall that the most sophisticated estimates of the economic consequences of enlargement for the EU-15 tended to stress increased trade from a larger single market as the most substantial likely effect (far larger than either the common external tariff or even labor migration from NMS to OMS). But this generalization also hid large sectoral variations. While some sectors showed little potential for increased trade as a result of enlargement, several others did, led by big potential trade increases in agriculture (+249%), food processing (94%), textiles and leather (134%), non metallic minerals (107%), fabricated metal products (56%), machinery (37%), electronic equipment (79%), transport equipment (94%), trade services (113%) (Lejour, de Mooij, and Nahuis 2004: 226).

As noted above, OMS firms could also play the diversification card and the ordering card at the same time in trade, insisting on steps to open CEE markets while protecting themselves from competition from CEE. Several pieces of evidence show that OMS firms have had this concern. For example, though illegal under EU law, many OMS investors imposed “vertical restraint agreements” prohibiting their CEE affiliates from using technology transferred to them for any production activities outside the framework of their joint-venture agreement with their OMS partners (Lorentzen and Møllgaard 2000). More legally, Volkswagen seems to have limited reimports to the OMS of its Skoda

products out of fear of cannibalizing its VW brands there.³⁷ My claim here has been that ordering bought time and essentially attenuated the diversification that did occur. CEE producers have posed few really stiff competitive challenges to OMS producers. So far. The ordering mechanism in trade depended very heavily on the CEEs' non-member status, which ended in 2004. Should offensive managers – aided by propitious tax, investment, and labor market policies in CEE – launch new offensives, it is harder to see how this pattern could be repeated.

Conclusion: Two out of three ain't bad

“Enlarging the sphere of EU influence” – one of five mechanisms purportedly at the core of managed globalization – has obliged private, state, and EU actors to scrap over the terms of what I called diversification and ordering. On balance, the offensive form – diversification – seems to have gotten the upper hand in only one of the three areas, finance. Even there, the EU emphasis on defensive ordering techniques later stripped CEE states of some of the tools they had been using to attract foreign capital. In the other two areas, defensive techniques clearly prevailed, as the EU paved the way for the OMS to put up barriers to labor mobility and delayed trade opening in sensitive sectors until FDI patterns increased OMS influence.

But although CEE states have rarely escaped the management efforts of the OMS, the result still has broadly been perceived as a win-win situation, at least in the short run. Even though the OMS states won all the key disagreements – over agriculture funding, the size of the structural funds, the time to membership, the stretching of the *acquis* – the

³⁷ I thank Bob Hancké for the detail about Skoda.

big gap in living standards between OMS and NMS means that even small gains have been meaningful to the CEE states. In most places, employment, growth, and investment are up while inflation is down. Moreover, the CEE states can now press their interests as full members – a situation that has often led to substantially improved conditions for previous waves of EU entrants. In the meantime, even though it has not caught up to the OMS economies, Poland now faces labor shortages. Afraid of undercutting its comparative advantage by raising wages, it imports Ukrainian workers.

Other interesting paradoxes start to emerge from these findings. Where Meunier and Abdelal show that the EU was more able to manage globalization in capital than in trade – Sbragia adds additional evidence of the difficulty of managing globalization in trade – the CEE cases show roughly the opposite pattern: the OMS much more easily managed the trade aspects of enlargement than the FDI aspect. This underscores again how powerful is the EU's gatekeeping leverage granted by virtue of the large internal market to which it controls access. The question is how well the EU deploys this leverage. Sbragia shows that the EU has often fared poorly, seemingly handcuffed by its commitment to multilateralism. Perhaps the EU is complacent about the leverage it enjoys. The “even a blind squirrel gets some nuts” approach doesn't quite account, however, for the pattern in CEE, where the EU did play its trade cards adroitly and to the clear benefit of OMS actors.

Another point that emerges is that the EU tends to enjoy the benefit of joining a conversation very late and still making a major impact. Kelemen's paper shows this more clearly by covering the way in which Europe, after lagging behind the US for decades, suddenly forged ahead in the environmental field. We saw this on a small scale in this

paper. Initially, OMS firms' diversification strategies in capital seemed to empower CEE states with whom they often worked very closely. OMS states and the EU often protested about the potential for social dumping and unfair tax competition. But by the time enlargement actually came around, the trade data seem to suggest that CEE autonomy was somehow still illusory. In that sense, two out of three *really* wasn't bad for the EU. It seems to me that part of the reason for this dynamic lies in the collective action problem of OMS firms. Many of them – not least large German firms – chafe at domestic restrictions 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 CEE, seems to dampen the fervor of their policy initiatives to force OMS reforms that might lower their home costs in the long-run. In that sense, CEE investment seems to have functioned as a “pressure valve” that, when released, somewhat deflates the pressure for domestic reform.

Before turning to some final questions, I now want to offer a quick detour to look at the other three mechanisms outlined in the introductory paper.³⁸ For CEE, my tentative conclusions are: First, the EU has had a relatively easy time *exercising regulatory influence* over CEE, which is hardly surprising given its membership conditionality and the deep discredit of the prior communist regulatory system. The EU has, however, sometimes been tempted to go beyond its own *acquis* in regulating CEE. Here, its

³⁸ As noted, the EU has faced virtually no pressure for mergers driven by CEE capital and so have not had to *legitimate economic patriotism* in response. There have been derogations running the other direction with some scope for CEE states to limit the purchase by foreigners of certain kinds of property, especially agricultural land.

defensive measures often seemed designed to attenuate forms of comparative advantage enjoyed by CEE member states and firms located there. Second, the EU has sometimes *empowered other IOs* in their dealings with individual CEE states. For example, when an election brought to power a Bulgarian government committed to seeking EU membership, this increased the effect of IMF conditionality in Bulgaria as well (Vachudova 2005). The role of IFIs is, however, complex. On one hand, as noted, the EU often obliged accession states to pay close attention to IFI demands. On the other hand, IFIs often reinforced TNC demands for economic liberalization in CEE. Thus, some functional prerequisites for membership were actually at odds with core tenets of defensive management. Third, *redistribution of the costs of globalization* has been funded in CEE out of the same account – the Structural and Cohesion Funds – that redistribute the costs of regionalization. The allocations have not been notably generous, at least not when compared with prior allocation for Ireland, Spain, Greece, and Portugal (Jacoby 2004: chapter three).

What lies ahead? One very plausible scenario is that defensive management through ordering will now be much harder to practice on states that are now members. To the extent that diversification strategies are still very much on the table, these might well vary widely by OMS state. The various varieties of capitalism typologies imply that there is no EU regional system but rather that Europe contains up to four fairly coherent economic models: 1) Nordic SMEs; 2) Continental SMEs; 3) LMEs; and 4) a southern European model (Pontusson 2005).³⁹ A potentially useful line of future research would ask the extent to which countries from each part of the typology have a distinct

³⁹ For earlier iterations, see (Albert 1993; Hall and Soskice 2001).

relationship with CEE. For example, Germany is, by some distance, the largest investor in CEE. On the other hand, the UK – which is well ahead of Germany and second only to the US in global FDI outflows – has been only a bit player in CEE, accounting for less than 5% of total FDI, except in Bulgaria (11%) and Lithuania (7%) (Bandelj 2007: 106-10). One hypothesis consistent with this data would be that the LMEs have the least to gain from CEE in terms of diversification (since their economies are already more liberal) and that they therefore invest less in CEE. A corollary might, however, be that LMEs have allowed more immigration from CEE, suggesting they want something different, but not that they are less interested in CEE. In other words, OMS likely use regionalization differently: Britain hosts CEE workers, while Germany prefers to invest there instead.⁴⁰

Yet it might also be that variation in CEE – not in the OMS – determines most future outcomes. If so, we have lots of very basic conceptual work ahead. Recent research in the varieties of capitalism tradition has tried to place countries in the CEE region into the now-established LME and CME camps. But there's little agreement. Some argue that we ought to see CEE states as a variant of liberal market economies that are, however, “dependent” upon outsiders, especially in their role as providers of FDI. If CEE is characterized by LMEs, that is consistent with the notion of using CEE as a broadly liberal sphere. By contrast, others place CEE economies in the camp of the continental coordinated market economies, though they also add an important qualifier by

⁴⁰ Consistent with this proposition, Ireland has virtually no CEE investment. On the other hand, Sweden – which also opened its labor markets from the start of enlargement – was actually the fifth largest investor in CEE.

noting that coordination is still “weak.”⁴¹ Moreover, not just policy matters. Greskovits (2006) shows that behind broadly liberal policy regimes very different economic structures are still being reproduced.⁴² 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).

And what will the EU do now? Examples of efficacious EU actions (e.g., the stripping of various competitiveness strategies of CEE states prior to membership) and inefficacious ones (the Commission preference for no barriers to CEE migrant workers after membership) have been discussed. The current agenda revolves around the EU’s reduced leverage for pursuing managed globalization over the heads of CEE states now that they are full members. If ordering broadly attenuated diversification up to 2004, what would it take for effective diversification now that membership is here and new barriers are hard to erect? And finally, by raising and controlling standards in CEE, did the EU-15 actually build a more stable basis for competing globally? Or, in managing CEE to minimize the erosion of their own national models of capitalism, did they rather miss a chance to make themselves more fit for globalization? In other words, did the EU over-

⁴¹ For LME, see (King 2007). For CME, see (Mykhnenko 2007). See also (Bohle and Greskovits 2007; O’Dwyer and Kovalcik 2007).

rely on ordering as a tool? If so, it may turn out that two out of three is kind of bad after all.

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