2012

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The Performance of Nations

Edited by
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ROWMAN & LITTLEFIELD PUBLISHERS, INC.
Lanham • Boulder • New York • Toronto • Plymouth, UK

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Context

The European Union (EU) represents the largest area of economic and monetary union in the world, comprising twenty-seven sovereign nation-states and nearly 500 million people (European Commission 2008). There are numerous other regional integration efforts around the world but none on this scale of success. The scholarly community has only begun to pinpoint exact factors behind the deepening of regional integration even if we have an understanding of how and why states chose to enter into regional integration agreements initially.

Often, we are confronted with the question: why is regional integration in Europe such a success story while other regions have failed? By using the concept of Political Performance, we provide an explanation of regional integration that goes beyond current models in the literature.

We adopt a systemic approach to explaining regional integration that focuses on the capabilities of regional leaders and member-states and the level of similar preferences among all members of a regional integration project. The role of regional leaders in developing integration is not new.[1] Prior research has often assumed that these leaders would be capable of aiding integration based on their economic size. It is assumed that if the economic size asymmetry of the leader, vis-à-vis other members, is large and similarity of preferences is high, then the probability of integration increases.

Economic size asymmetry alone is not a satisfactory measure of capability. It is possible for a larger member-state to lack the ability to draw from its society the means to lead an integration effort. Therefore we include not the economic size but the regional leader's capability to mobilize resources in support of its policy preferences. This is represented by the Political Performance of the regional leader. This chapter will also include the role of the member-states other than the regional leader. A focus on regional leaders' capabilities can mask the work of member-states and lead to overestimating the leading state's role. Therefore it is important to also examine capabilities relative to other member-states in explaining regional integration.

The chapter begins by reviewing regional integration theories. It then examines the need to include the capabilities of member-states with special attention to the capabilities of regional leaders. This is followed by a design to test our hypotheses, followed by conclusions.

INTELLECTUAL ENVIRONMENT: THEORIES OF REGIONAL INTEGRATION

Theories of international integration, like all political theories, are produced in order to better understand ongoing political events and solve distressing problems that preoccupy political leaders. Thus, they follow the times, and they compete with one another to set the trend. Those theories that get the most attention are "fashionable"; they are not necessarily the ones that will continue to provide inspiration for political thinkers a half-century, or even a decade, later.

In this chapter, several theories with varying degrees of staying power will be reviewed. None of them is sufficient to fully understand where the European Union (EU) is today, how it got that way, and where it will end up. But we will draw on those that are general enough and strong enough to give us part of the explanation. Political theorists also attempt to do three things: explain, predict, and prescribe. In this regard, theories of regional integration have done a better job of explaining what has happened than predicting what will happen. As such their utility for policy prescription has been rather limited.

Early theories of regional integration include federalism, functionalism, and Monnetism. *Federalists* believed that the vulnerable post–WW II states of Western Europe should join together in a political union in which they could exercise mutual self-help in the face of threats to their common security. By forming a federation under a common central authority, once-sovereign states could pool their individual capacities to organize their defenses, mobilize their resources and industrial strengths, and guide their economies in the direction of modernization and economic growth. The states would retain control over those aspects of their domestic affairs that were not seen to be vital for the common effort (Pentland 1973, chapter 5).

Unlike the federalists, the *functionalists* did not outline plans for an elaborate division of political responsibilities among member-states. Instead they concentrated on the immediate economic needs of post–WW II states (George 1990, 16–22). The leading functionalist theorist was David Mitrany (1966), who was interested not in the functional integration of European nations but in the creation of international organizations to fulfill certain specific needs. These included organizing relief efforts for war refugees, regulating air traffic, formulating and enforcing international health and safety standards, or promoting more efficient agricultural methods.

According to Mitrany's vision, several such organizations might come into being for different purposes and comprise different sets of member-states, sometimes including members from different continents and subregions around the globe. They would not all involve a given set of members found in a particular region. That is, they would not gradually become a collective state-like territorial entity in their own right.

Mitrany (1966, 64–65) rejected federalism on the grounds that it would replace the old states with a new, larger one without necessarily reducing human misery. Yet, he is generally regarded as a forerunner of a movement for *European* functional integration, which actually did achieve the first real success in that direction: the European Coal and Steel Community (ECSC). The ECSC was the brainchild of Jean Monnet. Monnet had served in the League of Nations as a liaison among France, Britain, and the United States during WW II, and after the war, as the head of the French economic planning commission.

Like Mitrany, Monnet believed that, when faced with their own inability to solve problems that could be solved only by international cooperation, states would, even though reluctantly, relinquish limited elements of their sovereignty and pool their efforts in international organizations. Government leaders of the Monnetist persuasion formulated a new agenda for the European six in the mid-1950s. The result was the creation, in 1958, of the European Atomic Energy Community (Euratom) and the European Economic Community (EEC).

Euratom achieved only modest results, largely because of the unwillingness of governments, especially that of France, to give up their sovereign control of what was considered a vital element of national strength. In contrast, the EEC achieved remarkable success as a customs union during the first decade of its life.[2] Yet by the end of that decade, its chances of achieving a full-fledged *political* union still appeared to be visionary. Monnet's ideas not only led to the creation of ECSC but influenced scholars like Ernst Haas to develop his theory of *neofunctionalism*.

Haas (1958 and 1964) was impressed enough by Monnet's strategy and tactics to put them into a theoretical framework that was more elaborate and academic in nature. He argued that functional integration would most likely occur if influential and powerful elites were motivated to take decisive steps toward it. He introduced a number of *neofunctionalist* concepts to help explain the steps toward regional integration that had already occurred, as well as elucidating any further steps that might occur. Two central concepts are *spillover* and *supranationalism*.

Spillover means that if the tasks of a regional organization were to expand, it would occur as a result of experiences with the tasks the organization was already performing. In other words, cooperation and success in one issue area would spill over into a similar cooperation in a related issue area among states. But Haas emphasized that there was nothing automatic in spillover. Task expansion by the regional organization would require political initiative. "Cross-national networks" were becoming more frequent and broader. This process of communication made it possible for elites to address common problems in concrete terms and to discover an "upgraded common interest."

According to Robert Keohane and Stanley Hoffmann (1991) this communications net corresponded to neither a federal nor a confederal framework; instead, it would be supranational as opposed to being intergovernmental. In the EU experience, this form of decision making became part of the governance structure with institutions like the European Commission, the European Parliament, the European Central Bank, and the European Court of Justice. Although the principal actors were nationally based, they came together predisposed to find common solutions to their mutual problems, and their method of arriving at decisions was by unanimous consent, avoiding votes, vetoes, and subsequent expressions of antagonism.

More contemporary variations on these theories came about as scholars tried to explain the complex nature of European Communities' (EC) transition to an Economic and Monetary Union (EMU) that characterizes the current nature of the EU with some exceptions (not all member-states are in the monetary union). One of these theories is a variation on intergovernmentalism that Andrew Moravcsik has developed as the "liberal intergovernmental" view of regional integration (1993 and 1998). According to this theory, the member-states are motivated primarily by economic interests when they decide to propose, accept, or reject compromises on EU policy issues. Moravcsik argues that these interests, as well as the institutional constraints, must be examined in order to understand policy outcomes.

Governments, according to Moravcsik, are not the billiard balls of international relations theory; they act "on the basis of goals that are defined domestically," with foreign policies "varying in response to shifting pressure from domestic social groups, whose preferences are aggregated through political institutions" (Moravcsik 1998, 481). Both neofunctionalism and Moravcsik's liberal intergovernmentalism emphasize economic issues central to their analyses of EU decision making. For Haas, initial integration of economic decision making gives supranational agencies the leverage to induce governments to support further integration.

According to Moravcsik, governments can be persuaded to pursue cooperation within the EU framework for economic objectives, but this is because they cannot attain their objectives unilaterally, not because they have been maneuvered into giving up their best interests by supranational policy entrepreneurs. There is no automatic spillover from fulfilling one policy commitment to reaching agreement on another. The process is controlled by the member governments coordinating their own agendas, with very limited help from the Commission.

Moravcsik's view of how EU decisions are made could, without too much trouble, be converted into a version of what is called rational-choice institutionalism proposed by Simon Hix (1994). It posits that national governments act rationally on behalf of their preferences, but Moravcsik downplays the significance of the EU's supranational institutions, whether the Commission, the European Parliament, or the European Court of Justice.

According to Hix (1994, 13) "if preferences change, outcomes will change, even if institutions remain constant, and if institutions change, outcomes will change, even if preferences remain constant." Thus, both preferences and institutions are important for analysis of what happens in any decision-making process for understanding deepening of regional integration and enlargement of membership. The example of the unanimity rule suggests that outcomes would change if the preferences of the last holdout changed to become more compatible with those of the rest of the members. But if the institutional rule were to change so that a qualified majority on the issue would suffice to adopt a proposed action, then the holdout can be ignored and concessions would not have to be made.

A more recent response to the rationalist and institutionalist approach to regional integration comes from the constructivist reinterpretation of neofunctionalism (Sandholtz and Sweet 1998; Risse 2004). Constructivists' explanation of EU integration argues that the deepening of integration is a consequence of an interaction of members' interests and social norms, in which actors are embedded, regulate their behavior, and constitute their identities, interests, and preferences. This is consistent with the constructivist argument that structures of world politics are social rather than material in character (Checkel 1999, 83–115).

When applied to EU integration, constructivists view EU policy making as "grounded in the accumulation of positive experiences of cooperation, which seep into the preference pattern of participating states and open the way to future integration. Cooperation among members develops into trust and a habit of coordination, which other actors are able to exploit and turn into specific instances of policy making" (Bicchi 2007). That is, constructivists focus on how European identities, with common norms, emerge and how such norms, in turn, affect the behavior of the players. These writers argue that this perspective captures intergovernmental bargaining much better than its realist or liberal intergovernmentalist alternatives.

Despite their relative explanatory powers of regional integration, none of these theories provides a satisfactory answer to the questions we propose in this study. Each of these theories of integration leaves out two important variables that are central to understanding regional integration. The first is the role of a regional leader in integration. The second is the capacity of each member-state to carry out proposed plans that would lead to the deepening of integration. The theories discussed above implicitly assume that all member-states have similar abilities and therefore treat capacity as a constant. But this is not the case and therefore a theory of integration must examine the role of capacity and how relative capacity among the member-states would influence the level of integration.

THE RELATIVE POLITICAL CAPACITY OF STATES AND REGIONAL LEADERS

As Arbetman and Kugler (1997) correctly observed, all countries face challenges of economic development with mixed results. Their answer to the challenge of uneven development is the role of government capabilities. Capable governments are able to resolve these challenges while those that lack capability cannot. Globalization produces yet another set of challenges with which all states must come to terms. Coming up with solutions is often easier than putting policies into action.

This is where state capacity becomes important because solutions that require a shift from closed to open markets can have detrimental effects to specific industries and groups. It would be up to the governments, both individually and in partnership, to smooth out the adverse effects of economic policy changes.

Regional integration is one method to deal with the challenges of globalization. By focusing on regional partnerships, states offer firms access to markets that have close proximity and consumers with similar tastes and preferences. Also within any region there can be enough of a variation in factor endowments that would allow the logic behind comparative advantage and economies of scale to be persuasive.

But the idealism of open markets may run counter to the desires of protected and entrenched economic sectors. Bargaining with groups that oppose regional integration is one way that state leaders can broker deals in order to garner vital support. However, offering incentives is not enough. The offers must be credible. Threatened groups require that the state have the ability to produce these incentives. Of course not all states can do this, but their regional partners may be able to fill in the capability gap, which would help assuage any doubts.

What incentives do states need to provide? Basically they are the same ones that all states at one time or another provide in order to foster development. These include stimulating economic growth without the debilitating effect of inflation, producing high levels of employment, and promoting technological advancement. A shift in policy orientation from relatively closed to open economies will harm the ability of some sectors, in the short term, to have these outcomes.

It will be the capable government that can change policies while maintaining these promises of development for the needed supporters. Therefore the idea of regional integration is tied to the capability of the state to smooth out the problems of the transition through incentives like side-payments, worker retraining, improved social insurance, and so forth.

The Political Performance of governments is defined in chapter 1 as the "ability of governments to reach their population, to extract economic resources from a population, and to allocate those resources to secure the long-term survival of the political structure." Political performance is derived from governmental ability to reach, extract, and allocate efficiently inside their countries, provinces, or states. Given the advanced state of development of EU nations, it was anticipated that the reach variable would not be as relevant and that proved correct. Allocation data is very difficult if not impossible to acquire given the complexities of the EU and member-nations. But the extraction variable has proved most powerful.

We define political extraction throughout this volume as the capacity to tap resources in order to carry out the policies adopted by a country's government. In similar words, it is the ability of the government to extract material resources in the society and mobilize these to advance goals. Extraction is a key component of understanding the deepening of integration. It helps to clarify why states partner with each other and seek to deepen integration. While all member-states could have sufficient capability to deal with the policy transition independently, it would be highly unlikely for this to occur given the uneven distribution of capabilities.

Partnerships of only equally capable states are also unlikely for the following reasons. Since regional integration, by definition, is a partnership among neighboring countries, this reasoning would limit cooperation to only those that happen, by geographic luck, to border countries with sufficient capacity to carry out the necessary reforms. Also there is the problem of enforceability of agreements. The partners would need to have the capacity to not only carry out the internal policies changes but also be independent enforcers to prevent free-riding by partner states. This would stretch the capacity of any one state if they have equivalent capabilities.

The final and related issue is the occurrence of economic shocks. Such a shock in any one member's market can lead it to defect from regional agreement because of the current political leadership's need for survival. Similarly capable states may not be able to aid the troubled partner given limited capacity especially if the economic shock spills over the political boundaries.

Therefore it is unlikely for similarly capable states to deepen their integration. First, the idealism of integration can evaporate when agreed-upon goals fail to materialize. Second, the farsighted pragmatism of credible execution may override any idealistic tendency among leaders. If the scenarios of free-ridership and defections produced by economic shocks are in the minds of negotiators, then they would seek out some sort of assurance that the capacity resources used in creating and deepening integration would not be wasted. It is unlikely to see leaders enter into long-term partnerships that use resources unwisely. If the scenario of similarly capable states leads to a theoretical dead end, then an alternative scenario of asymmetry of capability can prove to be the answer.

Some researchers have examined the role of asymmetric power distribution in explaining the level of regional integration (Efird and Genna 2002; Efird, Kugler, and Genna 2003; Genna and Hiroi 2004). All other things being equal, this research assumes that greater economic power translates to greater capability. However, does this assumption really hold? Do higher levels of national output correlate with higher levels of performance of governments?

The theory of integration proposed in this chapter hypothesizes that states that lack or have low levels of political performance necessary to open markets will require the partnership of a regional leader due to its high level of political performance. It is also theorized that the likelihood for a regional partnership formed by the regional leader and other member-states will improve with higher levels of mutual status quo satisfaction.

The role of a leader is first brought to attention in the works of Charles Kindleberger (1973, 1981, 1984, and 1986), who drew attention to subtle differences between *hegemony* and *leadership*. According to Kindleberger, the United States' role in restructuring of post–WW II international regimes was best described by *leadership* and not by *hegemonic stability* as argued by Robert Keohane (1984). For Kindleberger (1986, 841–842), hegemony has uncomfortable overtones of force, threat, and pressure whereas a leader can lead without "arm-twisting, to act responsibly without pushing and shoving other countries." In this regard a crucial issue that arises in economics is what has been called "the agency problem" (Jensen and Meckling 1976, 305–60).

The dilemma revolves around interests of the agent who is hired to carry out a task for the principal and those of the principal itself. When the two interests clash, the agent might be tempted to pursue his own interests at the expense of his principal! Typical solution involves the principal's decision to "add to the wage bill the expense of monitoring the agent's actions and of bonding him to cover the possible loss from malfeasance" (Kindleberger 1986, 845).

In the world of politics a similar relationship exists between majority and minority in democratic governance. Majority exercises restraint toward minority not only because roles might change in the future but also due to common ethical concern for the larger polity. In international relations, a similar relationship can exist as a contract between the leader and followers—that effective leadership will be met with effective followership. Our view on this relationship is that effectiveness of this leadership-followership relationship largely depends on the relative political performance of the stakeholders.

If a state possesses sufficient capacity to unilaterally open markets, integrate into the global economy, and deal with any negative shocks, then regional partnerships would not be necessary. States that lack sufficient levels of performance would venture into partnerships with others that could subsidize their political performance. The political performance of the regional leader would carry the policy transition costs of the less capable partner(s) and perhaps help partners in time of economic downturns (Genna and Hiroi 2007). This leads to our first set of hypotheses:

H_1: A state's Political Performance is associated with the level of regional integration with other states.

A state's political performance is theorized to include extraction of material resources. The extraction of material resources would aid in developing regional integration efforts because the wealth accumulated by the state can be redistributed to those that are harmed by greater market competition. Also, joining a regional integration that has undergone a series of stages of "deepening of integration," like the EU, could require the state to commit to fiscal responsibility, among other things.

The state's capability to extract taxes would therefore contribute to a successful implementation of regional integration. Using the capabilities asymmetry arguments just discussed above, as a state's level of this capability decreases, the new member-state might then need aid from a regional leader. In fact we do see some evidence of this by examining how the more economically powerful countries are net contributors to the EU's social cohesion and common agriculture policy funds, while the less economically affluent are net recipients. Therefore, it is crucial to see the independent effect of extraction on integration as well.

Based on these observations we propose the following second set of hypotheses:

H_2: The higher a state's relative political extraction, the higher the level of regional integration with other states.

H_3: The higher a regional leader's relative political extraction, the higher the level of regional integration of one state with other states.

We do not assume purely benevolent behavior of the regional leader. The regional leader would use this carrying capacity in order to shape agreements toward its preferences. The final bargain would be an exchange of capacity for regional economic policies (such as fiscal responsibility or conditions of labor mobility) that the leader prefers. Knowing that its policy preferences would be constrained, the smaller partner would integrate with a regional leader whose preferences are not distant from its own. This would reduce its "cost of integration" while improving benefits of the desired openness. Therefore there is an interaction between a regional leader's capacity and level of satisfaction among partners. The regional leader's relative political performance (RPP) conditions the effect the level of satisfaction has on the level of regional integration.

H_4: The higher the level of satisfaction among partners, the higher the level of regional integration as a regional leader's political extraction increases.

To move from closed to open markets and to further integrate require transition costs. These costs must be borne by someone, with the state being the assumed entity given its role in promoting economic stability. A state's level of capacity can promote or harm the likelihood of regional integration. However, states will seek out others to aid them in these transitions given the lack of political performance. Regional leaders are likely candidates since they possess ample performance. Since trading carrying capacity for preferences is a reality, smaller states would partner with larger states that share similar policy preferences. Finally, a regional leader is not immune to the costs of regional integration. It too will help or hinder regional integration depending on the type and level of performance it has in supply. The next step is to test these ideas using available data.

MODELING

We test our hypotheses using a directed dyadic relationship between European countries with a time series span from 1981 to 2007. As we further explain in this section, our timeframe begins in 1981 due to data limitations. Our formula is provided in this endnote.[3]

For the dependent variable, the level of regional integration, we use updated data compiled by Efird and Genna (2002) (also see Efird, Kugler, and Genna 2003; Feng and Genna 2003; and Genna and Hiroi 2004). The measure is referred to as the Integration Achievement Score (IAS), which is based on the work pioneered by Hufbauer and Schott (1994). IAS codes regional integration projects around the world by using implemented treaty text.

The score is an index of the following six categories: degrees of trade in goods and services, capital mobility, labor mobility, supranational institutional importance, monetary policy coordination, and fiscal policy coordination. Each category is given a value from 0 to 5, using a Guttman scale, with higher values indicating a deepening of integration. The categories (Ci) are summed, and then divided by six to give an average across all categories using the formula at this endnote.[4]

Since the data is limited to European countries, the values of IAS include the European Free Trade Area (EFTA) and the European Union. The two groupings together are referred to as the European Economic Area (EEA).[5] Effort was made to group IAS values according to membership and degree of membership. For example, Finland was a member of the EFTA from 1986, but then left this block to join the EU in 1995.

Not all EU member-states are members of the euro zone, so the IAS values for nonmembers are lower than for members. Finally the eastern expansion of the EU introduced ten new members in 2004 and two new members in 2007, but with conditions. None had the right to full free labor mobility and they were not members of the euro zone. Therefore, their IAS values are lower than full members of the EU. IAS values for nonmembers of the EFTA and EU are zero.

Relative Political Performance (measured in terms of Relative Political Extraction or RPE) is our first independent variable (Arbetman and Kugler 1997; and chapter 1 in this volume). Capable governments are able to "extract" resources from their populations. The extractive component of capacity represents efforts by a government to acquire the material resources necessary to carry out policy objectives. Since the observations are directed dyads, the first country's RPE is included in the equation.

The next independent variable is satisfaction. We operationalize satisfaction in two ways so as to capture political as well as economic dimensions. The political dimension is operationalized by the dyadic regime/institutional dissimilarity. Lemke and Reed (1996) have shown that satisfaction with a compatible regime type produces stronger peace effects. Their argument is supported by Andreski (1980), who found that military dictatorships have little incentive to engage in foreign military adventures, and Russett (1993) and Farber and Gowa (1995), who demonstrated unexpected cooperative patterns among democratic states and among narrowly defined authoritarian regimes.

Feng and Genna (2003) have also demonstrated that states with similar institutions are more integrated than states that are dissimilar. Therefore past research suggests that institutional similarity can operate as a good proxy for satisfaction. Indeed one of the major prerequisites of joining either the EU or EFTA is a state's continuing commitment to democracy. Therefore current and aspiring members need to be satisfied with this criterion.

We use Polity IV (Marshall and Jaggers 2001) data in order to measure regime similarity. We believe that it provides the superior measure and is more comprehensive than Vanhanen (2000) data.[6] Polity IV provides a composite democratic regime score for each country in our data set. We calculate a dissimilarity variable by taking the difference of score for each dyad. The larger the difference of Polity IV regime scores, the more dissimilar the pairs are. According to hypothesis three, we expect to see a negative relationship between the dissimilarity variable and the IAS.

Another dimension of satisfaction would need to estimate the economic closeness (proximity) between the pairs of states. A very large number of alternatives are available here, but we propose to use a measure of foreign direct investment (FDI) stocks between countries measured in dyads and as a ratio of total FDI stock over time using Organisation for Economic Co-operation and Development (OECD) data. Our time series is limited by the fact that this data is only available from 1981. Our rationale behind this choice is based on the assumption that the more satisfactory the relations are between pairs of countries, the more willing their respective firms will be to make long-term investment decisions in each other's economies.

We estimate our models using the following controls. The first is a Cold War dummy variable with the value of one for each dyad between 1981 and 1991 inclusively, and zero otherwise. Since the ending of the Cold War demonstrates an external shock to the international order, it may affect the pace of integration. Second, neofunctional theory stipulates that spillover occurs when integration is successful. Therefore a five-year lagged IAS value is also included. Third, each satisfaction proxy variable will operate as a control for the other. For example, when we include the institutional dissimilarity variable, both interactively with the regional leader's RPE values and independently, the FDI stock ratio variable operates as a control without interacting with the regional leader's RPE value. Finally, the models are estimated using time-series regression techniques with panel corrected standard errors.

RESULTS

Before we begin examining the results, one empirical question needs to be answered. This chapter was partially motivated by questioning the assumption that the largest economy in a region would be able to provide the carrying capacity of regional integration. In other words, does a large economic output translate to large relative political capacity?

Previous studies on global leadership of the United States focused on this assumption and its relevance for regional integration thus followed suit. Yet we question this assumption since large economic size does not necessarily translate to greater RPE. To answer this question in the European context, we included the largest economy, Germany, and the second largest, France, in each of the regression models as well as in the many unreported diagnostic models. Without exception, the French RPE variable does not demonstrate statistical significance when included with the German RPE variable. We also ran the models with each of the variables separately. The German variables offered greater explanatory value. Therefore each of the tests presented in this section uses German RPE_t in the place of RPE_{tl}.

Table 4.1 displays the results of the three estimated models—variation of model above. The first model is our baseline because it excludes German RPE. Of the three key variables, only institutional dissimilarity is statistically significant. A state's RPE alone is not enough to foster regional integration. Also the FDI stock ratio does not help explain deepening. However, the more dissimilar a state's Polity IV score is with a European country, the lower the level of integration. What is interesting is the negative coefficient on the Cold War variable ($p = 0.145$). Contrary to what is often stated, this period in time actually had a reducing effect on integration when compared to the post–Cold War period.

Models 2 and 3 introduce Germany's RPE values. Model 2 included the interaction of the regional leader RPE variable with the institutional dissimilarity variable and therefore leaves the FDI stock ratio variable as a control. Brambor, Clark, and Golder (2006) demonstrate that examining the statistical significance of the three interaction variables' coefficients is inappropriate when attempting to determine their explanatory value. Instead all

Table 4.1. Panel Correct Standard Errors Time Series Regression Results on Integration Achievement Score for European Countries, 1981–2007

	Model 1	*Model 2*	*Model 3*
RPE_{ti}	0.005	0.021	0.011
	(0.043)	(0.041)	(0.043)
RPE_{tl}	—	−1.18	−1.56*
		(0.549)	(0.401)
Institutional $Dissimilarity_t$	−0.075**	0.237	−0.082*
	(0.029)	(0.154)	(0.030)
RPE_{tl}*Institutional $Dissimilarity_t$	—	−0.624	—
		(0.320)	
FDI Stock $Ratio_t$	−0.093	−0.035	−2.50
	(0.129)	(0.112)	(1.449)
RPE_{tl}* FDI Stock $Ratio_t$	—	—	4.28
			(2.51)
IAS_{t-5}	0.854***	0.850***	0.857***
	(0.110)	(0.110)	(0.109)
Cold War	−0.255	−0.313*	−0.306*
	(0.116)	(0.122)	(0.123)
Constant	0.678	1.38*	1.57*
	(0.301)	(0.526)	(0.585)
Wald χ^2	343.7***	646.7***	555.7***
R^2	0.685	0.699	0.697
# of groups	391	391	391
N	3,619	3,619	3,619

Notes: Unstandardized coefficients reported, standard errors in parentheses; one-tailed significance tests: ***p=0.000, **p=0.001, *p=0.010.

three variables (RPE_l, Institutional Dissimilarity, and their product) need to be assessed based on Germany's RPE effect on the Institutional Dissimilarity variable.

Figure 4.1 plots the marginal effect of Institutional Dissimilarity on the level of European integration as the level of German RPE increases. The graph indicates that the Institutional Dissimilarity coefficient's reducing effect increases as Germany's RPE increases. This relationship is statistically significant when German RPE holds a value greater than 0.4 (since both sides of the 95 percent confidence interval are below the zero value), which is in the range found in the data set.

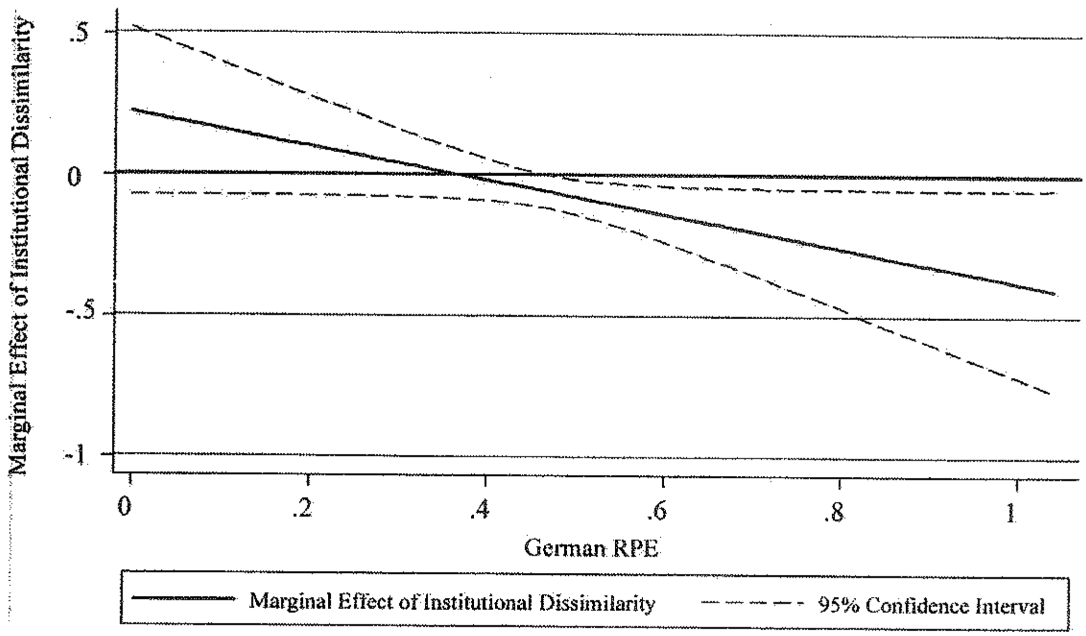

Figure 4.1. Marginal Effects of Institutional Dissimilarity as German RPE Changes

As German capacity increases, those that wish to participate in European integration, and take advantage of German capacity, have greater institutional similarity. At the highest value of German RPE, a one-point difference in the Polity IV score between dyads will reduce the IAS value by 0.45 in the post–Cold War era. This is a 9 percent reduction in IAS value. As a result German capacity is statistically and substantively tied to greater institutional homogeneity (i.e., similar level of democracy) and therefore regional integration.

Model 3 of table 4.1 uses FDI stock ratios as a proxy for satisfaction, leaving Institutional Dissimilarity as a control variable. Again institutional dissimilarity is associated with the level of IAS in the predicted direction. Figure 4.2 illustrates the effect German RPE has on the FDI stock ratio in explaining European integration. The graph indicates that the FDI stock ratio coefficient's value increases as Germany's RPE increases. This relationship is statistically significant throughout the range of German RPE except at approximately 0.6 (since both sides of the 90 percent confidence interval are either above or below the zero value).

When German relative extraction is low (<0.6), FDI stock ratios have a negative effect on the level of European integration. When German RPE is high (>0.6), FDI stock ratios have a positive effect on the level of European integration. Moreover, the relationship is large. An increase in German RPE increases the marginal effect of a dyad's FDI stock ratio on their level of integration. At the highest level of German RPE, an increase of one percentage point in the FDI stock ratio represents a 3.33 point increase in the IAS

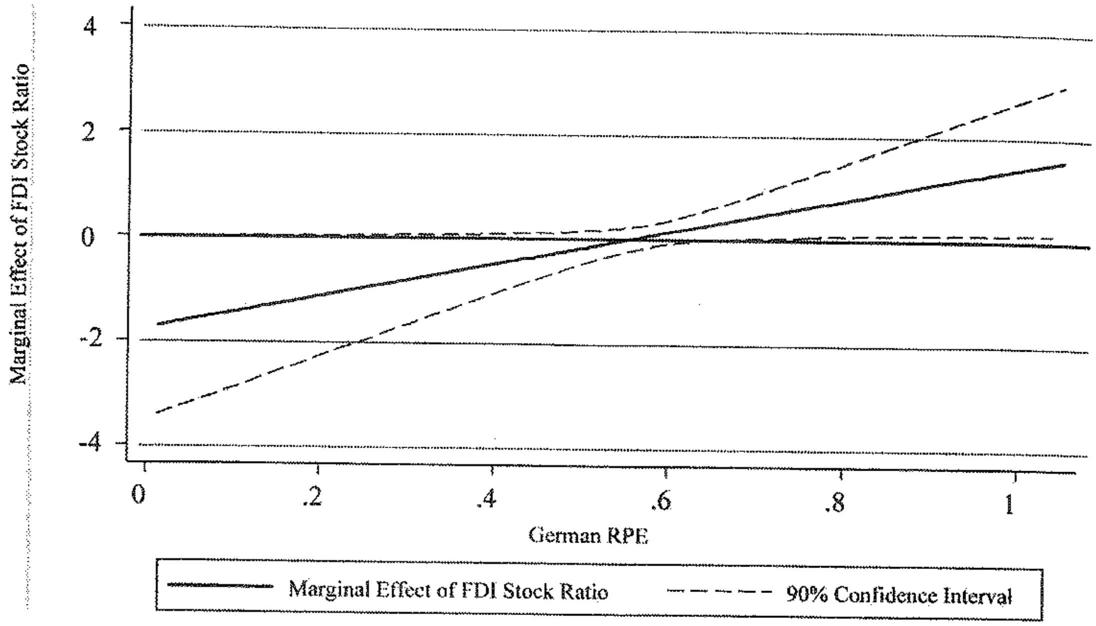

Figure 4.2. Marginal Effect of FDI Stock Ratio as German RPE Changes

value in the post–Cold War era. This translates to a 66.5 percent increase. Therefore once again German RPE has a statistical and substantive effect on regional integration based on its effect on FDI stocks.

CONCLUSIONS

We can conclude that a state's performance alone is not important in entering into integration agreements with other European states. It will need help to tap into this resource to smooth out the policy adjustments' adverse effects. Furthermore, results show that states will more likely join when they are satisfied with conditions under integration. This means that they would prefer little institutional differentiation and greater FDI. Finally, the level of integration improves when there is a regional leader who can provide the carrying capacity some partners lack.

This last observation supports Kindleberger's argument on the important role a leader plays in the international system with the caveat that the regional leader's RPE is the key determining variable and not its mere economic size. Our findings not only support his premise at the European regional setting but also shed some light on his observation concerning the significance of followership by other states. This is indeed a delicate balance between RPE and levels of satisfaction among all parties and presents some interesting insights for policy makers.

The carrying capacity of a regional leader is an important factor in deepening regional integration, but it is a finite resource. Therefore an expansion of membership with partners that greatly lack individual capacity may stagnate the process of integration or possibly threaten it. As others have demonstrated (Arbetman and Kugler 1997), the lack of political capacity makes development harder to achieve. Since integration is often seen as an avenue of prosperity, it will take the regional leader's political capacity to help the lower achieving states. But this comes at a cost for the regional leader and its carrying capacity may not be large enough to achieve policy aims and goals.

The recent Greek debt crisis in Europe handily illustrates three of the main elements of our argument: one, that the extractive capacity of governments is important to implement policy in general, and two, that the political will and capacity of the leading states is central to the project of economic and political integration because, three, those same leading states have not allowed the European Union institutionally to have the political capacity to enforce its own standards.

When the Greek debt crisis began to rattle markets in January 2010, the European Union had just finally passed the Lisbon Treaty creating the office of the president of the European Union, a single leader to call in a time of crisis. When that phone rang this winter it was answered by Belgian Herman Van Rompuy, an anonymous consensus builder supported by German leader Angela Merkel precisely because he would not threaten the initiative of individual national leaders. When the crisis hit, the German leader got what she asked for as the markets turned to Europe's leaders in France and Germany for a response.

The crisis began to simmer in October 2009 as Greece's low RPE came to the fore. Generations of patronage-based Greek governments have won elections by handing out fiscal treats to their constituents: not enforcing tax laws for conservatives, and high public salaries and low tuitions for the left. In October, the newly elected Greek prime minister announced that the new government discovered that Greek debt levels had been higher than previously reported and submitted an updated report to the Commission (Coy, Petrakis et al. 2010 and European Commission 2010).

This event caused such stern reverberations in the markets not because it was unexpected—Greece had been warned about its numbers before, and investigations of off-books financing have been ongoing since 2004 (Chaffin and Hope 2010)—but because it occurred in the context of an institutionally and politically weak European response to the crisis. Despite keen interest in stemming the crisis, 72 percent of Greek debt was held by Eurozone banks, preventing the spread of panic to Portugal, Spain, Ireland, or Italy, and stabilizing the euro.

Germany and France disagreed on the form and type of intervention (*The Economist* 2010a; 2010b). With Germany expressing reluctance to underwrite a rescue of a southern spendthrift while tightening its own belt and France also working to keep the IMF out of any bailout, the lack of leadership intensified the crisis and Greek debt interest rates climbed and Euros shriveled (Roche 2010).

The late and reluctant leadership of Germany simply amplified the crisis because Germany is the economic anchor of the Eurozone. The argument over a proposed €35 billion of European Union support in March became a pledge of €155 billion in early May, with €35 billion from the IMF, and the European System of Central Banks backstopping Greek debt in May sales.

Finally, after markets found the May 1 effort wanting on the fear that the Bundestag wouldn't support the effort, the €750 billion European Financial Stability Facility was created with €440 billion from Eurozone states, €60 billion in ECB debt instruments, and a €250 billion IMF contribution (Reuters 2010). During this episode, the position of the German government came to be the determining factor. Without German leadership no progress would have been possible at the Eurozone side just as without the United States the IMF support would have been questionable.

Yet, despite this show of leadership on the part of Germany, one crucial factor also became evident. This crisis further adds to taxing of the EU's regional leader and that, in turn, is bound to result in slowing the deepening of regional integration in Europe. An additional factor in this regard is what eastern enlargement meant for regional integration.

The latest enlargement of the European Union increased the population of the EU by over 150 million but only added 5 percent to the Union's GDP! It is no wonder that the German government favors slowing of enlargement of the EU for the foreseeable future. Completion of the EMU and shoring up the economies of the new member-states are two important policy areas that EU leaders must acknowledge rather than extending membership to current candidate and potential candidate countries of the Balkans.

Among these countries only Turkey has a large and dynamic economy but its low per capita GDP signals nothing but danger for sharing of EU's structural and regional development funds. This country's ability to contribute significantly to EU's economic growth is not likely to be realized until 2030–2040 (Yesilada, Efird, and Noordijk 2006). In the meantime, the weaker economies of the Western Balkan states will negatively impact the ability of the regional leader to provide the needed assistance for deepening of integration.

This reality cannot be reversed by a mere growth in EU's supranational institutions' decision-making power. Despite enthusiastic comments by EU officials over how the future looks bright for the Union, the fact of the matter is that the EU is not a substitute for Germany's regional leadership role in deepening of integration. Without a political union that would substantially change the EU's RPP, member-states' RPP will be the key variable in the future success of regional integration in Europe.

NOTES

1. Charles Kindleberger first talked about the important role a leader, not a hegemon as understood by political scientists like Robert Keohane, plays in international cooperation. See Charles Kindleberger, "Dominance and Leadership in the International Economy," *International Studies Quarterly* 25, no. 2 (June 1981): 242–54, and "Hierarchy versus Inertial Cooperation," *International Organization* 40, no. 4 (Autumn 1986): 841–47.

2. A customs union is a regime established between states in which all tariffs and quotas restricting trade between the participating countries have been removed, while common tariffs and quotas are established vis-à-vis other countries. A common market goes further in removing all obstacles to trade between the countries, including such impediments as border controls and government regulations, state purchasing policies, and taxes that discriminate between the producers of one member-country and those of another. The SEA of 1987, which provided for the removal of all such obstacles to trade among EC members by the end of 1992, popularly labeled "Project 1992," represents an effort to approximate the conditions of a true common market among the EC members.

3. $IAS_t = a + \beta_1 RPE_{ti} + \beta_2 RPE_{tl} + \beta_3 S_{ti} + \beta_4 (PRE_{tl} * S_{ti}) + \gamma Controls_t + e$

Where:

IAS_t = The Integration Achievement Score in year *t*;

RPE_{ti} = Relative Political Extraction (proxy for Relative Political Performance) of state *i* in year *t*;

RPE_{tl} = Relative Political Extraction of regional leader *l* in year *t*;

S_{ti} = Level of Satisfaction of *i* in year *t*; and

Controls = The vector of control variables in year *t*.

4. $IAS = \frac{\sum_{i=1}^{6} Ci}{6}$

5. Although Switzerland is a member of the EFTA, it is not formally a member of EEA. However it is economically connected to the EU through a separate bilateral agreement.

6. Existing long-term data sets on democracy include Munck and Verkuilen (2002a); Alvarez, Cheibub, Limongi, and Przeworski (1999) (n = 141 time table: 1950–1990); Freedom House (2000), covering all nations from 1972; Gasiorowski (1996), Political regime Change (n = 97 time table: independence-present); Hadenius (1992), (n = 132 time table: 1988); Polity IV, Marshall and Jaggers (2001) (n = 161 time table 1800–1999); and Vanhanen (2000) (n = 187 time table: 1810–1998). Three are quite comprehensive. Freedom House (2000) data measure politics rights (nine components) and civil rights (thirteen components), both as ordinal data using additive (at the level of components) and as the aggregation rule.

It is a comprehensive data set with clear and detailed coding rules. It is limited by a minimalist definition and omits participation in coding. The Polity IV is an improved and updated version of the earlier Polity III (Jaggers and Gurr 1995) and measures competitiveness of participation, regulation of participation, competitiveness of executive recruitment, openness of executive recruitment, and constraints on executive power scale and is comprehensive and reliable. The weakness is a minimalist definition that again omits participation. Aggregation procedures can be experimented with. Finally, Vanhanen (2000) measures competition and participation as interval data using a multiplicative aggregation rule. It has clear coding rules and comprehensive scope. It is limited by a minimalist definition as it omits offices and agenda setting. Appropriateness of the aggregation rule is also in question.

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