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The demand-side politics of EU enlargement: democracy and the application for EU membership

Walter Mattli and Thomas Plümper*

ABSTRACT Most theoretical arguments about enlargement have sought to elucidate why the EU may have an interest in accepting CEECs. While these 'supply-side' arguments are essential building blocks of a comprehensive account of enlargement, they need to be complemented by a theory that seeks to understand the politics and economics of enlargement from a demand-side perspective. We show in a formal model how a transition country's demand for EU membership relates to both regime type and its willingness to implement economic reforms. Specifically, we argue that leaders in more democratic regimes had a greater incentive to push ahead with costly 'institution-building reforms' which, in effect, aligned their countries with EU rules and institutions. The impetus for continuing pro-integration regulatory reforms came from the greater electoral accountability of these leaders. We test this claim with a Cox continuous time survival model with time-dependent covariates. The results confirm the dominant impact of increasing political participation on the likelihood of an EU application.

KEY WORDS Central and eastern European countries; enlargement; European Union; lobbying; public choice; reforms; transition.

I. INTRODUCTION

Shortly after the Copenhagen Summit of 1993, German Foreign Minister Klaus Kinkel announced a comprehensive programme of a European Union (EU) Ostpolitik and pledged to promote it during Germany's presidency of the Union which started on 1 July 1994. Such an Ostpolitik was not confined to Hungary, Poland, Slovenia, the Czech Republic, Romania, and Bulgaria, that is, countries with which the EU had already signed co-operation agreements, but included the Ukraine, Russia and other states to the east of the EU. Kinkel stressed, in particular, the importance of bringing the Ukraine quickly within the European co-operation system to ease the severity of its economic crisis and to diffuse tensions between Kiev and Moscow, two developments that threatened to affect the EU adversely. Shortly thereafter, the Community took the first concrete steps towards a comprehensive Ostpolitik by signing

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economic co-operation agreements with countries such as the Ukraine, Russia, and Belarus.

This episode illustrates that the boundaries of an enlarged EU were not clearly drawn in the minds of EU leaders during the first half of the 1990s. It is thus difficult to argue that the submissions of EU membership application by some central and eastern European countries (CEECs) during those years were motivated primarily by a clear understanding of what countries the EU would deem acceptable. Further, even though the EU had signed various types of economic co-operation agreements with the CEECs, it was careful not to encourage these countries to push for membership.[1] Indeed, a senior Commission official noted in the mid-1990s that 'the [EU's current] level of seriousness about enlargement is not minimal, it simply does not exist.'[2]

This raises a key analytical question that this paper seeks to address: why did some CEECs apply for EU membership while others showed no interest in doing so? A related question is: what explains the timing of application?

We claim that most theoretical arguments about enlargement provide only partial answers to these questions because they focus on the supply side of enlargement, that is, they seek to elucidate why the Union may have an interest in accepting the CEECs. Supply-side arguments, which we review in section 2, are essential building blocks of a comprehensive account of enlargement but they are not enough. They must be complemented by a theory that seeks to understand the politics and economics of enlargement from a demand-side perspective. Section 3 of the paper develops such a theory; it can be summarized as follows.

By the early 1990s, virtually all political leaders in the CEECs had successfully implemented quick 'first-round' reforms, such as price liberalization and small-scale privatization, bringing economic crises under control. With the worst over, the leaders now responded quite differently to the need of implementing politically much more costly and protracted 'second-stage' reforms, including large-scale privatization, enterprise restructuring, and legal and administrative reforms. We argue that leaders in more democratic regimes had a greater incentive to push ahead with these costly 'institution-building reforms' which, in effect, aligned their countries with EU rules and institutions. The impetus for continuing pro-integration regulatory reforms came from the greater electoral accountability of these leaders. Indeed, they saw reforms establishing sound private governance supported by effective judicial and administrative institutions as the most promising way to generate and attract investments needed for vigorous economic growth. The successful launching of 'second-stage reforms' naturally led these leaders to contemplate EU membership application; indeed, by submitting an application, these leaders expressed confidence in their country's ability and willingness to overcome the remaining internal obstacles to EU membership and work towards satisfying all membership requirements. An application thus represented a very public form of commitment to continuing deep institutional reforms.

Leaders in less democratic regimes, however, had less of an incentive to institute protracted welfare-enhancing regulatory reforms that were bound to alienate politically powerful special interest groups. As a result, the idea of applying for EU membership was of no appeal to them.

We test the hypotheses derived from our model applying a Cox regression with time-varying covariates. This method allows us to empirically model the impact of time on the application process. The results strongly confirm the dominant impact of democratic structures on the likelihood of application. Once we control for these structures, only foreign economic openness and GDP per capita influence the likelihood and timing of an EU application.

The study by Frank Schimmelfennig (in this special issue) finds similarly that the more democratic a state, the more likely it is to establish institutionalized relations with the EU and apply for membership. Drawing on constructivist theory, however, he explains this finding with reference to the force of mutual attraction that states sharing liberal democratic values sense; the higher the degree of normative or cultural match, the faster and deeper the process of horizontal institutionalization. We do not deny the power of norms and culture in the process of integration but simply propose an additional explanation for why leaders in more democratic regimes may find EU membership attractive.

II. REVIEW OF THE THEORETICAL ARGUMENTS ABOUT ENLARGEMENT

This section reviews the main theoretical arguments about enlargement which we classify as supply-side arguments. Its purpose is to clear the way for the demand-side theory of section III by bringing out the limitations of supply-side explanations whose focus is on the EU members' motives for admitting new countries located in central and eastern Europe (CEE). Supply-side arguments would be analytically sufficient to account for EU enlargement if the leaders in all CEECs were filled by some sort of invariant, homogenous, and natural desire to be part of the EU. The timing of membership would then be determined entirely by EU member states. We argue, however, that such desire is a myth and thus cannot be assumed. What we need instead is a theory that clearly and fully specifies the incentives and constraints of political leaders in different types of regimes across CEE. Such a demand-side account complements extant supply-side arguments.

First supply-side argument: negative externalities

The first argument assumes that the leaders of a union seek to maximize economic growth and prosperity of the union; they are thus unlikely to accept as new members countries that are undesirable candidates in the sense of being unable to make a net positive contribution to the union (for example, through net payments into the common budget, or by offering obvious commercial advantages) – unless the exclusion of such candidates is costlier to the union than accepting them.

More precisely, the argument is that an incentive for accepting poor and commercially unattractive countries exists when negative externalities originating in these outsider countries threaten to disrupt the union's stability, security, and prosperity. The sources of these externalities may reside in economic mismanagement, political instability, or social unrest. A particularly common form of negative externality is illegal immigration. Economic inclusion through integration rather than exclusion, goods rather than people, trade instead of migration may become an expedient integrative formula for defusing the threat of social disruption caused by such illegal immigration (especially when a union's labour market is saturated).[3] Trade and investment may raise living standards and increase employment opportunities, thus easing the pressure to migrate (Hollifield 1992a, 1992b; Hiemenz and Schatz 1979).

Events in Eastern Europe in the early 1990s suggest that the scope of negative externalities originating in the periphery of the EU did indeed shape the attitude of its members regarding enlargement to the East. The EU's eastern periphery was moving from an era of communism and rigid command economies towards a goal of democratic pluralistic regimes with market economies. This transformation represented a gargantuan social experiment of uncertain outcome. Its failure threatened to play havoc with West European projects for monetary and political union and seriously risked undoing most of the EU's progress up to that point in economic integration. Above all, Western Europe feared massive migratory movements if the process of political transition and economic restructuring in the East went awry. Economic 'push' factors, such as rising unemployment, food shortages and a decline in the already precarious standard of living, combined with ethnic tensions and mounting criminality, had already motivated hundreds of thousands to move West. In the early 1990s the United Nations High Commissioner for Refugees predicted as many as 25 million refugees from all over Eastern Europe if political instability and unfavourable socio-economic conditions continued (Shevtsova 1992).[4]

The threat of such massive migration caught Western Europe at a particularly unwelcome time. In 1991, there were 15 million unemployed workers in Western Europe, of which 12 million resided in the EU. This amounted to some 6 per cent of the population of Western Europe. The unemployment rate among those aged under 25 averaged 35 per cent. With the onset of the recession in the early 1990s these numbers stood to rise significantly. Immigration was rapidly becoming a core issue of electoral campaigns in many European countries. The growing number of foreigners who were competing with indigenous workers for a dwindling number of jobs fomented xenophobia and exacerbated social tensions.

Clearly the problem of migration had to be tackled at the source rather than through a policy of containment. The West responded to the plight in the East initially by offering technical assistance and advice in areas such as food distribution, privatization, banking, civil service reform, education, the environment and energy through the PHARE and the TACIS programmes.[5] Economic loans were provided by the European Investment Bank (EIB). The European Bank for Reconstruction and Development (EBRD) concentrated its lending on the nascent private sector. In addition to such traditional aid, on 16 December 1991 the Community signed far-reaching association agreements (also called 'Europe Agreements') with Czechoslovakia, Hungary and Poland, under which the EU promised to remove its barriers to industrial imports from the three countries within five years.[6] Still, Jackie Gower notes that

> [u]ntil the summer of 1991 the prevailing view in Brussels was that none of the former Comecon states could realistically be regarded as candidate members of the Community until well into the next century. Indeed, it is arguable that the EU's overriding objective at this time was to avoid the question of membership.
>
> (Gower 1993: 289)

However, this objective proved insufficient. The attempted Soviet coup of August 1991 signalled to the West that more effort was needed to avert chaos (Mortimer 1992: 21). Gower concludes that the shock of the attempted Moscow coup changed the EU's attitude towards enlargement (Gower 1993: 289–90). Avoidance was simply no longer a sensible policy option.

Thus, the EU signed similar association agreements with Romania and Bulgaria in 1993. More trade agreements between the Community and former Comecon countries followed shortly thereafter. Crucially, the Copenhagen European Council of June 1993 for the first time acknowledged the membership perspective of the associated countries.

This remarkable flurry of initiatives notwithstanding, the political will in the EU to carry out plans for further integration cooled markedly in 1995. A reason consistent with the logic of the externality argument is that the early market concessions of the EU were successful in warding off the threat of mass migration. The Union's share of former Comecon countries' exports and imports rose from 20 per cent in 1988 to almost 50 per cent in 1992 and has grown continuously ever since (Eurostat, various issues). Increased trade, in turn, led to brisk export-led economic growth that helped to re-establish a semblance of order and stability in the East. In view of this success it was not clear why the EU would have had an incentive to deepen integration with the East.

In sum, the negative externalities argument holds that the waxing and waning of a union's willingness to seek closer economic ties with outsiders depends on the extent of actual or potential crisis spill-over from neighbouring countries. While this argument captures an important supply-side motivation, its limitations are apparent. First, it does not account well for the resumption and intensification of accession talks in the late 1990s, especially with countries such as Hungary, Poland, and the Czech Republic, by then stable democracies with booming economies. Second, it fails to offer clear theoretical guidance as to which type of integration a union is willing to supply to the periphery to minimize negative externalities; indeed, the argument seems to be compatible with a broad range of integration types, including free trade areas, customs unions, common markets, and economic communities. Finally, the argument is at a loss to explain the varying pace of application across the CEECs.

Second supply-side argument: economic gains

The second argument holds that the EU is enlarging to reap large economic gains, and that the main beneficiaries (and thus supporters) of enlargement are multinational corporations (MNCs) in the EU and firms with large export interests in CEE (Brancati 2001).

Investment theories suggest that MNCs' intangible assets (such as special managerial and marketing skills, patented or non-marketable technologies, and a cheap source of finance) provide strong incentives for expanding production into CEE, particularly if pulled by location-specific advantages, including low labour costs, skilled or non-unionized labour, low material costs, access to extractive resources, and market proximity (Caves 1996; Dunning 1989).

Trade theorists argue that larger markets help firms to achieve economies of scale in production; that is, an increase in production lowers the average cost of output per unit. The phenomenon of extensive intra-industry trade among industrialized countries attests to the importance of economies of scale in production. Another argument is that trade is beneficial because it permits countries to exploit their comparative advantage. A comparative advantage arises when the marginal opportunity costs of producing one good in terms of another good differ between countries. Thus a country gains from specializing in the production and export of those goods which it can produce at relatively low cost (i.e. goods in which it is relatively more efficient than other countries).

Trade and investment are not necessarily separate activities. The existence of trade-related investment blurs the distinction. Trade-related investment is very common in international trade. One reason is that the process of specialization according to comparative advantage involves investment in increased productive capacity to service export markets. Trade-related investment can also involve vulnerable assets that are located abroad, such as transportation or storage facilities (Yarbrough and Yarbrough 1992). In short, investment generates trade, and trade attracts investment.

The risks of doing business in the CEECs, however, are numerous. First, there is uncertainty: economic mismanagement and socio-political unrest may render foreign assets or trade-related domestic investment worthless. Second, host countries may act opportunistically and implement measures of 'creeping expropriation' through laws and regulations that deprive investors of the value of their contract.

EU enlargement, however, would mitigate many of these risks; it would not only improve the overall climate of conducting business in CEE and offer new investment opportunities, it would also reduce investment transaction costs for MNCs and traders from Western Europe by extending EU rules, regulations, and policies, as well as EU monitoring and dispute resolution institutions to CEE. Lower costs of doing business in the CEECs will encourage MNCs to rationalize production on a broader regional basis which, in turn, will help them to compete more effectively in world markets (Brancati 2001).

Consistent with this argument, countries with strong business interests in CEE, such as Germany and the United Kingdom, have been the most eager to push the enlargement agenda. Also consistent with the argument, the EU favoured membership talks in the late 1990s with those countries that were the most advanced reformers politically, institutionally, and economically and thus posed the smallest risk both to MNCs and EU governments.[7]

Third supply-side argument: norms

Schimmelfennig has recently argued that economic gains alone cannot explain why the EU as a whole embraced enlargement and opened accession talks in March 1998 (Schimmelfennig 2001). Not all EU members stand to gain from enlargement and the states that stand to lose have long been fighting for their own national economic interests. In the early 1990s, for example, Portugal blocked further liberalization of trade with CEE in textiles, France vetoed concessions on beef meat, and Spain blocked agreement on steel trade; such obstruction tactics continued in later years (Schimmelfennig 2001: 55–60).

Schimmelfennig claims that the promoters of enlargement eventually succeeded in backing up their own selfish goals and pushing the enlargement agenda through by invoking the Community's traditional pan-European orientation and its liberal constitutive values and norms and shaming the opponents into acquiescing in enlargement. In other words, the strategic use of norm-based argumentation rendered attacks on pro-enlargement justification illegitimate and inappropriate, thus changing the bargaining power within the EU in favour of those who favoured enlargement.

The rhetorical entrapment of opponents worked, in part, because the promoters focused first only on those countries in CEE that had made the greatest progress in laying down a solid foundation for civil and political rights and instituting societal pluralism, the rule of law, democratic political participation as well as private property and a market-based economy. These states seemed to fully share the collective values of the EU. Proponents could thus effectively decry attempts by opponents to obstruct the enlargement process as acts of disloyalty to the ideational foundations of European integration.

This account compellingly supplements the earlier argument based solely on economic gains. On its own, however, it inevitably raises several questions. First, was the initiation of accession talks truly the result of rhetorical entrapment rather than silent threats or side-payments by the biggest and wealthiest

EU members? Also, it is not entirely clear why 'rhetorical entrapment' took so long to work. The demarcation line between promoters and opponents of enlargement was drawn as early as 1991; however, the many normative arguments in favour of enlargement do not seem to have had much 'entrapment power' in earlier years. Nevertheless, Schimmelfennig's argument is plausible and constitutes a sophisticated statement of the power of norms in the process of enlargement.

III. THE MISSING LINK: THE DEMAND SIDE OF ENLARGEMENT

Each of the supply-side arguments captures an important motivation driving the enlargement process. Together they provide a comprehensive analytical picture of the forces that led the EU to open its large economy to the CEECs. Supply-side theoretical arguments, however, cover only half the story of the widening of the EU; they leave unanswered questions pertaining to the demand side of enlargement. Most notably, why have some CEECs shown great eagerness in EU membership while others have adopted decidedly reserved views on the desirability of such membership; and what explains the varying pace of application across the CEECs?

Most arguments on the demand side are ad hoc, under-specified, and untested.

One argument is inspired by constructivist theory and holds that the desire of CEECs to join the EU is fuelled by a strong sense of identification with liberal democratic values that are fundamental to the EU, namely rule of law, social and political pluralism, private property, and free speech (Schimmelfennig in this issue). Further, accession is viewed as a natural act of reunion of two parts that belong to a single cultural tradition and historic heritage. The argument is attractive but possibly under-specified; it juxtaposes two factors, namely norms and desire to join the EU. What arguably is missing is a clearly and fully specified causal mechanism linking democracy and pro-integration preferences and policy outcomes.

The second demand-side argument takes a more prosaic view of the preferences of the CEECs and holds that the appeal of membership resides in the promise of technical and financial assistance, rapid economic growth, and prosperity. Indeed, the EU has expressed its willingness to share the enormous cost of modernizing the economies of the candidate countries and of aligning their laws and infrastructures with the *acquis communautaire*. Further, the EU provides extensive financial and expert assistance through the PHARE programme, which has been re-modelled to become an accession-targeted instrument. The programme's budget of 1.5 billion euros supports the effort of candidate countries to build strong administrative and judicial apparatuses capable of effectively implementing and enforcing the *acquis*. EU policies towards the CEECs are also frequently supported by the lending activities of the EIB.

Further, the EU dispatches technical experts from ministries, regional bodies, public agencies, and professional organizations in the member states to counsel and instruct their homologues in the candidate countries. These regular high-level contacts between representatives of ministries from the CEECs and the various directorates of the European Commission, as well as a multitude of other meetings within the framework of several partnership programmes have established dense political and bureaucratic networks that serve to provide continuing legal guidance and technical support.[8]

The greatest economic benefit of EU accession, however, is the inflow of transnational capital into the region (Mattli 1999: 44–50, 105–8; Baldwin *et al.* 1997; Lankes and Venables 1996; EIU 1999; European Roundtable of Industrialists 1999). Foreign direct investment (FDI) has grown from $3.6 billion in 1992 to $5 billion in 1994 and $11.3 billion in 1997.[9] The EU countries have been the most important source of FDI in the CEECs. In 1997, for example, the EU accounted for 61 per cent of the FDI stock in the Czech Republic, 63 per cent in Hungary, and about 55 per cent in Poland (United Nations 1998). Several recent studies predict that the influx of capital into the region will double or triple once the CEECs attain the status of full members of the EU.

Full membership will offer other attractive advantages: the CEECs will have unrestricted access to the single European market and will no longer have to fear reversals of free trade in sensitive areas. Agriculture, a large segment of the CEECs' economies, is likely to see its exports boosted with accession.

In sum, the economic benefits of enlargement unquestionably constitute a powerful force driving the demand for membership. However, similar to the norm-based demand-side argument, the economic argument is under-specified. As a result, it cannot explain the resistance of some political leaders in CEE to enlargement and the cross-country variation in the timing of application. We seek to explain these puzzles within a political economy framework.

IV. THE MODEL

Frank Schimmelfennig and Ulrich Sedelmeier (this special issue) aptly define enlargement as gradual horizontal institutionalization, that is, a process by which the gap in rules and institutional arrangements between insiders of a union and outsiders progressively becomes narrower. This narrowing is the result of successive rounds of pro-integration regulatory reforms and institutional adjustments to EU norms and practices undertaken by outsiders. The task for the formerly communist countries in CEE is gargantuan and fraught with difficulties.

Building on this process-related understanding of enlargement, we view the submission of an application for membership by a CEEC as an expression at an advanced stage of reform of that country's ability to overcome the remaining internal obstacles to EU membership and work towards satisfying all membership requirements. The confidence underlying a request for membership is rooted in the applicant's successful domestic effort to launch and maintain a drive toward far-reaching pro-integration regulatory and institutional reforms in the wake of the transition crisis. In other words, an application can be interpreted as a very public act of commitment to continuing deep institutional reforms that fully align outsiders to EU norms and rules.

During the transition crisis, virtually all CEECs implemented so-called 'first-round' reforms, including widespread liberalization of prices, external trade and currency arrangement, and small-scale privatization. These market-building measures involved few new institutional developments and thus were adopted relatively quickly. Indeed, by the early 1990s, market liberalizing reforms were in place in almost all countries in the region, bringing economic crises under control.

With the worst over, the leaders in the various CEECs now faced the considerably more daunting challenges of institution-building associated with large-scale privatization, financial sector reform, enterprise restructuring, legal and administrative reforms, and other protracted reforms (see Table 1). These reforms generally aimed at reducing the historically close ties between the political and the economic spheres. They would be neither quick nor easy since formidable vested interests were certain to resist change in order to keep privilege and wealth.

The willingness of political leaders to take on vested interests and push ahead with far-reaching institution-building reforms aimed at aligning their countries with EU rules and institutions varied considerably. Generally, the more democratic a regime, the greater the political will, and thus the more successful the process of implementing pro-integration regulatory reforms (Table 1).

The impetus for continuing pro-integration regulatory reforms came from the greater electoral accountability of political leaders in more democratic countries. Indeed, these leaders saw reforms establishing sound private governance supported by effective judicial and administrative institutions as the most promising way to generate and attract investments needed for vigorous economic growth. The successful launching of 'second-stage reforms' naturally led these leaders to contemplate EU membership application; indeed, by submitting an application, these leaders expressed confidence in their country's ability and a willingness to overcome the remaining internal obstacles to EU membership and work towards satisfying all membership requirements. By contrast, leaders in less democratic regimes were concerned that by embracing sweeping pro-integration regulatory reform programmes, they would alienate powerful interest groups whose support they needed for political survival. As a result, they were not venturing down the road of EU membership like their more democratic homologues.

To explain the level and pace of regulatory reforms leading up to EU application, we build on a standard model of political economy that considers the interaction between an opportunistic government, voters, and interest

Table 1 The impact of democracy on 'institution-building' market reforms across central and eastern European countries

	Autocracies polity < 0	*Moderate democracies polity 0–7*	*Full democracies polity 8–10*
Large-scale privatization	2.25	2.83	3.00
Enterprise restructuring	1.75	2.33	2.57
Competition policy	1.50	2.17	2.43
Banking reform	2.25	2.50	2.86
Securities market liberalization	1.75	2.33	2.43
Legal rules on investment	2.00	2.50	3.00

Sources: Authors' calculations based on rankings given in the European Bank for Reconstruction and Development (1995) *Transition Report 1995* (London: EBRD), and the polity database (see section V).
Note: The numbers range from 1 (no or little progress) to 4 (standard of performance typical of advanced industrial economies).

groups (Rodrik 1995). However, we go beyond this model and show how political participation relates to the degree of market distortions. In CEE, the use of market distortions as a means of increasing political support can be associated with the maintenance of old-regime-style regulations that primarily serve rent-seeking purposes. Our model predicts that in less democratic regimes the process of regulatory reforms does not proceed much beyond relatively easy market-building steps that minimally threaten vested interests.

In our model, individual policy preferences are determined by the impact of a government's special interest policies on individual welfare. Each individual favours such policies if and only if they affect his or her individual utility in a positive way. In the aggregate, however, special interest policies reduce the welfare of the population.[10] The more prevalent such policies, the slower the pace of implementation of 'institution-building' regulatory reforms, and thus the less the likelihood that the country will apply for EU membership.

An accessible formulation of this idea relates an individual's j utility to three sources of income, his or her labour endowment, his or her income from capital ownership and government spending which can be divided between the gains from the government's provision of public goods g and the degree of market distortions d. It follows

$$I^j = s^j_L wL + \sum_k s^j_k \pi_k + \sigma^j (g - d) \qquad (1)$$

where s^j_L, s^j_k and σ^j are j's individual shares in labour endowment ($0 \leq s^j_L \leq 1$), industry profits ($0 \leq s^j_k \leq 1$) and net taxation ($0 \leq \sigma^j \geq 1$), where w denotes wages and

$$d = \sum_k (p_k - p^*_k) m_k \tag{2}$$

represents the sum of sectoral market distortions (expressed as an increase in the price of goods in sector k relative to the free market price), where m is the sectors indexed k and $p_k - p^*_k > 0$ is the market distortion in sector k, while $p_k - p^*_k < 0$ suggests that the government implements policies that include positive externalities to sector k.

We assume the following resource balance constraints

$$m_k = -\frac{\partial \mathbf{p}}{\partial p_k} V\mathbf{p}^{-1} \sum_j I^j - \frac{\partial \pi_k}{\partial p_k}, \ \forall i \tag{3}$$

where $\mathbf{p}$ describes the vector of domestic prices p. Note that the model only explains relative prices so that the price of each good may serve as a denominator.

The aggregate welfare of the country is maximized if

$$\max_p W^* \equiv \mathbf{p} \sum_j I^j. \tag{4}$$

Accordingly, market distortions are not only redistributive measures, they also tend to reduce the country's aggregate welfare. A subsidy to one sector increases the net returns on capital and labour in that sector only to the expense of all other sectors

$$\frac{\partial \pi_k}{\partial p_k} > 0. \tag{5}$$

According to the model a social planner (that is, a government seeking to maximize aggregate welfare) intervenes in the market only to provide public goods. This raises the question of why the degree of market intervention in many transition countries remains high (high level of 'd') while few 'institution-building' regulatory efforts are undertaken that would increase positive externalities (low level of 'g').

Our answer is straightforward: the political survival of a government hinges not only on the support of the broader public but also on the approval of powerful interest groups. Individuals can gain influence on government activities by basically two means: they can vote and they can form interest groups l_k engaging in lobbying activities in the political arena. However, the creation of interest groups may not be successful in all sectors (Olson 1965). Therefore, the actual number of interest groups n falls short of the number of sectors m. This is important because the existence of no interest groups and the existence of one interest group in each sector lead to the same efficient outcome. It can easily be obtained from equation 1 that it is the goal of each interest group to increase the price of the good in that sector, from which the members of the interest group receive their income.

Governments in transition countries may stick to inefficient regulations to drive a wedge between actual prices and equilibrium prices (prices without intervention such as the world market price), because in doing so they redistribute welfare to politically more powerful actors at the expense of less powerful actors. Thus, governments redistribute income in order to maximize political support. For the sake of simplicity, we assume that the government's income from holding power is maximized, if the government maximizes the time it stays in office. The government is ousted when support falls below a critical level.

The incumbent would clearly prefer to hold office for an infinite time; to achieve this goal the incumbent may implement regulations that increase the domestic price of goods p_k, $k \in m$, thereby shifting income to individuals who derive income from the regulated sector k. In this case, the interest group provides political contributions that increase the incumbent's political support, thereby ensuring his or her political survival. However, the market distortion reduces the utility which, in turn, reduces the government's approval by the voters. The government therefore has to maximize (or satisfy) a political support function of the following kind

$$S_g(g,d) = \left[\sum_{l=1}^{n} C_l \right]^{\alpha} + \lambda\ [W(P)]^{\beta},\ 0 < \alpha,\beta < 1 \tag{6}$$

where C_l is the political support derived from an interest group's campaign contribution, $W(P)$ is the aggregate well-being of the constituency and $\lambda \geq 0$ is a weight that takes low values in less democratic countries and high values in genuine democratic regimes.[11] The incumbent faces a change in political support according to the following function

$$\Delta S_g = \partial \left(\sum_{l=1}^{n} C_l \right) + \lambda \partial W(P), \tag{7}$$

Hence, small deviations from the actors' optimal point reduce their utility slightly, larger deviations reduce their utility more rapidly. Figure 1 shows how an opportunistic government chooses a level of market distortions d.

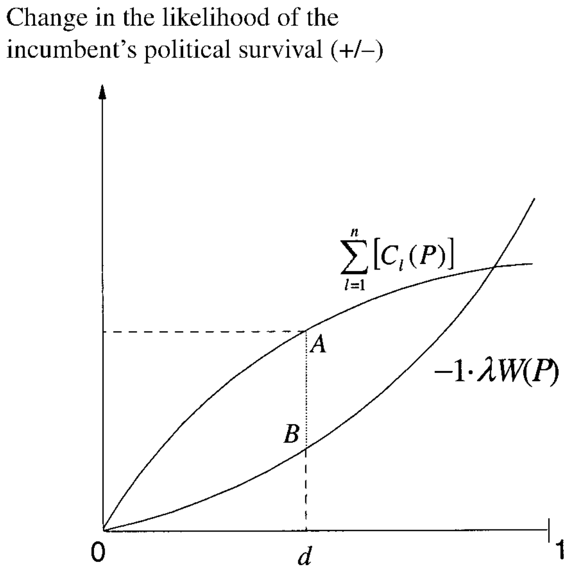

Figure 1 Political support and government's choice of inefficient policies

Figure 1 depicts the voters' and interest groups' support of the government as a function of the degree of market disturbances. All actors, voters as well as lobby groups, are assumed to have a quadratic utility function, where small deviations from the optimum cause little loss to an individual's utility; the marginal loss of utility rises, however, with a growing distance from an actor's preferred point. For any given value of g voters prefer d = 0, which is the efficient regulation, lobby groups prefer d = 1. Both react elastically to changes in government policy: while the interest groups increase their support, the voters' support gradually declines. For expositional convenience, we have multiplied the decrease in voters' support by –1. Hence, as market disturbances increase, the support function of the voters is upward sloping but nevertheless exhibits a loss, while the aggregate support functions of lobby groups register a gain. This allows us to identify the degree of market distortion that maximizes the government's political support. The net effect is positive, if and only if gains in support from the interest group exceed total losses from the implementation of inefficient regulatory policies. In Figure 1, this is the case for a wide range of policies. An opportunistic government's maximization problem can be stated as follows[12]

$$U_g(d) = \frac{\partial\left[\sum_{l=1}^{L} C_l\right]}{\lambda\partial[W(P)]}. \tag{8}$$

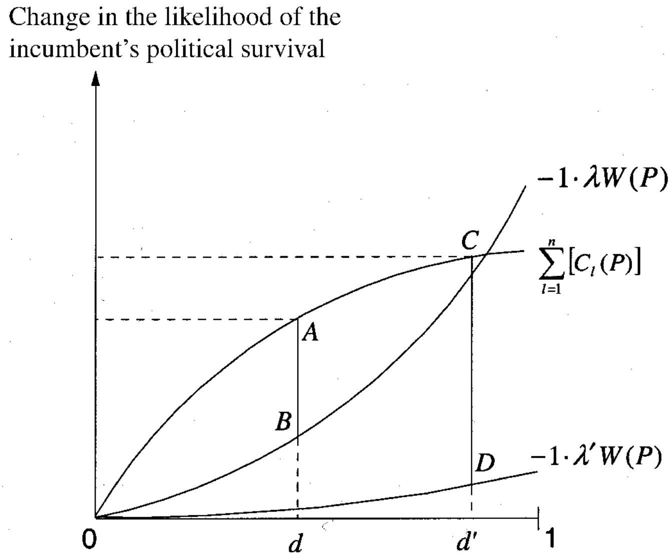

Figure 2 The impact of regime type on the support maximizing market distortion

We relate the benevolence of a government, λ, to its responsiveness to voters' preferences. For simplicity's sake, we assume that interest groups provide the same absolute level of political support regardless of a country's degree of democracy.

The relative importance of the voters depends crucially on the extent to which free and fair elections take place. This is expressed by the λ, with higher lambdas indicating the larger impact of voters in more democratic political systems. Hence, interest groups in less democratic regimes tend to be more influential than in true democracies, and, as a result, the former regimes tend to implement less efficient regulatory and economic policies than the latter (Wintrobe 1998: 341; Plümper and Martin 2001). This idea is expressed in Figure 2.

Figure 2 extends the logic of Figure 1 to two different lambdas ($\lambda > \lambda'$). The steeper slope of the voters' support function $-1 \cdot \lambda W(P)$ indicates a more democratic country. In comparison, $-1 \cdot \lambda' W(P)$ depicts the effect of distortionary policies in less democratic regimes.

Both types of government choose a support maximizing policy. In the democracy, this distance is maximized in d, giving a net increase in political support of $\overline{AB}$. Less democratic regimes choose d', leading not only to a much higher net gain in support $\overline{CD}$ but also to a higher equilibrium market distortion ($d' > d$).

The model thus predicts that less democratic regimes choose more distortionary economic and regulatory policies (d') which put them off the path of EU membership, whereas fully democratic regimes select 'institution-building'

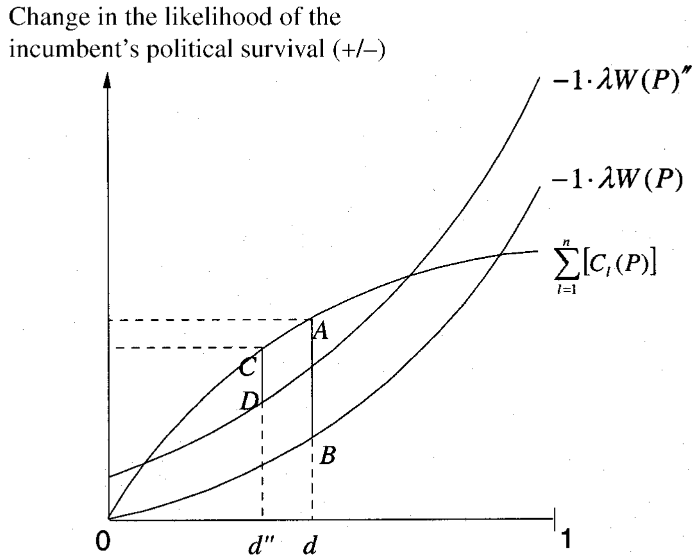

Figure 3a Economic crisis and the reduction of market distortion in genuine democracies

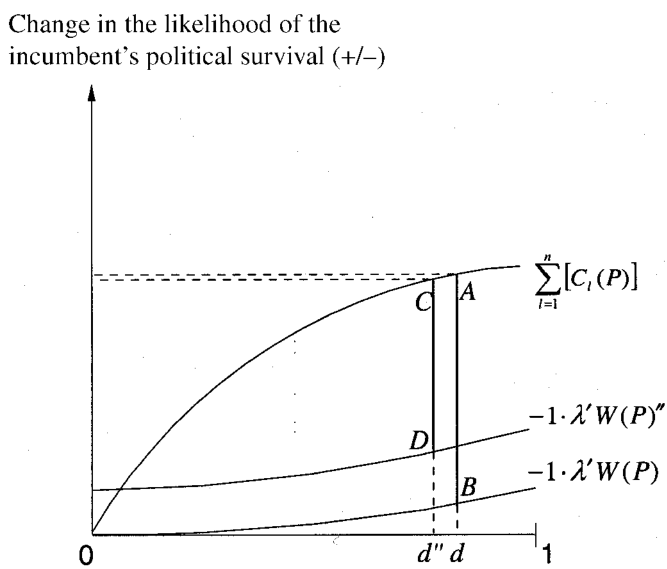

Figure 3b Economic crisis and the reduction of market distortion in less democratic countries

regulatory reforms and are thus more likely to apply for membership of the EU.

Figures 3a and 3b illustrate the varying responses of different types of regime to economic crises and introduce an additional hypothesis according to which the severity of a crisis acts as a powerful spur to reforms.

Figures 3a and 3b show that governments in democratic countries react more elastically to economic crises than less democratic regimes, that is the distance between d'' and d is larger in countries with more political participation. An economic crisis is modelled as a reduction in the political support of the voters. Since we again multiply the reaction function of voters by –1, we have to move this function to the north of the diagram. This illustrates that the support of voters declines if economic performance worsens, reducing the level of market distortions in both types of regime. However, a comparison of both figures reveals that less democratic governments tend to reduce the market distortions to a lesser extent. This explains why democratic governments are more likely to vigorously respond to economic crises, and may also explain why the transition difficulties under more accountable and democratic regimes were less severe and ended earlier.

V. A COX SURVIVAL ANALYSIS OF APPLICATION

The objective of this section is to empirically test the asserted causal impact of democracy and crisis severity on institution-building regulatory reforms and EU application in CEE. We use a Cox survival model with time-varying covariates. This estimation technique allows us to control for changes in the economic and constitutional environment of policy-making that occur as these countries move from central planning to market economies. Importantly, continuous-time models apply partial likelihood estimation and yield the flexibility so that one can assume time dependency without being forced to specify the functional form (Yamaguchi 1991: 101).

The sample consists of nineteen CEECs for which reliable data are available.[13] The maximum time period spans from 1991 to 1998. We consider 1991 as the first year in which application is at risk, simply because most transition countries lacked a stable political authority before that date. In addition, we selected an even shorter observed period of time for countries experiencing further political instability such as Czechoslovakia (the Czech Republic and Slovakia). Application is coded 1 in the year the country applies for EU membership, and 0 otherwise.

The variables of principal interest are proxies for the existence of democratic institutions, the time since the end of the transition crisis and the severity of the transition crisis. The most prominent source for democracy is the polity dataset. The polity dataset includes three composite indicators: DEMOC, AUTOC and POLITY. While DEMOC and AUTOC can take values on an additive 11-point scale (0 . . . 10), POLITY is computed by subtracting the AUTOC score from the DEMOC score. This unified score ranges from –10 (strong autocracy) to +10 (strong democracy). We use the POLITY score as a first proxy of the political decision-making institutions and the political incentives.

However, since the weights used to calculate DEMOC and AUTOC appear to be arbitrarily chosen, we also employ a principal component analysis to compute a composite measure for democracy (REGIME). This proxy is based on the original Polity4 indicators: 'Regulation of Executive Recruitment' (XRREG), 'Competitiveness of Executive Recruitment' (XRCOMP), 'Executive Constraints' (XCONST), and 'Competitiveness of Participation' (PARCOMP). This procedure suggests that democracy is unidimensional, with the first principal component already capturing more than 78 per cent of the original Polity variables.

The correlation (Kendall's Tau) between POLITY and REGIME is 0.86. Nevertheless, the following differences between the two variables are worth noting: POLITY gives Latvia and Poland the same score and considers both countries more democratic than Russia; REGIME, however, ranks Poland first, followed by Russia and Latvia. The relatively high score for Russia in REGIME results from the lesser importance of Executive Constraints in the principal component analysis. POLITY, however, is biased against presidential systems which explains the lower democracy score of Russia.

If the results for POLITY and REGIME differ, we can make some bold but conceptually grounded speculations about the impact of a presidential system on the likelihood of EU application. We test this by adding a categorical variable measuring the relative power of the president relative to the parliament (PRESID).

To control for the lengthy period of 'institution-building' regulatory reforms in the wake of the transition crisis, we include variable PASTCRIS.[14]

In addition, we control for a number of intervening factors. We include per capita income (GDPC) without formulating an expectation about the sign. On the one hand, one might expect a positive impact (a hazard rate above 1), since richer societies may find it less burdensome to implement the reforms required for an application; on the other hand, poorer countries may find it relatively more attractive to join the EU. We also control for the export dependence of transition countries (XOPEN) and expect that more trade-dependent countries are more likely to apply.

Table 2 gives an overview of the countries in our sample, the final year of the transition crisis, the severity of the crisis, and the country's POLITY score. In addition, we include the month and the year of the formal application for EU membership and our predicted year of application.

Despite its simplicity, our account makes only one clearly wrong prediction. Macedonia was predicted to apply in 1996. The fact that it failed to do so may be the result of its close ties to the former Yugoslavia or may have to do with its conflict with Greece about the country's name.

Table 3 reports the results of five models: Model 1 is the baseline model, the others are variations to assess the robustness of our key findings. Model 2

Table 2 A summary

Country	*Last year of transition crisis*	*Decline in per capita income (%)*	*POLITY score*	*Predicted year of application*	*Date of application*
AZE	95	67	–6	–	–
BUL	93	17	8	95/96	12.95
CRO	93	35	–3	–	–
CZR	92	5	10	94/95	01.96
EST	93	15	6	95/96	11.95
HUN	92	2	10	94/95	03.94
KAZ	95	43	–4	–	–
LAT	93	42	8	95/96	12.95
LIT	94	37	10	96/97	12.95
MAC	93	12	6	95/96	–
MOL	–	51	7	–	–
POL	91	3	8	93/94	04.94
ROM	92	5	5	94/95	06.95
RUS	–	30	4	–	–
SLV	92	3	10	94/95	06.96
SLA	93	5	7	95/96	06.95
UKR	97	47	7	–	–
UZB	95	25	–9	–	–
YUG	93	45	–7	–	–

adds a EURO variable to examine whether being labelled a 'European' country increases the likelihood of application.[15] Model 3 is identical to Model 1 except that we drop Azerbaijan, Kazakhstan, and Uzbekistan. Model 4 replaces the REGIME variable by the more widely used POLITY variable. Finally, we compare our model with a 'state of the economy' model (Model 6) that includes all variables that we found significant excluding REGIME, and adds consumer price inflation (DCPI), budget deficit (BBAL), government spending (G), and reported unemployment. We speculate that increases in these new variables reduce the likelihood of EU application.

The key results of our baseline Cox regression model are that democratic institutions (REGIME) and time since crisis recovery (PASTCRIS) increase the likelihood of a country's EU application.[16] Per capita income (GDPC), *ceteris paribus*, reduces the odds of an EU application.[17] Neither including the EURO variable (Model 2) nor dropping the three countries from the sample (Model 3) changes our key results. We interpret this as meaning that even if Azerbaijan, Kazakhstan and Uzbekistan were geographically located much more in the West, they would not have applied.

The results of Model 4 show that a change in the operationalization of democracy (replacing the widely used POLITY data by REGIME) alters neither the results of the control variables nor the sign of the democracy variable. However, compared to REGIME, POLITY is statistically insignifi-

Table 3 Determinants of EU application: results from a Cox survival regression with time-varying covariates

	Model 1 Baseline	*Model 2 EURO*	*Model 3 –3 countries*	*Model 4 Polity*	*Model 5*	*Model 6*
Democracy						
REGIME	5.117	4.751	4.830			
	(1.633)	(1.558)	(1.575)			
	[4.002]**	[3.471]*	[3.552]*			
POLITY				1.580	1.587	
				(0.457)	(0.462)	
				[2.241]	[3.028]*	
PRESIDENT					2.083	
					(0.734)	
					[0.981]	
Time since transition crisis						
PASTCRIS	7.035	6.601	6.766	5.698	6.255	22.916
	(1.952)	(1.887)	(1.912)	(1.740)	(1.833)	(3.132)
	[6.952]***	[6.115]**	[6.500]**	[4.715]**	[5.691]**	[4.834]**
Country specifications						
GDPC	0.999	0.999	0.999	0.999	0.999	1.000
	(–0.001)	(–0.001)	(–0.001)	(–0.001)	(–0.001)	(0.000)
	[4.203]**	[3.746]*	[3.930]**	[2.925]*	[5.691]**	[2.952]*
EURO		0.000				
		(–9.077)				
		[0.001]				
XOPEN	1.048	1.046	1.047	1.034	1.045	1.102
	(0.047)	(0.045)	(0.046)	(0.033)	(0.044)	(0.097)
	[3.377]*	[3.059]*	[3.230]*	[1.917]	[2.481]	[4.451]**
DCPI						0.973
						(–0.027)
						[0.735]
BBAL						0.618
						(–0.482)
						[0.874]
UNEM						0.903
						(–0.027)
						[0.696]
G						0.797
						(–0.227)
						[1.153]
Initial –2 LL	[53.560]	[53.560]	[48.820]	[53.560]	[53.560]	[50.535]
–2 LL	34.757	34.594	34.636	34.871	33.881	27.677
Chi^2	18.803***	18.966**	14.184***	18.690***	19.680***	22.858***
N	105	105	81	105	105	77

Notes: The table reports the exp^betas, beta coefficients in round brackets, and the results of a Wald-test in square brackets. * = significant on the 10 per cent level; ** = significant on the 5 per cent level; *** = significant on the 1 per cent level.

icant. We interpret this result as suggesting that presidential systems are less likely to seek EU membership. MODEL 5 controls for this hypothesis by the inclusion of a dummy variable (PRESIDENT). Surprisingly, presidential systems seem to be more likely to apply for EU membership though the result is statistically not significant. More interestingly, however, once we control for presidential systems, POLITY becomes significant. There thus is little doubt that democracy increases the likelihood of market-driven policy reforms and also the odds for an EU application. Finally, as expected, Model 6 (which substitutes a number of 'state of the economy' variables for democracy) has low explanatory power and no indicator turns out to be significant though they all have the expected sign.

In sum, these results provide strong support for our theory, since they highlight the importance of democratic institutions. In addition, the period following the transition crisis (PASTCRIS) seems to be of greater explanatory importance than the severity of the crisis itself. The duration of the transition crisis in less democratic regimes tends to be twice as long as in true democracies and the crises are more severe in the former. True democracy therefore has a threefold positive impact on the likelihood of application: it tends to improve the economic stability of transition countries, it increases the willingness of governments to implement 'institution-building' regulatory reforms, and it accelerates the speed of the transition process.[18]

VI. CONCLUSION

Most students of EU enlargement seem to believe that given the enormous welfare gains of EU membership, all CEECs naturally desire to become full members. This belief is based on the erroneous assumption that governments are solely concerned with maximizing aggregate welfare. This is not necessarily so. We have argued in this study that, in order to understand why some CEECs have been eager to apply for EU membership while others have shown no such interest, we need a theory that clearly and fully specifies the incentives and constraints of political leaders in different types of regime. We have shown that, in the wake of the economic transition crises of the early 1990s, leaders in more democratic countries had a strong incentive to implement politically costly and protracted 'institution-building' reforms that constituted a natural stepping stone towards EU application. Leaders in less democratic regimes, who are not overly concerned with the general well-being of the population, felt less pressure to contemplate deep reforms. Their survival depended largely on the support of a few powerful interest groups that derived great economic and social benefits from the politico-institutional status quo. EU membership was decidedly unappealing to these leaders.

More generally, the aim of this study has been to complement extant supply-side theories of enlargement, which have examined the EU's motivation for accepting new members, with a demand-side theory of the political economy of enlargement. We thus hope to contribute to the building of a more comprehensive analytical picture of a historically highly significant process and to offer a coherent theoretical framework to guide future comparative research and case studies on enlargement.

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NOTES

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1 See Baun 2000, especially pp. 32, 46, 53–4, and 61.

2 Quoted in Lionel Barber, 'Brussels keeps shut the gates to the East', *Financial Times* (16 November 1995), p. 17.

3 The 'push' factor of migration, namely marked differences in the marginal productivities of labour and capital from one economy to another, will disappear (according to the factor–price equalization theorem) even in the absence of capital flows when free trade is allowed (Stolper and Samuelson 1941; Samuelson 1948). Perfect factor–price equalization, however, is not a necessary condition for migration to cease, for migration is costly. It involves separation from family and friends, acclimatization to a new cultural and linguistic environment, and sometimes even payment to smugglers. Rational expectations about improved domestic opportunities may thus suffice to dampen emigration pressures.

4 Baudoin Bollaert, 'L'Occident face à la misère de l'autre Europe', *Le Figaro* (22 November 1990), p. 4. See also Norbert Kostede, 'Igor Ante Portas', *Die Zeit* (14 December 1990), p. 13; Kuno Kruse and Brigit Schwarz, 'Neue Freiheit, Neue Grenzen', *Die Zeit*, Dossier (15 February 1991), pp. 13–15; J. Dempsey, 'Seven million may leave the Soviet Union', *Financial Times* (26 January 1991), p. 22; 'Poor men at the gate', *The Economist* (16 March 1991), pp. 11–12; Manfrass 1992: 389. The crisis proportion of such an influx becomes clear when this predicted number of refugees is compared with past averages. The yearly average net migration into the twelve EC countries was 161,400 for 1980–84; and 533,000 for 1985–89. This latter number is higher than usual owing to a rise in asylum applicants and mass migration of ethnic Germans into Germany (Coleman 1992: 449).

5 PHARE is the acronym for 'Pologne, Hongrie: Activité pour la Restructuration Economique'. TACIS stands for Technical Assistance to the Commonwealth of Independent States. For more details, see e.g. Kramer 1993: 221–6.

6 For details on the Europe Agreements, see e.g. Kramer 1993: 229–30. After the dissolution of Czechoslovakia, separate negotiations were conducted between the EU and the Czech and Slovak Republics.

7 Countries with more mature economies and stable polities are less likely to be a burden on the EU budget than poorer countries with fledgling political institutions.

8 Some observers question the partnership aspect of the relationship between the Community and the applicant states. Fritz Scharpf, for example, recently wrote: 'My concern . . . is with the Commission's role in imposing the *acquis* on new Member States that had no voice in its definition and whose economic and social conditions differ fundamentally from those of the Member States from whose self-interested bargains these rules had emerged. If they are enforced with all legalistic determination of which the Commission and Court are capable, the fragile economies of new Member States will be destroyed just as the East German economy was destroyed when the *acquis* of the West German legal order was imposed and enforced without modification' (Scharpf 2001: 2–3). Friction and accidents are bound to occur in the process of adoption of the *acquis*, but we see little general evidence supporting the view that this process has hurt the applicants more than it has benefited them. See also Elster *et al.* 1998: 188; Fisher and Sahay 2001.

9 The numbers measure FDI in Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia, Latvia, Lithuania, and Estonia.

10 The underlying game between individuals can therefore be described as a prisoners' dilemma.

11 'Truthful strategies', strategies which are pareto-efficient for the government as well as for all lobby groups, can be derived by maximizing the net welfare of all organized lobby groups and the support function of the government. This procedure suggests an outcome where wealth is redistributed from unorganized to organized parts of the population. The lower the degree of government benevolence, the more redistributive and the less welfare-enhancing a government's preferred policy.

12 It is surprising that the 'benevolence' of governments, λ, has never been endogenized in the political economic literature. Grossman and Helpman, for example, apply a similar model to trade policy and write: 'The incumbent government cares about the total level of political contributions and about aggregate well-being. The government values contributions, because they can be used to finance campaign spending and . . . they may provide other direct benefits to the officeholder. Social welfare will be of concern to the incumbent government if voters are more likely to reelect a government that has delivered a high standard of living' (Grossman and Helpman 1994: 838).

13 The economic data are from the Economist Intelligence Unit database, the political information is taken from Polity 4. The event data 'application to EU membership' was kindly provided by Frank Schimmelfennig.

14 We postulate this period leading up to application to be two to three years. A related theoretical justification for the insertion of such a variable in the context of policy reforms can be found in Alesina and Drazen 1991.

15 We borrow this variable from Schimmelfennig, this issue.

16 In a Cox regression analysis, a variable increases the likelihood that the event at issue happens, if the beta-exponent is larger than 1.

17 Since the EU applicants are the relatively rich Eastern European countries and since democracy and wealth go hand in hand in Eastern Europe, one might be tempted to conclude that the effect is caused by multicolinearity. However, removing POLITY and REGIME from the empirical model does not alter the results in favour of GDPC's significance (results not reported here).

18 It will be interesting to see how long it takes Yugoslavia to apply for EU membership now that a genuinely democratic regime is in place.

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