

In May 2004, Poland, Hungary, the Czech Republic, Slovenia, Slovakia, Malta, Cyprus, Estonia, Latvia and Lithuania joined the European Union bringing the number of its members to 25. In a not too distant future, this number may well reach over 30, as several countries in the Balkans, such as Romania, Bulgaria and Croatia, as well as Turkey are accepted into the fold of the EU.

Can the current European institutions and the Union itself survive the process of enlargement? Can the European Union maintain its democratic and social nature as it includes some of the poorest countries of the continent? Must the European Union reform its institutions in a more drastic way than what has been accomplished in the current constitutional draft? If so, how? Should the EU tighten its decision-making procedures or should it decentralize its policy-making mechanisms? Should a two-speed Europe be put in place? What are the institutional and social pre-conditions that must be met to sustain and deepen the process of European integration?

To answer these questions this paper anchors its analysis in current empirical democratic theory and applies the latter's theoretical propositions to assess the future development of the European Union. More specifically, this paper is built as follows. In its first section the paper surveys the set of social and economic conditions under which democracies (mainly understood as a decision-making procedure but also as an institutional structure associated with advanced welfare regimes) are politically viable. In the second section the paper applies these insights to describe the most appropriate constitutional arrangements to resolve political disagreements between territories that differ in the nature of their interests. To put it briefly, a central implication of this analysis consists in showing that the degree to which political actors, regions or, for that matter, countries can pool their resources and policy-making procedures together in a feasible manner is a function of the extent to which their interests (and, particularly, their standards of living) are relatively homogeneous. The third section then proceeds to use the preceding theoretical discussion to shed light on the case of the European Union. It accordingly outlines

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## The Institutional Accommodation of an Enlarged Europe

several of the consequences of the current enlargement and makes a few recommendations about the type of constitutional configuration that may be most adequate to sustain a working European Union.

### Democratic Theory

To determine which are the most appropriate procedures to govern the European Union, that is, to establish the extent to which its members may be willing to pool their resources and authority together, I first proceed to delineate the conditions under which a democracy is a viable system of government for a given territory and population.

Let me start by noting that a democracy consists of a procedure through which its citizens decide by casting a vote or a sequence of votes how to govern themselves - that is, what rules should bind their collective life, which should be the optimal distribution of assets and so on.

This mechanism of decision implies that, once a vote is conducted over a certain issue, the majority of the population determines the position (or welfare) of each member of the population and therefore of the minority that has not agreed with that majority. In other words, in a democracy the minority is subjected to the will of the majority.

If that is the case, that is, if in a democracy the minority remains at the mercy of the majority, it is plain that a democratic regime will only become possible if the minority nonetheless accepts the electoral outcome in which it participates. Now, since the definition and composition of the minority may vary with each issue or decision put to a vote, we can restate the same idea in more general terms. We will say that a democracy will only be possible if their participating agents accept the possibility that the outcome generated by a popular vote may differ from their most preferred alternative.

To shed more light on this question, consider it in a slightly more specific manner in the context of a representative democracy where two candidates compete for a given political office, i.e. the presidency of the state. After both candidates engage in an electoral campaign and voters cast their ballots, the candidate

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with most votes is proclaimed winner and therefore assumes the presidency. The loser must wait for new elections to be held in the future (after a given period of time) to have a chance to be elected. In the meantime, he has to accept the decisions and the policy program of the elected politician.

Notice that the electoral process carries no guarantees, in itself, that any of the two politicians will respect the terms and continuity of the procedure. The loser may abide by the election, accept the defeat and wait till the new electoral contest takes place. But, if it is too unsatisfactory for him to behave well, that is, if the current benefits of the office he is forsaking are too large, he is likely to denounce the results and eventually stage a coup to grab the presidency by non-electoral means. In turn, the winner may have as well an incentive to use her tenure of the presidency to shift resources in her favor to boost her future electoral chances, to alter the rules of electoral engagement and even to postpone or cancel the new election.

A stable or successful democracy, that is, the uninterrupted use of free and fair voting mechanisms to arrive at political decisions and to select public officials, will only take place if both the winner and the loser (or, if you will, the majority and the minority) have an interest in complying with the outcomes of the periodic votes they employ to decide how to govern themselves.<sup>1</sup>

Whether the political candidates, or, more generally, the citizenry, will comply or not with the electoral procedure will depend on the alternative value reported by each one of the political strategies they may follow. If the gain they expect to obtain from an electoral victory is larger than the net benefit they would accrue from rejecting the democratic outcome, they will accept the democratic game. Otherwise, they will contest the democratic procedure and try to curtail the space of policies in which the majority may govern. To put it differently, losers may abide by the election, accept the defeat and wait till the new electoral contest takes place. But, if it is too unsatisfactory for them to behave well, that is, if the current benefits of the office they are forsaking are too large, they will be likely to denounce the results and try to block the adoption of democratic procedures.

The protection of minority interests may be achieved through the introduction of vote aggregation procedures that curb down the powers of the majority. Those mechanisms may take many forms: redistricting, the overrepresentation of certain constituencies in par-

liament, the use of plural voting, a second chamber in the hands of the minority, the distribution of powers to different territorial units and so on. More radically, the losers of elections may attempt to establish an authoritarian regime.

The extent to which all citizens will accept or reject the democratic order is a function of two things. In the first place, the smaller the differences in ideal policy positions between majority and minority, the higher the incentives everyone will have to comply with the democratic outcome since the losses experienced by the minority will tend to be negligible. The variance in policy preferences may have different sources.

It may reflect diverse interests over the distribution of wealth in a given economy. The distribution of income may affect the chances of introducing and sustaining a democratic regime as follows. A more unequal distribution of wealth increases the redistributive demands of the population and the ultimate level of taxes in a democratic system. As the potential level of transfers becomes larger, the authoritarian inclinations of the wealthy increase and the probabilities of democratization and democratic survival decline steadily. Conversely, as the less well-off grow richer and their income becomes closer to that of high-income voters, economic tensions decline, and the rich are increasingly inclined to accept a democratic regime - elections have a marginally minor impact on the wealthy's consumption level.<sup>2</sup>

Preferences may vary also according to religious and ethnic preferences - as fragmentation along those lines increases, heterogeneity should go up as well, and the chances of democracy should decline.<sup>3</sup>

In the second place, the likelihood of a stable democratic outcome will increase with the costs of overturning democracy - in more general terms, the probability of a stable democracy will rise as the political and organizational resources of both the majority and the minority become more balanced.

2 This insight is proved more rigorously, both formally and empirically, in Boix 2003. This book also shows that, in addition to growing equality, democracy is fostered by a decline in the extent to which capital becomes either more mobile or harder to tax (or both). As the mobility of capital increases, taxes rates necessarily decline since otherwise the capital holder would have an incentive to transfer his assets abroad. Similarly, whenever capital can be easily hidden from the state or it becomes of a kind that can only be used by its owner, the temptation to confiscate it also declines. As the redistributive pressures from non-capital holders on capitalists diminish, political conflict levels off and the likelihood of democracy rises.

3 As shown in Boix 2003: 83-84, although religious and ethnic heterogeneity have a negative on democratization and democratic consolidation, their impact is much lower than income inequality.

1 On democracy as a self-enforcing mechanism, see Boix 2003. Przeworski 1991 and Weingast 1997.

## Federalism and Secession

Having sketched the conditions under which a democratic regime is feasible, I now turn to explore the implications for the joint governance of several territories that differ in preferences and income levels. This should lay down the basis for a discussion of the prospects of the European Union, its future enlargement and the choice of its governing institutions.

## Territorial Divergence and Economic and Political Unions

Assume a continental area with two regions or countries, *A* and *B*, which entertain the possibility of establishing some kind of economic and political union. Whereas *A* is a rich region, that is, most of its inhabitants and, particularly, its median voter, are wealthy, region *B* is a low-income region and most of its inhabitants are relatively poor. If the two regions decide to integrate their economies, they will pool both their assets and their economic authority. Asset-pooling implies that the two states will agree to reduce or remove barriers to exchange that exist between them. They will also establish an institutional procedure in which their populations vote together over policies that affect both regions. If we further assume that *B* has a larger population than *A*, once the two regions decide to join in a single country, the electoral majority would be in the hands of low-income voters. Accordingly, the latter (and specially *B* voters) could impose high taxes on the wealthy individuals and, particularly, on region *A*.

Integration will happen whenever the *net* benefits of the union are positive for the two regions involved. On the one hand, there are two types of benefits that should push them to vote for integration: economic or trade gains, which result from their specialization in the production of particular bundles of goods; and peace gains, which accrue to them as a result of a reduction of the military threat that each region poses to the other one or as a result of *A* and *B* pooling their army and military resources to balance against a third territory, *C*. As is well known, these types of benefits underlie most of the existing theories explaining the current process of European integration.<sup>4</sup> As trade and peace gains increase, the incentives to integrate go up. Notice that those gains are relative to the level of trade integration and peace at the world level. For example,

as trade integration at the world level goes up, the incentives to achieve trade integration through an institutional mechanism specific to the two regions of our example declines since the latter do not need to establish any particular joint institutions to secure a level of trade openness (or military cooperation) that is already in place at the continental or world level.

On the other hand, integration comes at a cost, particularly for the would-be minority territory. It gives the poorer region the capacity to engineer significant transfers from the wealthier to the less developed territories. The degree to which those transfers will be set up will vary with the income differences across regions. The more divergent the standards of living across countries, the higher the incentives of low income voters to tax the richer areas (or to establish common regulations to homogenize the distribution of wealth). The threat of more redistribution reduces the willingness of richer regions to join into an economic and political union with less developed areas. Accordingly, as the differences between territories (regions in a nation or countries in a continent) increase, integrating the latter under a common state, that is, inducing everyone to pool their assets and authority under a joint decision-making organization, should be harder.

## Decentralization as a Partial Solution

If the costs of taxation exceed the benefits of trade and peace to the point of deterring one or more territories from joining the union, a partial solution to achieve some form of integration would consist in limiting the degree to which all the regions pool their assets and authority together. This strategy would imply maintaining most political decisions in the separate hands of each region that joins the union and then enumerating, in a relatively strict manner, the policy domains (such as free movement of labor and capital) in which common decisions are taken and the procedures according to which they should be taken.

To put it differently, as the level of heterogeneity rises, and holding constant trade and peace gains, the level of political decentralization (and the strength of the guarantees to be given to every territory vis-a-vis the other members of the union) should rise to make the political and economic union feasible.

Naturally, this is a partial solution since although the low-income regions would rather have this type of weak union to no union at all, they would prefer complete political integration (with tax and transfer powers in the hands of all the union) over any other alternative constitutional arrangement.

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<sup>4</sup> On economic explanations of European integration, see Moravcsik 1998 and Mattli 1999. For a security-driven account, see Rosato 2004.

Table 1: *Observed Probability of Democratic Breakdown by Federalism and Economic Conditions, 1850-1990*

	<i>Non-Federal Systems (In parenthesis: Parliamentary regimes)</i>			<i>Federal Systes (In parenthesis: Parliamentary regimes)</i>		
	<i>Annual Observations</i>	<i>Observed Failures</i>	<i>Probability of Breakdown<sup>a</sup></i>	<i>Annual Observations</i>	<i>Observed Failures</i>	<i>Probability of Breakdown<sup>a</sup></i>
<i>Per Capita Income US \$ of 1985 (1850-1990)</i>						
0-1,999	397 (203)	25 (13)	6.30% (6.40%)	97 (67)	3 (0)	3.09% (0.00%)
2,000-3,999	690 (518)	14 (7)	2.03% (1.35%)	163 (93)	3 (1)	1.84% (1.08%)
4,000-5,999	283 (246)	1 (0)	0.35% (0.00%)	148 (87)	2 (0)	1.35% (0.00%)
6,000-7,999	191 (173)	0 (0)	0.00% (0.00%)	96 (63)	1 (0)	1.04% (0.00%)
8,000 and over	340 (316)	0 (0)	0.00% (0.00%)	185 (133)	0 (0)	0.00% (0.00%)
Total	1,901 (1,456)	40 (20)	2.10% (1.37%)	689 (443)	9 (1)	1.30% (0.23%)
<i>Average Percentage of Non-Agricultural and of Urban Population (1850-1980)</i>						
0-24.9	125 (78)	11 (7)	8.80% (8.97%)	39 (28)	1 (0)	2.56% (0.00%)
25-49.9	599 (426)	18 (7)	3.01% (1.64%)	234 (143)	1 (0)	0.43% (0.00%)
50-74.9	447 (377)	1 (1)	0.22% (0.27%)	284 (195)	5 (1)	1.76% (0.51%)
75-100	63 (63)	0 (0)	0.00% (0.00%)	17 (11)	0 (0)	0.00% (0.00%)
Total	1,234 (944)	30 (15)	2.43% (1.59%)	574 (377)	7 (1)	1.22% (0.27%)
<i>Gini Index (1950-90)</i>						
Above 50 %	47 (24)	2 (0)	4.26% (0.00%)	15 (0)	1 (0)	6.67% (0.00%)
35% - 50 %	270 (165)	6 (2)	2.22% (1.21%)	89 (63)	0 (0)	0.00% (0.00%)
Below 35 %	162 (151)	0 (0)	0.00% (0.00%)	93 (67)	0 (0)	0.00% (0.00%)
Total	479 (340)	8 (2)	1.67% (0.59%)	197 (123)	1 (0)	0.51% (0.00%)

<sup>a</sup> Ratio of observed failures to annual observations.

The introduction of politically decentralized institutions to manage inter-territorial differences is not exclusive of potential international unions. It is well extended among countries that exhibit some non-negligible degree of inter-territorial heterogeneity. Political and tax decentralization are rather straightforward strategies to stabilize democracy in territorially diverse countries (Beramendi 2003). Again, in the presence of considerable income differences across territories, a completely centralized policy authority fuels political tensions and makes those populations concentrated in the richer areas more likely to contest democracy. The political resistance of the latter should decline as political and fiscal sovereignty is devolved to smaller units – although political demands for more centralization may probably increase among the majority.

Table 1 shows the probability that a democracy will break down as a function of its social and economic conditions (per capita income, level of urbanization and industrialization, and income inequality measured

through the Gini index) and of the type of constitutional arrangement, either federal or unitary, in place. The data are collected for the period between 1850 and the late 20<sup>th</sup> century and consist of country-year observations about the type of regime in place and the number of democratic breakdowns that occurred over that period. The probability of democratic breakdown is then calculated as the ratio of the total number of cases of democratic breakdown over the total number of annual observations of democracy of the universe under analysis.<sup>6</sup> The table also shows, in parenthesis, the data for parliamentary (as opposed to presidential) regimes.

<sup>6</sup> The definition of democratic political regime is taken from Boix / Rosato 2001). All sovereign countries from 1800 to 1999 are coded there as either democratic or authoritarian. Countries are coded as democracies if they meet three conditions: elections are free and competitive; the executive is accountable to citizens (either through elections in presidential systems or to the legislative power in parliamentary regimes); and at least 50 percent of the male electorate is enfranchised.

By level of per capita income, federalism works much better in countries whose per capita income is below \$4,000. Between \$4,000 and \$8,000, federalism is slightly worse, basically because the data reflect the Argentinian crises of 1962, 1966 and 1976. Above \$8,000 the type or territorial structure has no impact. Notice that among parliamentary systems federalism is much more stable than unitary systems – there is only one democratic breakdown. The same pattern of higher stability among federal systems emerges for different levels of urbanization and industrialization. At high levels of inequality (a Gini above 50 percent or few family farms), the probability of breakdown is slightly higher in federal systems. Yet for middle levels of inequality, democratic breakdowns fluctuate around 2 percent in non-federal countries against 0 percent in federal systems. Again, the most stable regime, with very few or no breakdowns, is one that combines federalism and parliamentarism.

## The European Union

Let us now examine the extent to which the previous discussion on the feasibility of democratic regimes and on the use of federal structures may have any bearing on the governance of European institutions.

### Economic and Political Integration at the World Level

Differences in per capita income across the globe are extraordinary. Figure 1 shows the distribution of world population according to average per capita income of the country where they lived in 1993. If we apply the insights of the previous section, three facts stand out.

In the first place, the incentives to establish a single political union at the world level (with a roughly democratic procedure of a majoritarian bent) are simply absent, at least among developed countries.

In the second place, if all countries were to unite under a single political authority, democracy, that appears to be sustainable in separate countries with different income levels (provided each one of them is internally homogeneous and politically independent), would simply collapse. The world Gini index in 1993 was 66 percent – equal to the maximum national Gini across the world since 1950.<sup>7</sup> In a unified country, such

wide disparities of income would engender harsh political tensions and lead to the introduction of an authoritarian system or to violent revolutionary explosions. According to the estimations I have made elsewhere, in a country with a Gini index of 66 percent, the *annual* probability of a transition to democracy is 0 and the annual probability of an authoritarian coup is 0.76 (Boix 2003: 156).

In the third place, democracy survives in part of the globe as a result of a system of territorially divided sovereignties. Today's system of separate nations makes sure that the 'South' does not effectively impose redistributive mechanisms on the 'North'. The lack of truly unified supranational institutions in fact secures the maintenance of stable democracies in the developed world as well as in certain developing countries. Similarly, the survival of relatively democratic regimes in the North Eastern and Western areas of the United States in the 19th century was dependent on the maintenance of a de facto confederate system - where states enjoyed nearly complete sovereignty over taxes and the legality of slavery. With a very centralized state, those units would have been affected by the harsh inequalities of the South and a democratic system would have been harder to sustain. Indeed, it was the assertion of the federal government, under an administration opposed to slavery, that led to the American civil war.

### Regional Integration

Political integration, which seems impossible at the world level, may still be feasible among certain subsets of countries, provided they at least meet two conditions: first, that sufficient trade (and security) gains can be derived from their union; and, second, that their living standards are relatively similar and so the level of internal conflict under the union may be managed with little difficulty.

It is worth stressing again the importance of the second condition (i.e. relative income homogeneity) to secure trade agreements and political and economic integration for the following reason. Traditional trade theory predicts free trade (and, accordingly, the creation of some joint institutions to oversee and sustain it) particularly among countries that can realize substantial trade gains, that is, among countries that are very dissimilar because they are specialized in different types of industries. By this token, we should see numerous North-South or developed-developing integration schemes because the factor endowments of the two areas are so dissimilar that all customers should

<sup>7</sup> Figure 1 and the world Gini index are taken from Milanovic 1993. The maximum Gini index (of 66.43) corresponds to Zimbabwe in 1990 according to Deininger / Squire 1996.

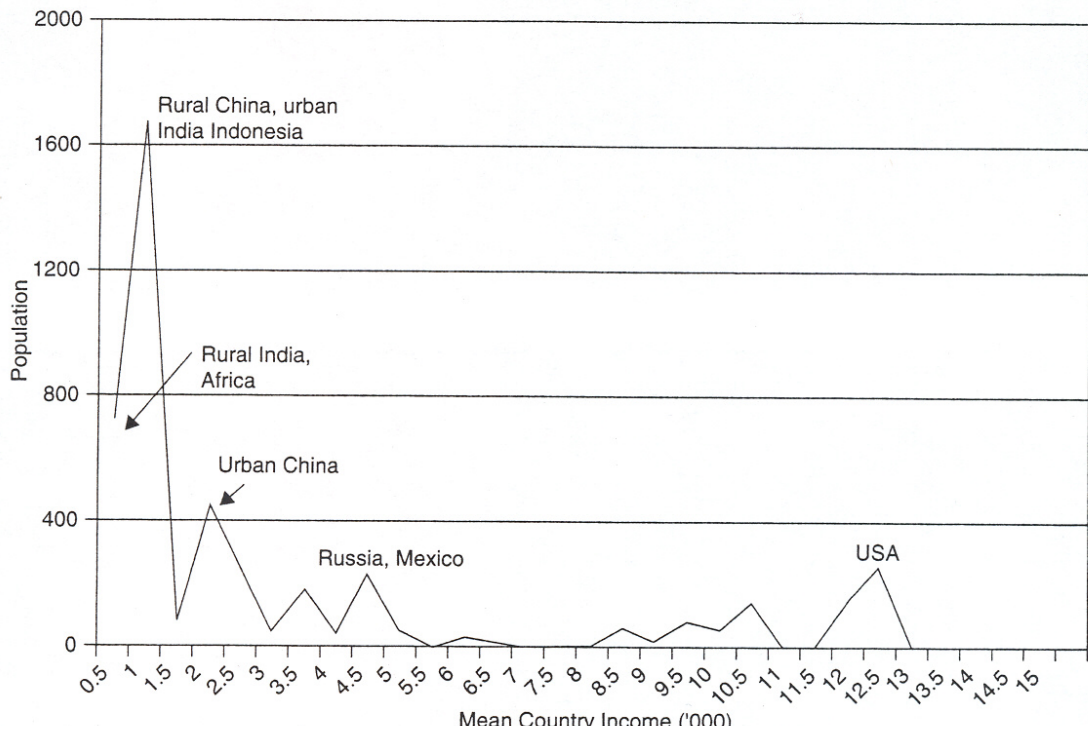


Figure 1: Distribution of Population according to Average Per Capita Income of Country of Residence

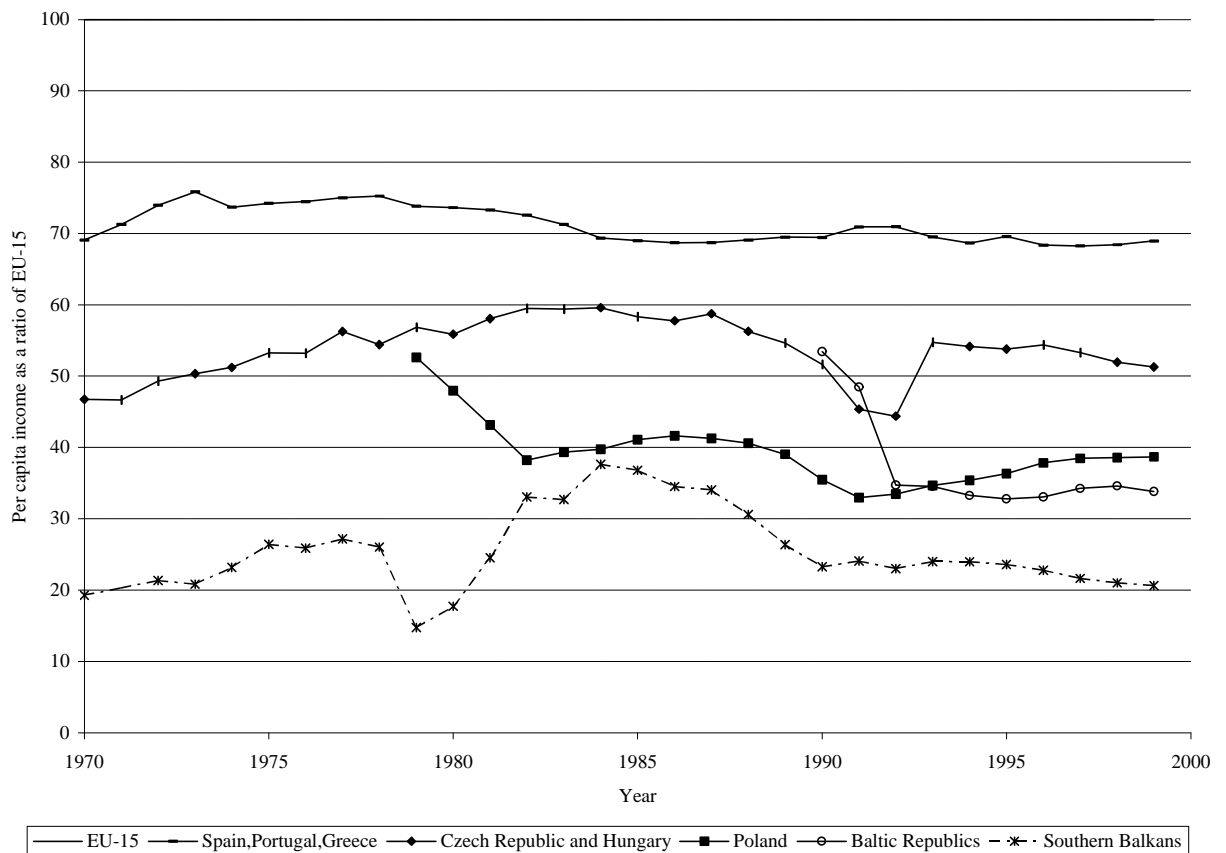


Figure 2: Per Capita Income in Selected European Countries, 1970-99

gain from the creation of a common market. Yet, with the exception of NAFTA, the prediction of standard trade theory is not born at all. The only possible reason is that the very dissimilitude in factors and industry types that exists between countries would lead to strong distributional imbalances and harsh inter-territorial pressures in the context of a joint political structure. This would in turn push public opinion, especially in rich countries, to block any free trade or integration arrangement or, at least, to make it as loose or decentralized as possible.

Table 2: Regional Gini coefficients in 1993  
(distribution of persons by \$PPP income per capita)

Africa	47.2
Asia	61.8
Latin America and Caribbean	55.6
Eastern Europe and Former Soviet Union	46.4
Western Europe (EU-15)	32.4

Source: Calculated based on the data set "Household survey data used to derive the first 'true' world income distribution - version-1," gathered by Branko Milanovic at the World Bank and available at <http://www.worldbank.org/research/inequality/data.htm>. The regional Gini index is calculated by treating each individual equally - simply as an inhabitant of that region

Holding peace and trade gains constant, income differentials across countries should be a good predictor of the chances of building supranational democratic bodies in each area. Table 2 displays the Gini index for several regions in the world in 1993. The level of income inequality ranges from a Gini of 61.8 in Asia to a Gini index of 32.4 in Western Europe. In line with the theory just considered, Western Europe, that is, the continental area that exhibits the lowest level of income differences across its countries, has been the only region where there has been a sustained process of political integration in the last four decades.

## European Integration

What are the implications of the theory for the European Union, its expansion and its internal constitutional structure? Consider first the evolution of living standards among EU members. Figure 2 shows the evolution of per capita income across several European countries from 1970 to 1999 as a proportion of the average income of the current members of the Euro-

pean Union. Greece, Portugal and Spain, which joined in the mid eighties, have a per capita income of about 70 percent of the EU average. All the new countries that either will become members in 2004 or have applied or plan to apply for membership have much lower standards of living. Per capita income in the most advanced countries, such as Hungary and the Czech republic, stand at between 50 and 60 percent of the European average. In Poland and the Baltic republics, per capita income does not reach 40 percent of the European average. The difference is even more abysmal among western Balkan states: their per capita income is equal to about a fifth of the European Union average.

Table 3: Income, Inequality and Poverty in the EU

	Popu- lation (a)	Aver- age income	Median income	Gini index	%Low income (b)
EU-6	222	9,326	7,892	31.0	12.5
EU-9	289	9,343	7,892	32.1	14.2
EU-12	348	8,633	7,166	34.2	19.9
EU-15	370	8,622	7,274	34.2	19.9
EU-25	444	7,685	6,231	38.0	29.6
EU-27	476	7,314	5,959	39.9	33.3
EU-28	535	6,793	5,426	42.3	38.5
EU-28+	550	6,662	4,973	43.0	40.0
EU-28++	620	6,138	4,633	45.4	45.6
USA	258	12,381	9,924	39.4	10.0
Australia	18	9,083	7,600	34.5	10.0
Canada	29	11,716	10,082	31.0	10.0
India	901	521	443	32.8	100.0

(a) in millions; (b) income below 50% median of EU-6

EU-27: EU-25 + Bulgaria and Romania;

EU-28: EU-25 + Bulgaria and Romania and Turkey;

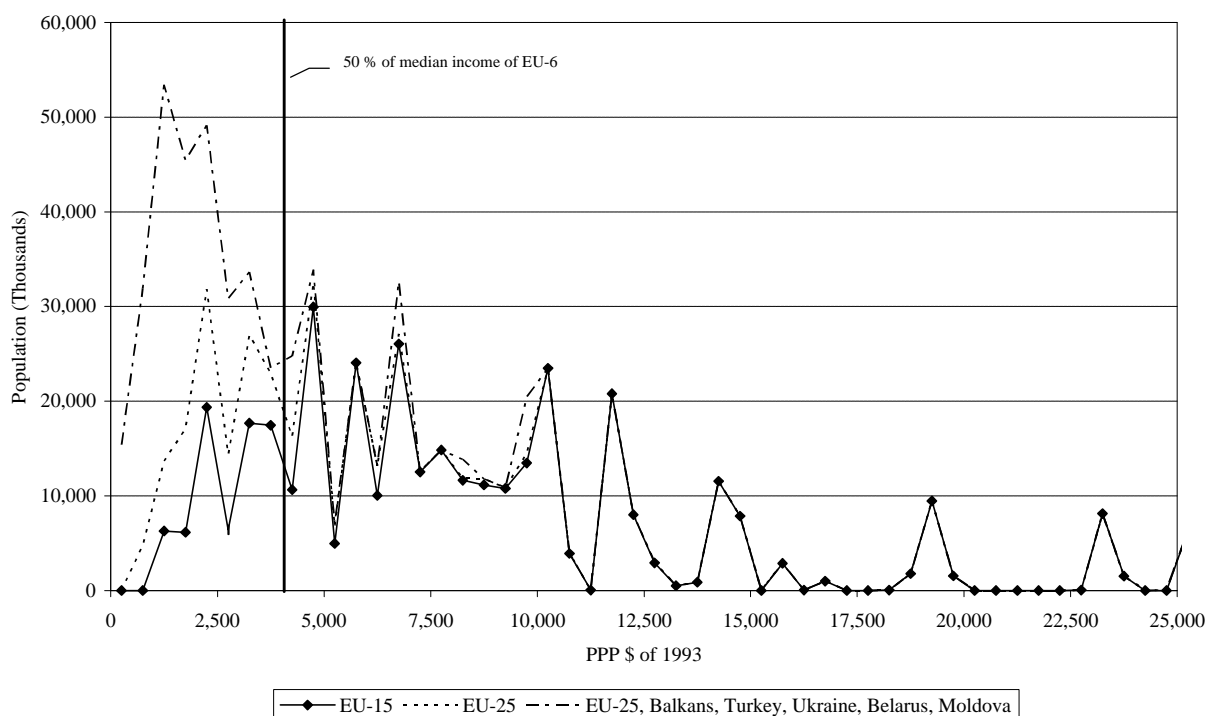
EU 28+: EU-28 + Western Balkans

EU 28 ++: EU-28 + W. Balkans + Belarus + Ukraine + Moldova

Source: Calculated based on the data set "Household survey data used to derive the first 'true' world income distribution - version-1," gathered by Branko Milanovic at the World Bank and available at <http://www.worldbank.org/research/inequality/data.htm>.

Examine next the actual distribution of income among European individuals. Using World Bank data, I calculate and report in Table 3, measures of per capita income and inequality for past (EU-6, EU-9, EU-12,

Figure 3. Distribution of Population by Per Capita Income  
(in each \$500 segment)



EU-15), present (EU-25) and potentially future European Union areas. Table 3 shows the average and median average income, the Gini coefficient and the percentage of low-income population. Low income is defined as any income below 50 percent of the median income of EU-6. For purposes of comparison, Table 3 also reports measures for four other big federations in the world: the United States, Australia, Canada, and India.

Inequality in the European Union remained relatively low until the entry of Southern European countries in the mid 1980s. The Gini index grew slightly from 32 percent to 34 percent at that time and did not change after the entry of Sweden, Finland and Austria. With the last enlargement, the Gini index has risen to 38 percent and the percentage of low-income people has jumped to almost 30 percent of the population.

Any new enlargement should lead to even higher levels of inequality. The entry of Bulgaria and Romania would push the Gini index upward to a higher level than the United States. It would also increase to about a third the proportion of the population with low incomes, or about three times the percentage in the United States. The entry of Turkey and western Balkan countries puts the Gini at 43 percent – higher than the Philippines or Venezuela and close to Nigeria. Inequality and poverty are even more extraordinary in an expansive concept of Europe that includes Ukraine, Belarus and Moldova: almost 50 percent of the population

would live under poverty and the Gini index would reach 45.4 percent. Figure 3 reinforces this fact by showing the distribution of the population by income level in EU-15, EU-25 and the broadest definition of Europe (without Russia).

In the light of the theory employed in the paper, the integration of less developed countries cannot but have substantial consequences for the European Union. Unless the trade and security gains of any new enlargement wave are considerable, the European Union will be forced to delay any plans for tighter institutional integration. New enlargements may even result in a movement toward relatively more decentralized structures of power. This latter solution may adopt different forms. It may simply consist of passing new clauses that give additional voting powers or jurisdictional guarantees to certain countries in the Union. More radically, it may finally press European politicians to embrace a two-speed institutional structure.

### Conclusions and Policy Recommendations

The European Union is the result of the decision by several European countries to establish a common economic area overseen by joint political institutions. This decision is in turn the result of at least two conditions: first, the realization that European countries can accrue significant trade and security gains through the



construction of a union; and, second, the fact that differences in standards of living are not excessive and that a political and economic union should not result in inordinate transfers from the wealthy to the poor countries.

The level of political and economic integration of the European Union, that is, the degree of asset- and authority-pooling, has been far from perfect or complete. This may partly be due to the absence of a commonly perceived idea of European citizenship or legitimacy among European citizens. But it is mostly the result of a diversity of interests that, as in any other federal or federative system, call for the maintenance of barriers between its state members.

As a matter of fact, the success of the European Union in part derives from the decision made by its members to establish a relatively 'soft' set of overlapping institutions (the European Commission, the Council of Ministers, the European Parliament, the European Court of Justice) in line with the relative degree of internal heterogeneity of the Union. Those institutions are 'soft' in the sense that the set of policies over which they can act is limited (although growing as a result both of new treaties among the states that form the Union and of some policy and institutional spillovers). They are overlapping in that more than one of them are required to make fundamental policy decisions affecting all the members of the Union. Although these two characteristics make them prone to the criticism that the European Union suffers from some sort of 'democratic deficit', they are the best guarantee that none of the states will impose its interests over the rest of the members of the European Union. This guarantee in turn ensures that all members have an incentive to maintain their commitments to the Union.

The enlargement of the European Union imposes clear limitations on the extent to which Europe can push for deeper levels of integration or establish more centralized structures in the short and medium run. At a time when the heterogeneity within the European Union is growing, any attempt to make the pooling of assets and authority much more complete could jeopardize the whole project of European integration. Tied up by the growing diversity of interests at the continental level, the most likely horizon is one in which the Union will hardly move away from its current institutional status quo. A possible, although less probable, outcome would consist in the creation of a two-speed Europe, which would again put in place significant barriers between the core and the periphery of Europe.

To speed up the process of economic convergence and then achieve a deeper political integration of Europe, the European Union could consider two alternative strategies. On the one hand, it could raise

native strategies. On the one hand, it could raise the volume of funds to be transferred to incoming members to accelerate their growth rates. This redistributive strategy faces, however, two problems: first, it looks politically unfeasible since any transfer scheme of significant size would be met with the resistance of the European core of wealthy nations; second, it seems economically ill-advised since the European structural funds spent on the countries that joined the Union in the 1980s do not appear to have sped up the former's economic catch-up with the European core in any considerable manner. On the other hand, the Union could press the incoming members to rapidly modernize their political and institutional infrastructure. This should then make them attractive to European business, quicken the flow of capital from Europe's core to its periphery, and result in higher levels of economic convergence in the medium run. Only then it would be possible to push forward any stronger federation scheme.

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## **The Institutional Accomodation of an Enlarged Europe**

**T**his paper examines the impact that the process of enlargement may have on European Union institutions in the light of both current democratic theory and the literature on the political economy of trade.

The paper assumes that any set of countries will only establish a continent-wide economic and political union if they all benefit in net terms from jointly pooling together their economic assets and political authority. On the one hand, the gross benefits of integration increase with trade and peace gains. On the other hand, integration comes at the cost of losing political sovereign.

With complete political integration, the most populous countries can establish regulatory mechanisms on the smaller nations. Thus, the more divergent the standards of living and the distribution of interests and preferences across countries, the more burdensome a political union will be for would-be minority territories and integration will be harder to achieve.

If the costs of taxation and regulation exceed trade and peace gains to the point of deterring one or more countries from joining a union, a partial solution to achieve some form of integration would consist in limiting the extent to which all countries pool their assets and authority together. More generally, holding trade and peace gains constant, the depth of political integration would be correlated with the homogeneity in income and interests of the potential members of the union.

These insights can be applied to the evolution of the EU. Employing recent data on income distribution, the paper shows, in the first place, that the relatively low level of inter-state inequality in Western Europe explains why this is the only region at the world level where there has been a sustained process of political integration in the last four decades. The paper investigates, in the second place, how this relatively homogeneous distribution of income may change as the EU expands. The paper estimates that the level of inequality has increased from low levels (a Gini index of 32 percent for EU-9 and 34 percent for EU-15, similar to Canada and Australia respectively) to much higher levels (a Gini of 38 percent for EU-25, close to the United States' Gini index). If the EU proceeded to include the Western Balkans and Turkey, the Gini would shoot upwards to about 43 percent.

Based on these results, the paper concludes that, unless the trade and security gains of any new enlargement are very substantial, the EU will not achieve any tighter institutional integration and, in fact, may have to accept more decentralization in the future. The paper ends by exploring possible strategies to reduce income heterogeneity and increase political integration in the medium run.