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Consequences of Reversing the European Union Integration

Jacek Kugler and Ali Fisunoğlu

Claremont Graduate University

and

Birol Yeşilada

Portland State University

Today, financial crisis once again threatens the unity among member states and future of the European Union. The magnitude of the problem is so grave that observers and analysts have concluded a big decision must be made regarding fiscal union (thus political union) to save EMU. "Is this really the end of the road for Eurozone?" Using Power Transition theory, our analysis shows that trust and relative political capabilities are essential to build a stable Union. While it is clear that the center of global politics is shifting away from Europe and the United States to the Asian giants—the transition from West to East can be effectively planned so that the future units are satisfied with each other rather than distrustful, dissatisfied, and contentious. The slowdown of integration is not simply a regional problem with serious consequences for the economic stability of Europe. Far more importantly, our analysis suggests that the process of integration that has reduced tensions within a region previously characterized by major wars may be declining and that this in and of itself could reset the stage not only for regional confrontations but increase the likelihood that global wars may once more be considered as means to solve disputes. The European Union cannot afford to move from the cooperative contest to a confrontational one where solutions are arrived at by force rather than reason. Therefore, the challenge for European leaders is to resolve the current crisis in the EMU and build upon it a reinvigorated union that once more provides a path for complete regional integration.

Today, financial crisis once again threatens the unity among member states and future of the European Union. The magnitude of the problem is so grave that observers and analysts[1] have concluded a big decision must be made regarding fiscal union (thus political union) to save EMU. On November 26, 2011 *the Economist* published that unless Germany and the ECB moved quickly, the single currency's collapse was looming on the horizon. For the last year and a half, the talk of the town has been nothing but "Is this really the end of the road for Eurozone?"

Response of EU members to current financial crisis has been less than unanimous. At the European summit of January 2012, 25 of the EU's 27 member

[1] For a detailed discussion of this crisis, see proceedings of the conference on *Redefining European Economic Governance* in College of Europe, Bruges March 1, 2012.

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states, led by Germany, agreed to join a fiscal treaty to enforce budget discipline. As expected, the Czech Republic and the UK refused to sign up calling into question the future stability of the agreed arrangement. The goal is for a much closer coordination of budget policy across the European Union to prevent excessive debts accumulating. The new treaty will empower the European Court of Justice to monitor compliance and impose fines on rule-breakers. It also enhances the role of the European Commission in scrutinizing national budgets. At German insistence, the treaty for the first time empowers the European Court of Justice as the enforcer of fiscal rectitude in the Eurozone, makes it possible to levy quasi-automatic fines against countries in persistent breach of the new rules, and obliges all Eurozone countries to introduce binding legislation or constitutional amendments abolishing governments' rights to run up excessive levels of national debt. Although it is far short of a fiscal union in a federal sense, this new agreement is hoped to stabilize market fears about future fiscal discipline in the European Union and put member states back on track in achieving economic and monetary union. This treaty led to important decisions at the meeting of the Finance Ministers on December 13, 2012 to establish a banking union for the European Union. While it fall short of a full-blown fiscal union and that the EU heads of government still need to finalize the deal, the agreement aims to put around 200 of the biggest banks under the direct oversight of the European Central Bank, which will act as chief supervisor of Eurozone banks (*Financial Times*, December 13, 2012). The agreement represents the first stage of a banking union—known as a Single Supervisory Mechanism (SSM)—which EU leaders believe can be put in place without having to change EU treaties. Under this plan, the European Central Bank becomes responsible for the overall running of the SSM and will work in close cooperation with other supervisory authorities in member states and the EU-wide European Banking Authority (EBA). The EBA creates banking rules across all 27 member states. However, once again, the UK, which is not in the Eurozone, will not be joining the banking union but obtained some protection against being marginalized when key decisions are taken.

Given the gravity of problems facing the EU, the objective of this paper is twofold. First is to assess the magnitude of policy challenges facing member states and second to show consequences of inaction on EU's global statues vis-à-vis other major economies. For the latter query, we will explore to what degree the relative size of member states affects their capacity to support integration and to what degree the level of trust in the European Union helps advance integration. These two questions would help us understand the probability of moving forward with a serious political union while maximizing EU's ability to achieve its global objectives.

The Magnitude of Current Crisis

The European Union provides the most interesting argument in favor of integration. The expectation is that members of such a community will grow faster and become more competitive largely due to economies of scale. In today's competitive economy, societies that do not take advantage of all the opportunities are likely to fall behind and be unable to maintain continuous growth in the face of competitors with much larger markets and investment potential. The second argument is that integration reduces the likelihood of conflict among agents because they provide a modicum of consistent rules, make each component dependent on the others, and presumably increase the level of trust among participants.

Whereas the European Union represents the most successful and complex form of regional economic and political integration between sovereign member states, it is faced with the most severe financial crisis of its history that threatens the very existence of the Union. Moreover, the EU's bold leap forward into EMU failed to make it the leader of global economy. In its Lisbon declaration of 2000 (European Commission 2000), European Union set ought "to become the most competitive and dynamic knowledge-based economy in the world" by 2010. There is no denial that this goal has failed. Not only targets of the declaration have not been met, the European Union has fallen further behind the United States, while both China and India economies continue to make steady progress to become larger than the European Unions in the next 20–30 years. Problems facing the European Union are product of its unique approach to regional economic integration that span 60 years of intergovernmental and supranational mix of policymaking.

Throughout its history, the European Union has followed a continuing, though irregular, course of integration. It has been a course that has always found a middle way between integration that is strictly economic in nature and integration that is strongly political, and it has, with each integrative step, brought institutional changes representing compromises between the principles of intergovernmentalism and supranationalism. The outcome of their collective efforts was the completion of the Common Market (Single Market) in 1992 that met the original intent of the Treaty of Rome. However, complex internal and external challenges that EU member states faced convinced them to take the next logical step in economic integration—Economic and Monetary Union. It is beyond the scope of this paper to dwell into the factors behind EMU. It should suffice to note that when European leaders launched EMU, they were responding to problems associated with what Benjamin Cohen termed the problem of Unholy Trinity (Cohen 2000:251):

> [In] an environment of formally or informally pegged rates and effective integration of financial markets, any attempt to pursue independent monetary objectives is almost certain, sooner or later, to result in significant balance-of-payments disequilibrium and hence provoke potentially destabilizing flows of speculative capital. To preserve exchange-rate stability, governments will then be compelled to limit either the movement of capital (via restrictions of taxes) or their own policy autonomy (via some form of multilateral surveillance or joint decisionmaking). If they are unwilling or unable to sacrifice either one, then the objective of exchange-rate stability itself may eventually have to be compromised. Over time, except by chance, the three goals cannot be attained simultaneously.

Indeed, the impossibility of balancing three legs of monetary policy led to speculative attacks on exchange rates within the Exchange Rate Mechanism (ERM) and caused *havoc* in financial markets. Having experienced the horrific results of Black September of 1992, majority of EU leaders at the time sought to secure monetary stability by pushing ahead with EMU in accordance with a provision in the Maastricht Treaty Article 109G and the subsequent Delors Plan for EMU. Yet, this latest phase that followed the signing of the Maastricht Treaty sets the course for EMU with a much lesser degree of political union between member states (Padoan 2002). In addition to this, the reluctance and, in some cases, opposition among some members to deepening political union resulted in a lopsided regional integration characterized by (i) EMU among 17 member states, (ii) Economic Union between all members, and (iii) intergovernmentalist political union.

Debate over the need of a fiscal, thus deeper political union remained. Two schools of thought characterized the nature of the debate during the 1990s in the European Union. According to one school, monetary union could not survive in the long run unless a strong political union accompanied it and cited numerous historical cases to support its position. Going as far back to work of

Riker (1964) in his powerful analysis of the rise of a federated United States argued that confederations couldn't succeed unless there are continuous positive gains for the members. Indeed, he showed that the United States confederation collapsed when taxes were to be imposed on the US population. In a similar manner, this is the type of crisis that the European Union faces today.

1. Are EU members willing to support others?
2. What are the limits of national as opposed to European actions?
3. What are the consequences of the weakening or disintegration of the European Union?

The second school of thought maintains that the present degree of political union in the European Union is sufficient for the long-run survival of the monetary union and that there is no urgency of creating a federal structure in the Union similar to one found in the United States. As De Grauwe (2009) correctly states, debate between these two views about the link between political and monetary union is somewhat difficult by a lack of clarity about the meaning of political union. One can look at a monetary union as a union between countries that use the same currency and have a single monetary authority (central bank). However, a political union is much more difficult to define. It involves several key policy issue areas and institutions of governance that could cover foreign and security policies, taxation, judiciary, and so forth. For the purposes of this paper, we will focus on the fiscal union aspects of political union as it is at the heart of current financial crisis facing the European Union.

Political union affects monetary union in several ways. First, it makes it possible to centralize a large part of national budgets at the supranational level and enables significant fiscal transfers between states as insurance against asymmetric shocks. Second, it reduces the risk of asymmetric shocks that are political in nature. When member states are independent in pursuing their respective fiscal policies, unilateral decision of any member to increase or lower taxes creates an asymmetric shock. A simple Stability and growth Pact that followed EMU was simply insufficient to correct these imbalances as apparent from the current crisis. The magnitude of the problem is reflected in another asymmetry that is found in the degree of integration between two camps of EU member states—thus creating a two-track European Union.

Figure 1 provides a visual summary of two-track European Union. In the mid-1990s, the European Union that had grown successfully and expended substantially split over the creation of a common currency.

The United Kingdom, Sweden, and Denmark chose not to give up their currencies and adopt the Euro as a common currency thus supporting nothing more than what one might call a loose confederal system of governance.[2] UK's ambivalence toward further deepening of economic and monetary integration is exemplified by its resistance to fuller fiscal union and by its decision not to join the banking union. On the other hand, a larger number of member states are willing to join the Eurozone as full participants. The recent addition of Eastern European nations following the collapse of the Soviet Union in 1989 added Poland, Hungary, Check Republic, Romania, Bulgaria, Lithuania to the Union. These nations in general are on a waiting list to join the Euro area. With such diverse commitment of members to future of full economic and monetary integration, it is debatable if the European Union could meet its ambition to be a global actor.

[2] What the authors refer here is a type of governance structure that relies heavily on intergovernmentalism with economic union without a complete monetary and fiscal union.

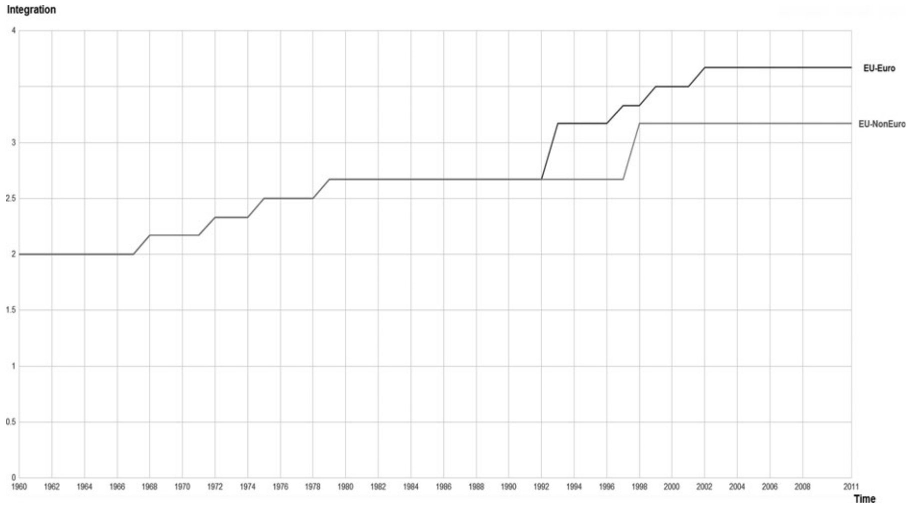

Fig 1. Integration in the European Union

Power Transition Analysis of EU's Crisis and Future Prospects

There have been numerous midrange theories ranging from functionalism to neoliberal institutionalism that identify and address domestic and regional motivations for regional integration (Haas 1958; Mittrany 1966; Lindberg and Scheingold 1970; Pentland 1975; Moravcsik 1991). However, these theories do not address international factors that affect states' motivation to pursue deeper regional integration nor the collective units' ability to be a major player in the international system. Power Transition theory provides a useful perspective to address these issues when we consider the European Union as a single actor in the international system.

Because it has a strong empirical record in accounting for conflict and integration among societies, we center on the Power Transition perspective to define the structural and dynamic elements that lead to integration. Global politics is composed of a hierarchy of nations with varying degrees of relative capabilities and trust that lead to cooperation or confrontation. Power Transition specifies the relative roles of nations within this hierarchy, the system of governing rules, and then outlines how powerful countries attempt to manage global politics. Structurally, Power Transition's central core of concepts provides a foundation to understand the basic relationships of world politics. Power Transition paints a picture of world politics that is integrated horizontally and vertically. Dynamically, the theory stipulates that political interactions among nations are based on the varying commitment among national elites to the existing institutional *status quo*. This broad acceptance of international rules and norms determines whether a country is satisfied or dissatisfied with its position in the hierarchy and trust that the institutions created advances their interests. The most powerful nations hold a position at the top of the global or regional hierarchy. The dominant nation attempts to manage the regional system with a coalition of stable, satisfied supporters. When agreement is in place the dominant nation can ease the process of integration. When disagreements emerge among large nations who do not trust the institutions created, integration comes to a standstill or recedes.

Power is the ability of one nation to advance policy goals by altering the policy of another. While the concept is transparent, its measurement is not simple. Power reflects the intersection between politics and economics. The first measurement approximation at the national level was total GDP.[3] Power Transition proposed that wealth reflected power potential[4] and is fungible in that it could be allocated to security, growth, or other priorities, as needed depending on the level of threat perceived by the ruling elite.[5] This indicator remains the most useful tool when rough forecasts of future performance are attempted and has been generally adopted by the applied security community (Organski and Kugler 1980; Organski et al. 1984; National Intelligence Council 2000, 2004; Tammen et al. 2000).

Power Transition fundamentally departs from realist theories of world politics that assume anarchy.[6] Power Transition views this as a major misspecification in theory and practice. The two-way street of anarchy does not govern relations within and across nations, instead they vary substantially based on satisfaction or its absence. Satisfied nations enjoy each other's trust because they have built institutions that regulate their behavior. This does not mean that nations are always fully satisfied with each other, but it does mean that nations interact differently based on the degree of shared preferences. The relations between Britain and the France today differ fundamentally from the relations between them prior to 1945, or between the United States and France or Germany today. Policies flow from these satisfaction differentials. Through satisfaction, Power Transition provides a linkage between the concepts of anarchy and cooperation by assessing trust. There is growing evidence that the assumption that individuals as well as nations are selfish, greedy maximizers, so useful to obtain game theoretical solutions, is not totally consistent with human activities (For individual level see Kahneman, Knetsch, and Thaler 1986; Smith 1998; Plott and Smith 2008; Zak and Kugler 2011. At the national level, see Organski and Kugler 1980; Tammen et al. 2000; Lake 2001). Particularly when nations share the same evaluations of the *status quo*, they willingly coordinate efforts and cooperate. The level of cooperation among nations does vary in direct proportion to the proximity to the *status quo* among competing parties. The actions of EU members after World War II differ fundamentally from their choices prior to that war. The key reason is increased satisfaction and the mutual trust they developed over ensuing years.

The development of measures for trust has become a cottage industry, which is yet to reach a commonly accepted single measure. Here, we use survey data that reflect the level of support of EU institutions. While the continuity of questions may be of some concern, the concept captured is the one defined by the theory as a measure of support for the *status quo*. If two states are each satisfied with the EU institutions, they are very likely to support further integration and be willing to pay the costs associated with that process. On the other hand, nations dissatisfied with the institutional progress of the European Union are likely to attempt to slow it down and will differ with those that wish further integration.

Lemke (2002) made a major breakthrough moving Power Transition toward a general theory of world politics by demonstrating the applicability of this perspective to regional hierarchies. His careful empirical analysis shows that the

[3] GDP was used to reflect demographic size and productivity. Power = GDP/Capita × Population.

[4] Using Knorr's (1978) terminology, the attempt here was to reflect "power potential" rather than "actual power."

[5] The relationship between GDP and the Composite Indicator of National Capabilities (CINC) that aggregates six indicators (military expenditures, military personnel, energy consumption, iron and steel production, urban population, and total population) is high among developed (Kugler and Arbetman 1989). But an advantage of using GDP as a measure of power is that it can be disaggregated to provincial, local, or even individual level providing the opportunity to analyze relations within as well as across nations.

[6] Integration is not possible among nations that practice anarchy for the goal here is to preserve national sovereignty.

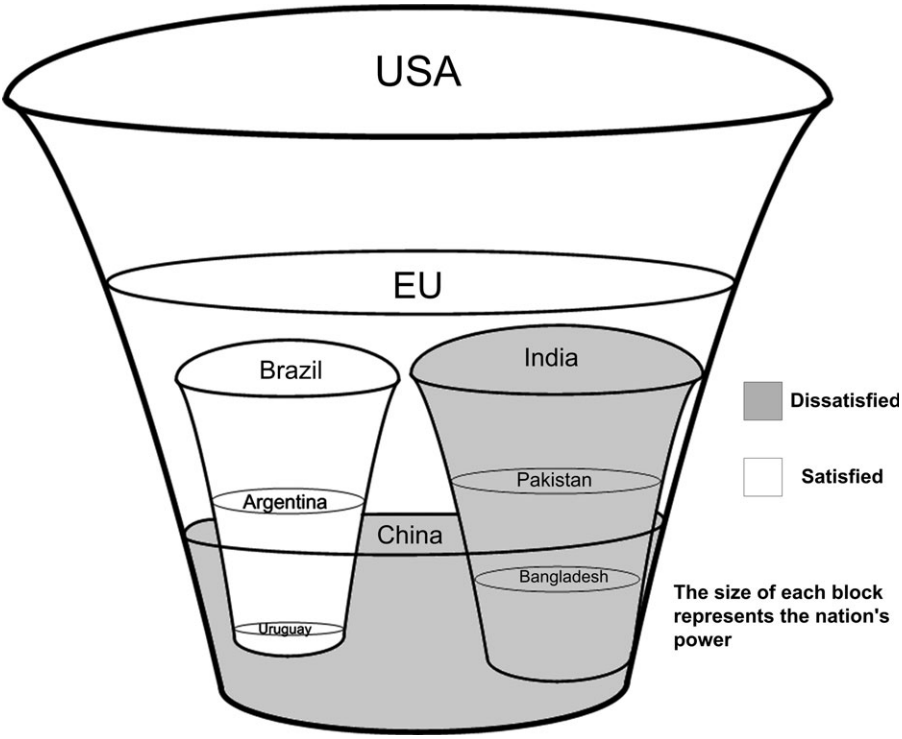

Fig 2. Interaction Within and Between Global and Regional Hierarchies

same principles that hold at the global level define interactions within regional hierarchies as shown in Figure 2.

Members of regional hierarchies interact with each other (Appendix 1). Understanding regional hierarchies adds complexity and generality to the Power Transition perspective. Global powers like the United States, European Union, Russia, and soon China can directly intervene to alter outcomes in a region. They are able to interact, of course, but on matters of strategic importance, it is a one-way street. There is more reason and opportunity for global powers to intervene in those other regions (Efird, Genna, and Kugler 2003; Yesilada, Efird, and Noordijk 2006). This interferes with the ability of regional powers to operate under the normal rules. Lemke informs us that the rules within regional hierarchies normally match those at the global level, but the ability of global powers to intervene does not make this an exact parallel (Lemke 1995, 2002; Lemke and Werner 1996).

Dynamics and Power Transition

According to Power Transition theory, when a dissatisfied challenger overtakes a dominant power the region of overtaking generates the necessary but not sufficient conditions for severe war. This rare event is generated by the differential rates of growth among competing powers who vie over the rules and norms that govern the international system.

Turning to other dynamics, Kim (1989) incorporates alliance conditions into Power Transition and drops the purely dyadic assessments prominent in most power transition analyses. He applied expected utility calculations to estimate the best times for war between states but measured their power as being augmented by the likely contributions of their allies. Thus, for Kim, "parity" does not refer strictly to the calculations of relative power between states A and B. Rather, for Kim, "parity" exists when the capabilities of state A plus those of its allies are roughly equal to the capabilities of state B plus those of its allies. Importantly, just as traditional dyadic power transition analyses support the main hypothesis of parity and dissatisfaction being leading causes of war, Kim's alliance work shows that parity makes war more likely even when taking into account the likely contributions of allies. Parity and dissatisfaction are thus robustly shown to correspond with war. Extensive statistical tests spanning over the last two centuries support the expectations of Power Transition outlined above. These show that global patterns reemerge within regions (Lemke 2002). Note that whereas this model has been extensively applied in the study of conflicts (Organski and Kugler 1980; Kugler and Lemke 1996; Tammen et al. 2000), it also has empirically verified direct implications on regional integration (Efird and Genna 2002; Efird et al. 2003; Feng and Genna 2003; Genna and Hiroi 2004; Yesilada et al. 2006).

Efird et al. (2003) demonstrate that outcomes that lead to conflict and cooperation are part of the same process. Instead of accounting only for severe conflicts—as realist theories do—and separately for integration—as neoliberals do—Power Transition accounts for cooperation and integration and confrontation and war in the same structure. Satisfaction and dissatisfaction is the second component of world politics that distinguishes between conflict and cooperation. The third crucial element of symmetry globally or regionally reflects the constraints faced by individual nation leaders. Symmetric and asymmetric environments capture the third dimension of Power Transition (Figure 3).

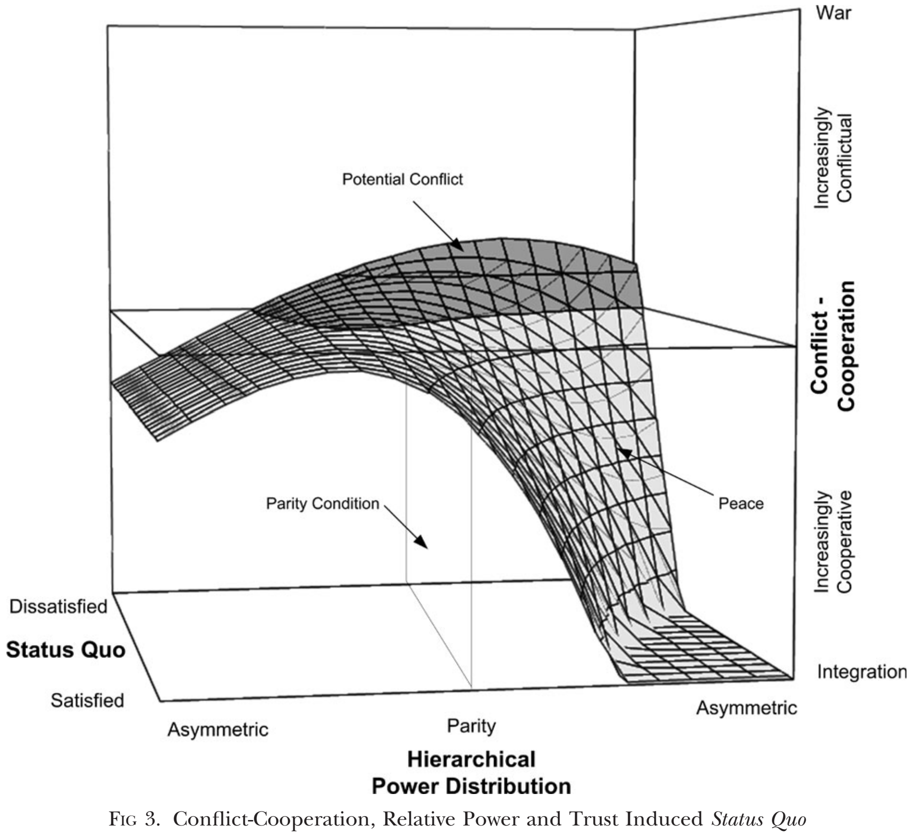

Fig 3. Conflict-Cooperation, Relative Power and Trust Induced *Status Quo*

As Figure 3 shows, the conflict-cooperation processes leads to integration when trust replaces anarchy and new institutional rules and norms increase the *status quo* shift across dyads. The conditions for cooperation emerge when a dominant regional nation—in this case Germany—supports cooperation. Consistent with Kindleberger's (1981) and Keohane's (1984) hegemonic stability argument dominant power is needed to cover the costs of cooperation that when sustained encourages integration. This makes the role of the satisfied dominant state critical in this process of creating the process of integration. The dominant power has many management responsibilities but at the top of its list is the spread and deepening of satisfaction. Genna, Yesilada, and Noordijk (2012) demonstrate that in the case of EU integration, the regional leader role played by Germany is the most important factor behind stability and deepening of integration but that as ability of this regional leader to provide necessary resource base is taxed to the limit integration slows and eventually comes to a standstill.

Trust and Relative Capabilities

In 2010, the European Union had the following patterns of relative capabilities measured in total output and the following levels of trust toward the institutionalization of the European Union as shown in Figure 4.

It shows all members of the European Union, with non-Euro members specified in black borders, and darker colors indicating lower trust levels. Among the largest powers, Germany, France, Italy, and Spain support the European Union and mainlining a Euro zone in place. Among the nations that chose not to adopt the Euro, only Sweden support further integration. The Denmark is reluctant to expand the EU mandate and does not trust that institution. The UK is the only large European nation strongly opposed to the EU institutions. The remaining EU members that have not yet adopted the Euro—Poland, the Czech Republic, Romania Bulgaria, Lithuania, and Latvia favor EU institutions but have not met requirements to fully adopt the Euro.

This static representation is supported by UK Prime Minister David Cameron decision to block a treaty of 27 countries setting rules for Eurozone fiscal

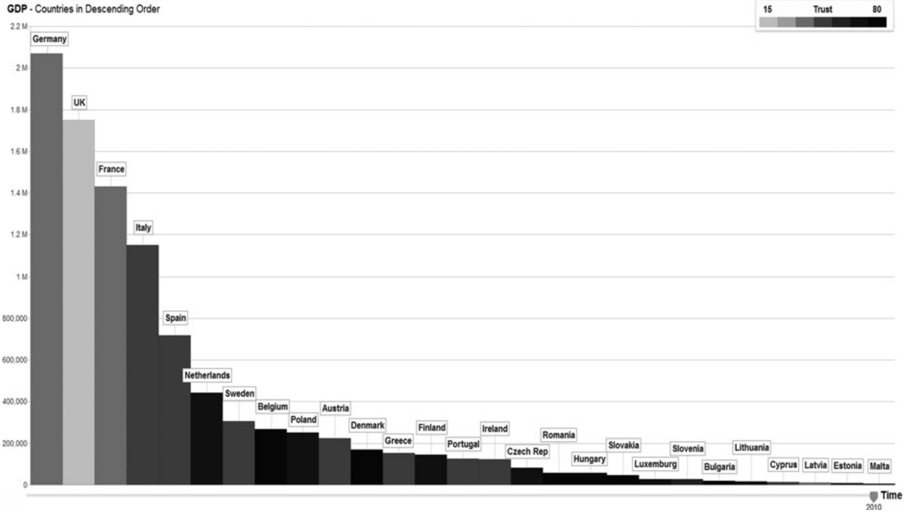

Fig 4. Trust and Relative Capabilities in the European Union. Data for Trust Levels is Acquired From Eurobarometer Surveys (European Commission 2011), and Data for GDP is Acquired From World Development Indicators (World Bank 2011)

discipline at the December 2011 summit of the European Council. In the context of Power Transition, the UK is "dissatisfied" with any attempt to increase the integration level within the European Union and delegate additional fiscal responsibilities to that institution. Recall that Riker's formal study of the United States' evolution from a confederation to a federation indicated that to maintain stability the central government needed to have the ability to tax and to maintain a national currency. Stability would of course be maintained when prosperity drove all nations to consistently faster growth than they could achieve on their own—as Monnet suggested—but when challenges generated by a slowdown or decline in a specific nation took place, the community may be too weak to cope. This is the test that European Union is undergoing as we speak.

Rather than static cross-sectional representation, Power Transition is concerned with the longer-term dynamics of change in trust levels. The record of growth in overall output is well known, but the level of satisfaction and trust generated by the expansion of the European Union is not frequently considered. For clarity, we include nations at the top of the relative power hierarchy (Figure 5), while the whole set of member states are presented in Figure A2 in Appendix 3.

In general support for the European Union correlates with economic conditions of the times—more positive during economic expansion and lower when recession is seen. Trust in the European Union is also higher at the beginning of the key events of deepening of integration that is surrounded by high levels of media fanfare (that is, signing of the Maastricht Treaty), but this initial excitement slows down and public support declines over time. The observed sharp decline in public trust in the European Union in 1997 is an anomaly that requires more in depth examination since it does not coincide with a sharp economic recession in Europe. However, it could be a reaction to EU's decision to sign the Amsterdam Treaty, which increased EU's power on issues related to personal security and immigration, and uncertainties among citizens over planned Eastern enlargement. With the exception of the UK, citizens of member states trust European Union by 40% or better except for 1997–2000 period. This support increased in the first part of 2000s until the financial crisis of 2009.

Among the large nations, the United Kingdom consistently opposes further transfer of national sovereignty to EU's supranational institutions and distrusts

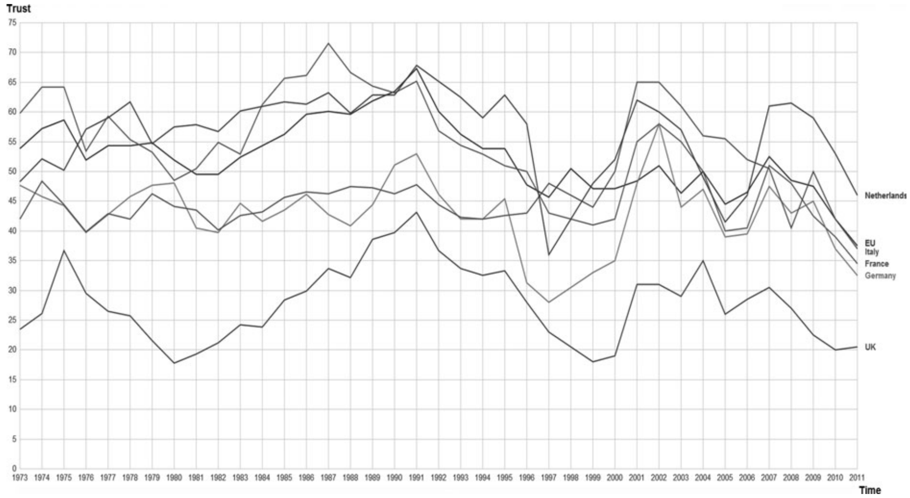

Fig 5. Trust Levels of Major Powers in the European Union

the rules and norms established therein. Germany, France, and Italy are supportive, and the Netherlands is the most committed among them.

This graph represents quite accurately the process of integration. Among them, only the UK refused to join the Euro and is the single nation opposing joint fiscal responsibility for Greece and other potential nations with fiscal difficulties including Portugal, Spain, and Italy.

Britain and the European Union

Power transition theory focuses on the largest members of a hierarchy because their behavior has the capacity to alter outcomes. Britain, along with Germany, France, and Italy, has the largest allocation of votes in the Council of the European Union, and these four countries also the economically largest members of the Union. Of these four countries, only the UK has a record of continuing dissent and has the lowest levels of trust suggesting its dissatisfaction with the EU structure.

The UK, along with Denmark and Ireland, joined the European Union in EU's first enlargement in 1973. In fact, the UK applied for membership to then-European Communities in 1961, but was vetoed mainly due to the resistance by Charles de Gaulle, who was hesitant because of the UK's close relationships with USA. At that time, the UK was a founding member of European Free Trade Association (EFTA), which was a trade block similar to European Economic Community (EEC), but had looser terms. EFTA members did not have a common external customs tariff as EEC members did. The UK reapplied for membership in 1970 after De Gaulle left office, largely to be able to achieve further access to bigger EEC markets, and became a member in 1973.

Although the UK is an early member of the European Union, it was more interested in economic cooperation rather than political integration. It tried to keep its domestic institutions as independent from direct EU influence and regulations as possible and successive British governments always preferred to see European Union as an intergovernmental organization with limited supranational powers (Yesilada and Wood 2010). All along, Britain has refused to join any attempt by other member states that suggested the slightest probability of leading toward a more political union: ERM in 1978, EMU since its early planning in 1991 onward and financial integration. And recently with the 2011 European Union Act, British Parliament required a referendum to be held on any new treaty of the European Union. This act will potentially slow down the UK's integration with European Union, since it provides higher control on British public on issues related to transferring of powers to European Union, and as shown in our data, the UK public consistently shows little trust for EU institutions. Yet, British governments have benefited from having access to EU markets and from receiving substantial repayments from the European Union in the form of the British rebate. This can be viewed as a classical free-rider issue in collective action problem (Olson 1965). The rebate came about in order to prevent another empty-chair crisis during the budget talks in 1984, as Britain demanded a more egalitarian burden sharing among the member states. The outcome of these discussions at the Fontainebleau summit in 1984 was the British rebate, which gave back Britain part of her contribution to the EU budget. This was a fair deal because at the time Britain was the third poorest member of the European Community (EC). Basically, the rebate is a two-thirds reduction in Britain's net contribution to the budget, which, in turn, is funded by other member states. It is worth about 5€ billion a year. However, as the rebate still continues, it is rather ridiculous to justify its existence on the ground that Britain remains a poorer member of the European Union—especially after the Eastern enlargement. Recently, the British rebate became a topic of serious disagreement during the budget talks in the fall of 2012 when the President of the European Council and the Commission proposed to reduce the British rebate by 1€ billion in the 2014–2020 budget. However, the British Prime Minister David Cameron ruled out any such reduction and threatened to veto the budget if other member states go ahead with the proposed plan.

Given the increasingly apparent policy differences between Britain and most other member states over the future nature of the European Union, it is quite possible that not in too distant future the British government will have to decide on either joining others for a more political union or opting out of the European Union altogether. In the past when deepening of economic integration, and to lesser extent political integration, was agreed by member states, Britain first opted out and later chose to join in some of the policies like the Social Charter and the old ERM. Yet, as integration moved further down the road of more supranationalism and fiscal (political) union, the British government adamantly remained opposed to policies and treaties that threatened UK sovereignty: these include such decisions like the single currency, fiscal compact, banking union. Under increasing pressure from other big powers in the European Union to "play ball," it is conceivable that the UK might chose to leave the European Union. Most Britons favor the UK leaving the European Union according to a survey by *Daily Mail* (October 20, 2012). The British politicians are divided over the matter, and the *Economist* outlined the benefits and costs of such a move (*The Economist* December 8, 2012). It should be noted, however, that UK's potential departure would not only affect Britain's economic and political relations with the European Union but would also affect the Union's aspirations to be a global actor as it competes with other giants on the world scene—namely China, India, and the United States (Yesilada et al. 2006).

Empirical Analysis and Results

We now want to explore whether the suggestive patterns shown thus far produce a consistent political picture of the evolution of the European Union. Our data set includes information on all members of the European Union from 1973 to 2011. Considering the structure of our data set, we rely on country fixed effects regression model to empirically test our arguments.

The dependent variable is the integration of the European Union, measured by Integration Achievement Score (IAS) version 4.3 by Genna (Appendix 2). Based on six political and economic categories, this measure is a continuous index of regional integration. IAS is calculated by taking the average of these six categories for each year. It takes values between 0 and 5, with higher values representing greater levels of integration.[7] It is transformed by multiplying each year by 20 to vary between 0 and 100 in order to simplify the interpretation of coefficients.

GDP data are obtained from World Bank World Development Indicators. Relative power is calculated by calculating the ratio of each country's GDP for every year with respect to Germany's GDP, since Germany is the leading actor within the European Union. Throughout the period of analysis, Germany is distinctively the most powerful country of the European Union, constituting at least 1.12 times the GDP of the second most powerful, United Kingdom, and up to 1,500 times the GDP of the smallest country, Malta, any time of the analysis.

Questions related to support for the European Union in Eurobarometer surveys between 1973 and 2011 are used depending on data availability as

[7] A more detailed explanation of the data set is placed in the appendix.

measures of trust.[8] Each member country is included in the analysis from the year they joined the European Union. For years after 1996, we used a question that directly asks whether the participants tend to trust the European Union. For the remaining years, we took the values for the trust question as the base to extrapolate back using the rate of change of question that asks whether being a member of European Union is a good thing or not. This procedure allows us to analyze a consistent series for 38 years.

In addition to the main explanatory variables, GDP per capita is included to control for the effect of wealth, and population is included to control for the effect of size of nations on integration. Both are taken from Penn World Table (Heston, Summers, and Aten 2009).[9] A control for being a Eurozone member, taking the value 1 after a country adopted Euro and 0 otherwise is also included as a control. Finally, the UK is the only member with the highest voting rights in the Council of the European Union that also constantly displays mistrusting behavior. To capture the effects of UK's lack of trust in integration, a control variable is used that applies UK's trust values to each EU member.

Table 1 presents the results of the country fixed effects regression for the period 1973–2011. The results are consistent with our expectations and support the power transition argument. All coefficients are in the expected direction and statistically significant. For robustness test, see Appendix 4.

The relative power term is positive and highly significant. More specifically, a 10-point increase in relative power boosts the EU integration by 2.29 percentage points. This means that a more powerful Germany has a higher ability to enhance the integration levels. Thus, the integration in the European Union increases with an ordered hierarchy, in this case under the lead of Germany.

As expected, the coefficient for trust in European Union is positive and significant.[10] This suggests that more trust in EU augments integration levels. Despite the speculations, as we do not have any case of a country leaving European Union or Eurozone yet, our model cannot say anything about when would integration turns into disintegration. However, EU integration increases when countries become increasingly trusting and comes to a standstill when trust levels decrease.

The UK restricts EU integration. The coefficient for the UK trust levels is negative and significant suggesting that it works to slow down the progression of integration. In fact, having the UK's trust levels has a larger effect than the general individual trust levels. This result supports the observations in UK's behavior in opposing further deepening in integration beyond the Single Market. Since the UK is one of the most powerful countries in the European Union, which is at the same time one of the least trusting, its impact on integration is substantial. Recent developments also suggest that especially in times of crisis, the UK focuses more on domestic politics rather than on the well-being of the European

[8] The specific questions used are as follows:

- For after 1996: "For each of the following institutions, please tell me if you tend to trust it or tend not to trust it?"
- For until 1996: "Generally speaking, do you think that (your country's) membership of the European Union is/would be ⋯?" a good thing versus a bad thing.

For years, in which the data are available for more than 1 month, we used the average of available results. The 1998, which is the only year that no data are available, is linearly interpolated.

For the countries that are extrapolated, these two measures correlate at 67% for the overlapping period.

[9] Data for GDP per capita and population are generated using International Futures (IFs) version 6.47 (Hughes 2011).

[10] We controlled for the interaction between relative power and trust and found that the results are insignificant. We thank an anonymous reviewer for pointing out this omission.

TABLE 1. Country Fixed Effects Regression Analysis of Integration in the European Union, 1973–2011†

Variables	*Integration*
Relative Power	0.229 (0.0167)***
Trust European Union	0.054 (0.013)***
Trust European Union, United Kingdom	−0.160 (0.017)***
Euro	3.934 (0.308)***
GDP per capita	0.001 (3.60e−05)***
Population	0.001 (9.3e−05)***
Constant	13.83 (2.051)***
Observations	593
R-squared	.895

(*Notes*. Standard errors in parentheses.
***$p < .01$; **$p < .05$; *$p < .1$.
†The standard diagnostics are performed to determine the suitable model. Wooldridge test for serial correlation modified Wald test for group-wise heteroskedasticity, and Hausman tests revealed that using fixed effects is appropriate in this case. The fixed effects model enables us to control for the unobserved heterogeneity, thus capture the dynamics and characteristics that are country specific and not represented in the data. This method is very similar to panel-corrected standard errors (PCSE) with country dummies, providing the same coefficients and similar standard errors. As robustness tests we used a pooled ordinary least squares (OLS) model with heteroskedasticity robust standard errors and PCSE with country dummies. Not surprisingly, we found almost identical results in PCSE with country dummies. Pooled OLS with heteroskedasticity robust standard errors gave very similar results too, with the only difference that GDP per capita and Trust's coefficients became insignificant. For a wider discussion, see Appendix 3, and the theoretical discussion on the use of fixed effects versus pooled OLS model, see Greene (2008), chapter 9. We are aware that having time invariant variables is problematic in fixed effects models. However, our Euro variable changes from 0 to 1 when countries join Euro, thus creating a variance within and across countries depending on the year they joined Euro.)

Union. This is contrary to behavior of Germany and France that concentrate on EU interests as much as on their respective domestic priorities.

Being a Eurozone country also increases integration. Keeping everything else constant, adopting Euro increases integration by 3.9 points. Surprisingly, GDP per capita has a rather small coefficient. Being $1,000 per capita, richer increases integration levels by about 1 point. Affluent societies are more satisfied with integration since higher GDP per capita values result in higher integration levels. Population has almost an identical impact on integration. Having 1 million larger population increases integration by about 1 point. Thus, larger and richer members advance the EU integration. This supports the two-tiered integration in Europe: the wealthier and Eurozone countries integrate faster than non-Eurozone countries.

This analysis shows that within Europe, the Power Transition perspective accounts effectively for the decline in the rate of integration. The "dissatisfaction" of the UK slows down the process of integration in the same way as "dissatisfaction" among competing countries that might lead to conflict. Germany appears to be the key dominant nation that can sustain or scuttle the integration process, which is consistent with the findings of Genna et al. (2012) on the regional leadership role of this country.

Long-Term Implications of Alternate EU Futures

The power transition logic that is used to assess the effects of integration warns us of the consequences of EU disintegration for the stability of the international system. While coherent, satisfied, and substantial members of the international community maximize the likelihood of long-term cooperative interactions, fractionalization, dissatisfaction, and the lack of dominant and large satisfied entities set the preconditions for conflict when major economic changes are under way (Tammen et al. 2000). The non-obvious implications of an EU realignment are

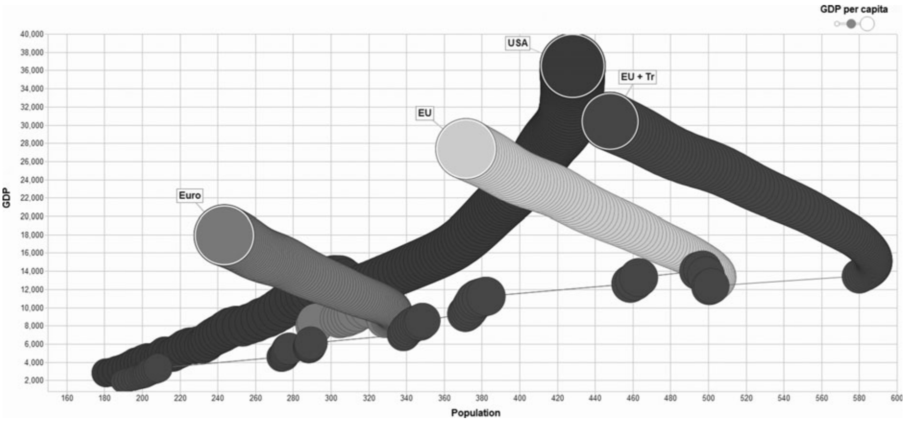

Fig 6. The Timeline of USA, European Union, and Eurozone, 1960–2100

not only regional but global. Below we explore the likely implications of EU contraction along with potential rearrangements that can dramatically affect global politics.

Consider first the regional consequences of a *more* integrated Eurozone led by Germany that excludes large *free riders* like the UK, compared with the European Union and an enlarged European Union that includes Turkey. The United States is added to provide a size comparison (Figure 6).[11]

This four dimensional graph presents total output to assess the size of the society in *y*-axis and population to assess the future potential of the society in *x*-axis. The size of the bubble is the GDP per capita to approximate the productivity of the population. Lastly, the time dimension is embedded through the flow of bubbles. The initial bubbles, which start near the origin, stand for the year 1960, and the outermost bubbles, where the labels are attached, stand for the year 2100. Each bubble in-between represents a year from 1960 to 2100. Bubbles linked by lines indicate EU expansions.

The smaller Eurozone could become more of a federation but at the expense of reducing much of the population and power capability of the current European Union. While not inconsequential, this unit would represent about half of the power of the United States and less than half its population. The current European Union would be closer to 75% of the United States. This situation points out a classic Catch-22. A smaller Euro group would be cohesive, but would have far less capacity to incorporate other large members and would be less powerful at the global level. A more intergovernmental European Union that reverts back to a Single Market could attract more new potential large members. Yet, with reduced trust, it would be less powerful at the global level for lack of cohesiveness. The way out of this dilemma is a more federal union with fiscal, monetary, and security union.

If the European Union were to add large counties like Turkey, Ukraine, and perhaps even Russia into its ranks, the anticipated trend line changes substantially. In these cases, the United States and the new larger European Union would be equal partners in the future.

These observations are magnified when we consider global implications. First consider what would happen if the European experiment were to revert back to less than an EMU (that is, Common Market) or collapse altogether returning to pre-EC patterns. In those situations, we would not be able to consider the aggre-

[11] The following analyses use forecasts generated by IFs modeling system version 6.47 (Hughes 2011).

gate impact of partly integrated economies of the member states, but focus on the impact of individual EU nations as global actors. If this were to happen, the patterns that emerge are as follows (Figure 7):

We select Germany for illustration because it is the largest and most significant global European actor. By extension, the UK, France, and Italy would be very small members of the international system compared with the larger United States, and the preponderant China or India. Size would assure that any European nation will have a limited impact on global politics. Market size and power are prerequisites for international influence. Compared with the overall capabilities of the United States, China, and India, individual European nations are and would be far too small to impact policy and international norms. Clearly, to maintain global European influence a viable, preferably expanded, European Union is required.

Let us now turn to Figure 8, which compares how a fully integrated European Union fairs in global competition with other great powers. By the end of the twenty-first century, the European Union and its likely ally the United States are expected to have half the economic power of China and India, and one-third the size of their respective populations.

China or India alone will have the overall capabilities of the United States and the current European Union. These Asian giants will no doubt dominate global affairs in the next century. For this reason, an expansion of the European Union and the recreation of an Atlantic alliance are central if the Western nations are to play a principal role in the next Century.

As a final check for these assessments, we consider how the Atlantic Alliance (NATO countries) fairs against each of the Asian giants and a possible but not probable coordination of China and India's interests. The results are shown in Figure 9:

Consistent with Tammen et al. (2000:53–5), Asian giants will overtake the Atlantic Alliance as dominant powers by mid-twenty-first Century. China and India will even individually match the capabilities of a possible Atlantic Alliance. From the power transition perspective, this outcome increases the probability of a conflict during this transition unless trust is built to offset dissatisfaction.

An unlikely unified Asian coalition would create a super dominant hegemonic structure for the international system. Even a unified Atlantic alliance would face an overwhelmingly Asian collation that, like the United States following World

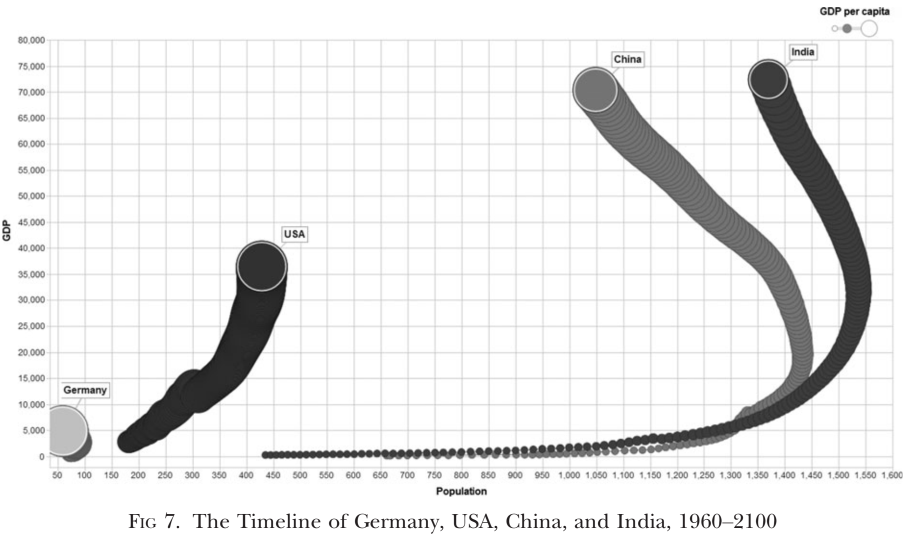

Fig 7. The Timeline of Germany, USA, China, and India, 1960–2100

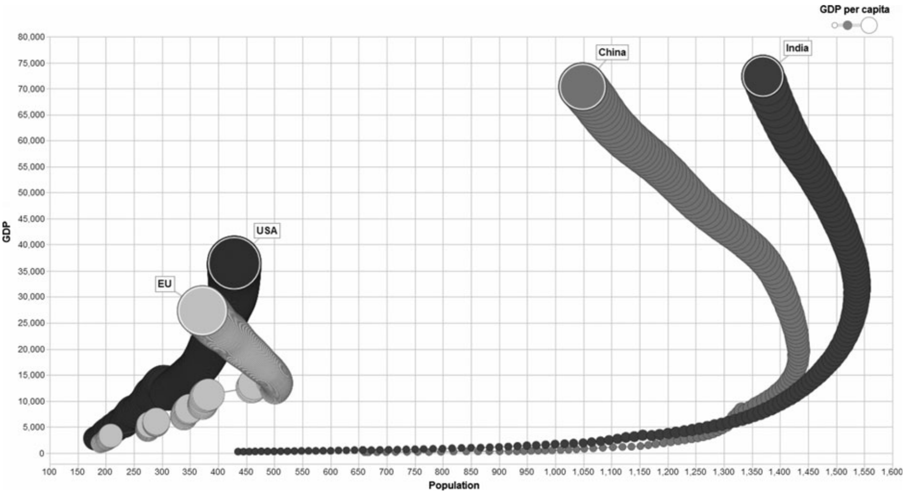

Fig 8. Integrated EU against other Great Powers

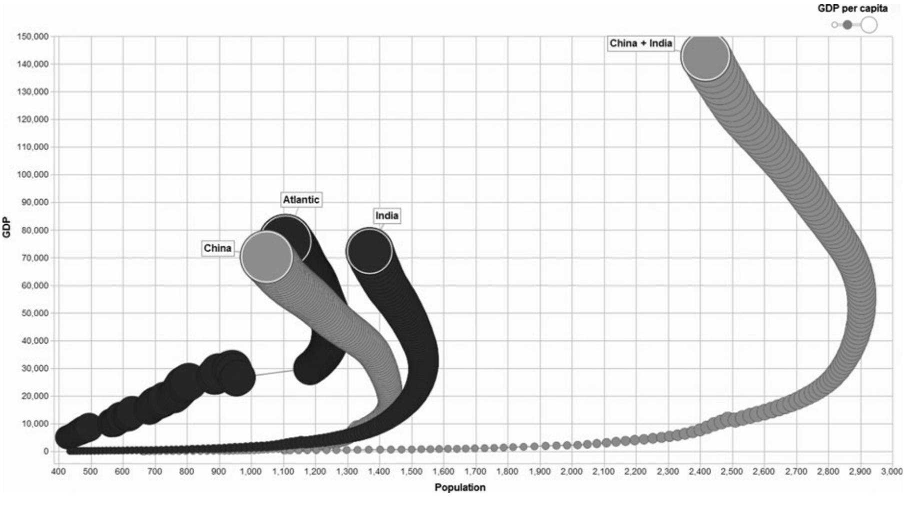

Fig 9. Atlantic Alliance against China and India

War II, could set the norms of international interactions for the latter part of the next Century.

Conclusions

Whereas a quick fix to the current financial crisis in the European Union dominates policy debate, our analysis shows that far more serious consequence would result from altering the progression of economic and political integration in Europe. Stability will follow from further integration even if the European Union shrinks because of a British defection, but coherence is added in the Eurozone.

Using Power Transition theory, our analysis shows that the progression of integration can be anticipated. Trust and relative capabilities are essential to build a stable European Union structure. While it is clear that the center of global politics is shifting away from Europe and the United States to the Asian giants—the transition from West to East can be effectively managed so that the future dominant nations or coalitions are satisfied with each other rather than distrustful, dissatisfied, and contentious.

The slowdown in EU integration not only generates regional problems, but it also has serious consequences for the economic stability of the international system. Moreover, the slowdown in integration that has reduced tensions within the European region previously characterized by major wars could reset the stage not only for regional confrontations but increase the likelihood of a global conflict.

Regionally and globally, the European Union cannot afford to move from the cooperative contest to a confrontational one where solutions are arrived at by force rather than reason. Therefore, the challenge for European leaders is to resolve the current crisis in the EMU, build upon it to reinvigorate the integration process and provide a path for complete regional integration. The non-obvious implication of regional stability is that similar global arrangements may insure peace for the long term. The alternative scenarios of member states reverting back to pre-Maastricht or pre-Single European Act years are simply non-starters for the future of a stable European Union and global peace.

Appendix 1: Systemic and Regional Hierarchies

Dominant powers in asymmetric hierarchies allow supporters of the *status quo* to challenge core propositions, but reject dramatic changes in rules demanded by the dissatisfied. This is a general pattern. We argue that in world politics, like electoral systems, rules can be altered following agreed upon election rules. Contenders rely on persuasion, rather than imposition to settle disputes. Nations satisfied with rules—as within the European Union—can use persuasion more effectively than coercion to achieve change; while nations that do not share common perspectives—such as Palestine and Israel—attempt to impose their own view on opponents based on relative capabilities. The hierarchical relations anticipated by power transitions are based on micro-foundations. Black (1958) established a foundation for the power transition logic though using an American politics argument (Hinich and Munger 1997). In his elegant demonstration of the parity principle, the median voter theorem, Black identified a universal application to any competitive environment. He pointed out that political elections are contests where voters choose among alternatives, with a majority winning the prize. When distributions of voters are approximately equal, elections are strenuously contested since either side can win. As each party attempts to maximize their expected gains, they seek victory to generate policies consistent with their own preferences. Conflicts are more likely and serious when norms are weak, and more restrained when norms are clear. Black's median voter theorem provides a convincing explanation of why parity in all international contexts (global or regional) produces severe conflicts (Figure 1A).

A hierarchical distribution preceded both World War I and II in Europe. The English- and German-led coalitions held quite different views about desirable international norms. The classic confrontation between Nazi-Fascism and Democratic principles was the most extreme example of divergent views about how to structure the international system. Such events are not limited to the global arena and are now present in the Middle East region, and were the precursors to the Iran–Iraq war as well. The cooperative condition reflects competition among parties that do not differ fundamentally in their preferences about international norms. While a contest can still be intense if parties are relatively equal in power, they can negotiate acceptable solutions. Under these conditions, soft

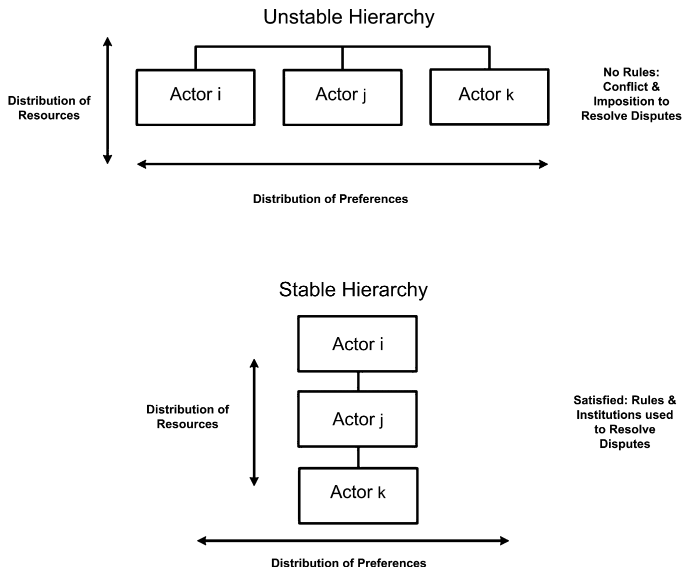

Fig A1. Hierarchies, Preferences, Resources and Conflict Resolutions: The Median in the Upper Condition Reflects Sharp Difference in Norms Among Competing Sides. This Condition Can Lead to Severe Conflict

power is a very useful means of resolving disputes (Nye 1990). Both sides aim for equivalent outcomes. Neither wishes to alter the rules of the game fundamentally for future contests. Legal means can be invoked to settle such disputes.

Appendix 2: IAS Description

Originating from Hufbauer and Schott's (1994) concept, Genna (2002) developed IAS. He advanced his forerunners by expanding the time period for all the regional integration organizations they have used in the original data set. IAS consists of six categories that measure the level of regional integration. To calculate the IAS, a value of 0 (low) through 5 (high) along a Guttman scale is given to each category, and then the average of these values are taken for each year for every institution. The following are the six categories that make up the index and the coding system.

1. Trade in Goods and Services.

0 = No agreements made to lower tariffs and nontariff barriers.
1 = Preferential Trade Agreement.
2 = Partial Free Trade Area.
3 = Full Free Trade Area.
4 = Customs Union (Common External Tariffs).
5 = No barriers among member countries.

2. Degree of Capital Mobility.

0 = No agreements made to promote capital mobility.
1 = Foreign Direct Investment allowed in limited form.
2 = Capital withdrawal allowed.

3 = Full access for foreign investment and capital withdrawal, except for national government procurement.
4 = Full capital mobility except for large scale mergers and acquisitions.
5 = Full capital mobility without restriction.

3. Degree of Labor Mobility.

0 = No agreements made to promote labor mobility.
1 = Right of movement granted for select professions.
2 = Full right of movement.
3 = Transferability of professional qualifications granted.
4 = Transferability of pensions and other retirement devices.
5 = Full freedom of movement.

4. Level of Supranational Institution Importance.

0 = No supranational institutions.
1 = Establishment of nominal institutions.
2 = Information gathering and advisory role.
3 = Ability for institutions to amend proposals.
4 = Ability for institutions to veto proposals.
5 = Supranational institutions operate as primary decision node.

5. Degree of Monetary Policy Coordination.

0 = No monetary policy coordination.
1 = Consultation regarding policy.
2 = Commitment to maintain parity.
3 = Coordinated interventions.
4 = Regional Central Bank establishment.
5 = Single currency.

6. Degree of Fiscal Policy Coordination.

0 = No fiscal policy coordination.
1 = Consultation regarding policy.
2 = Commitments regarding deficit spending and taxation.
3 = Sanctions regarding breaking commitments.
4 = Uniform tax code.
5 = Single budget.

Appendix 3: Trust Levels in the European Union

See Figure 2A.

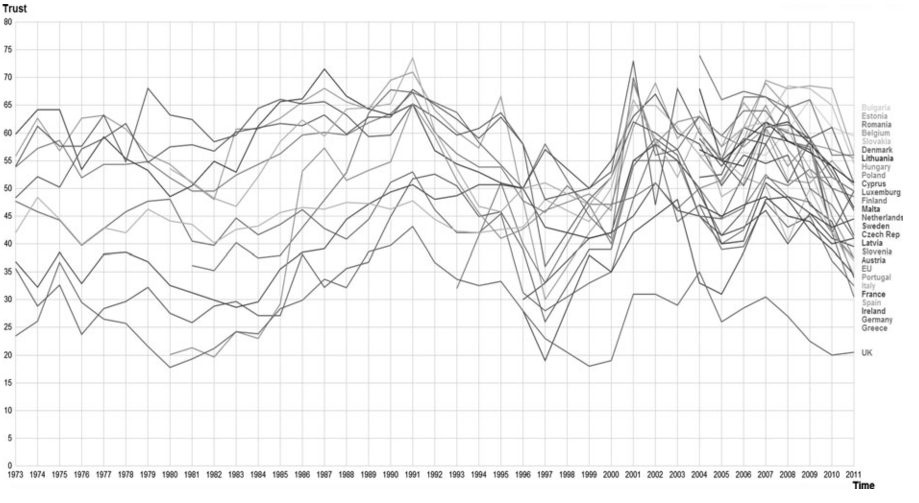

Fig A2. **Trust Levels of European Union Members**

Appendix 4: Results of Alternative Regression Models and Specifications

Table A1. Robustness Tests for Regression Results

Variables	(1) Integration	(2) Integration
Relative Power	0.0172 (0.0039)***	0.229 (0.0252)***
Trust European Union	0.0362 (0.0251)	0.0545 (0.0132)***
Trust European Union, United Kingdom	−0.169 (0.0415)***	−0.160 (0.0318)***
Euro	9.146 (0.493)***	3.934 (0.387)***
GDP per capita	1.31e−05 (3.00e−05)	0.001 (4.9e−05)***
Population	−2.14e−05 (9.23e−06)**	0.001 (1.01e−05)***
Constant	60.982 (1.354)***	30.43 (1.329)***
Observations	593	593
R-squared	.419	.923

(*Notes.*

Robust standard errors in parentheses.

***$p < .01$; **$p < .05$; *$p < .1$.

Model 1: Pooled ordinary least squares (OLS) model with heteroskedasticity robust standard errors.

Model 2: Pooled OLS model with Panel-Corrected Standard Errors (PCSE) with country dummies.)

Model 1 using pooled OLS model with heteroskedasticity robust standard errors is substantially less effective than the fixed effect model we presented in the paper (Table 1). In this case, pooled OLS model is biased since it treats observations as being serially uncorrelated for a given country and does not take into account the panel structure of the data, thus fails to control for the unobserved heterogeneity. Furthermore, note that trust in the European Union shows negative effect on integration inconsistent with the expectation. For further discussion, see Greene (2008).

Model 2 using pooled OLS model with PCSE with country dummies (country dummies are not reported) is almost identical to using fixed effects. For further discussion on using fixed effects versus PCSE with country dummies, see Green, Kim, and Yoon (2001).

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