The Political Economics of EU Enlargement

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Abstract

In a theoretical model we show that centralization and enlargement may cause lobbying expenditures to fall. The reason is that due to the common pool problem associated with centralization, national policy makers in a central committee have stronger incentives to stand up for domestic special interest groups if compared to decentral decision making. Because national politicians act as agents for domestic special interest groups, this reduces the equilibrium level of compensating contributions for domestic lobby groups. Further, we argue that enlargement magnifies the common pool problem and thus makes national policy makers even more instrumental to special interest groups. As a result, the cost of lobbying fall.
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1 Introduction

With enlargement of the EU as a top priority for policy makers, the analysis of the effects of economic integration and political centralization has moved back to center stage. Although the economic effects are notoriously difficult to pin down, most studies agree that enlargement should benefit both new and existing members of the EU (e.g. Baldwin 1997, Bertola 2002). However, many contributions in the political economics tradition stress that centralization of policy making reduces economic efficiency because it results in overprovision of public goods. In an influential paper Persson and Tabellini (1994) demonstrate that centralization induces lobbying for local public goods, which increases spending on them to an inefficiently high level. Because more members means a more severe common pool problem, enlargement results in more lobbying expenditures and hence in even higher spending on local public goods. Both can be viewed as welfare reducing.[1]

A key characteristic of the Persson and Tabellini analysis and the contributions following them is that political centralization creates federations: countries hand over sovereignty to a central policy maker. This approach fits EU policy making naturally as an important characteristic of the integration process has been "ever closer union" which involves delegating more and more responsibilities to policy makers in Brussels. Hence, centralization shifts lobbying from the national capitals to the European Commission which sets the agenda and acts as a power broker in the policy game that is played among the member states. Moreover, as Greenwood, Grote and Ronit (1992) note, the Single European Act introduced majority voting in a wide range of policy fields, thus making the national route for lobbying Brussels for lobbyist less dependable. Consequently, more and more lobbying efforts shifted to Brussels to influence European policy makers directly.

However, there are many case-study testimonies that the national route to influence policy making in Brussels still is and is likely to remain very important for pressure groups (e.g. Lanzalaco 1992, Spence 1993, van Schendelen 1993, 1998). For instance, Alesina (2002) and Pollack (2002) show that in the end of the 1990s the Union expanded in policy areas where the Union's institutions have at most shared competencies and potential national veto's still play an important role. In these new domains cooperation among the member states is important. Further, in the policy domains where the Union does hold exclusive

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[1] In addition to criticism of the political economics contributions mentioned in the main text, there is a well established branch of normative analysis in the Oates (1972) "decentralization" tradition.

powers, the European institutions remain heavily influenced by the activities of policy makers and civil servants of the member states. Mazey and Richardson (1993, pp 211) note "...the growing importance of EC regulation has in many cases reinforced the dependency which exist at the national level between groups and "their" ministries, since the latter are effectively *intermediaries* (original italics) between groups and the EC in the final stages of Community decision-making ". Spence (1993), in his account of the role of the British civil service in lobbying Brussels, goes a step further and calls national officials 'lobbied lobbyists'. Moreover, many doubt that a truly European policy maker actually exists. For instance, as *The Economist* newspaper states on recent proposals to reforms the European Commission: "In theory, these commissioners will think only of the European interest, yet the ferocity with which the smalls are demanding to keep their right to a national commissioner suggests otherwise".[2]

Inspired by the actual practice of EU policy making, we extend the standard approach to allow for the influence of national politicians on central policy making. In our set up, a committee consisting of national politicians decides on central policy. We restrict our analysis to the situation where the central policy outcome is jointly efficient for all members of the committee, possibly resembling the situation of intergovernmental policy making by the European Council in areas where unanimity is still required.[3] Our analysis provides two main results. First, intergovernmental cooperation may reduce lobbying expenditures if compared to decentral policy making. The intuition is that because centralization magnifies the common pool problem, this gives national politicians a stronger incentive to cater to local organized interests if compared to the decentral policy making. Although centralization gives interest groups stronger incentives to lobby the national policy maker, depending on the properties of benefits and costs, this may be more than offset by the fact that the interest groups can exploit the increased incentives of national policy makers to bend central spending towards to the special interest group. Second, we show that enlargement may result in lower lobbying costs for special interest groups as the common pool incentive for national policy makers becomes larger.

We make use of the well explored Grossman and Helpman (1994, 2001) workhorse-model to analyze lobbying. In this two-stage model,

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[2] The Economist, *Tyranny of the tiny?*, Januari 23rd, 2003

[3] Messerlin (2001) argues that unanimity also implicitly is the rule in policy domains where there is qualified majority voting. Because countries anticipate the fact that outvoting may cause veto's in unanimity domains, they are likely to bargain for policies that are jointly efficient.

organized interest groups offer a credible and "truthful" contribution schedules to the policy maker, where payment is contingent on the policy outcome. In the second stage of the game the policy maker decides on public goods provision. Besides public goods in Tabellini and Persson (1994) and the original contribution on trade policy, the Grossman-Helpman model is extensively used to explain redistribution towards organized interests, for instance in environmental policy (Aidt 1998) and labour market policies (Rama and Tabellini 1998).[4]

The main modification we make to the Persson an Tabellini (1994) set up is that we allow for legislative decision making at the central level by policy makers who are driven only by the interests of their constituency. In contrast to Helpman and Persson (1998) however, who also combine lobbying and legislative bargaining, we do not adopt a specific legislative bargaining set up as for example the Baron and Ferejohn (1989) agenda setter or coalition formation.[5] Instead, we rely on the assumption that policy outcomes reflect Coasian bargaining between the member states of the EU. This reflects the implicit threat of veto's by member states in intergovernmental decision making.

The remainder of the paper is organized as follows. In section 2 we introduce the model and determine socially optimal spending on public goods. Section 3 shows the decentral provision of public goods if the national policy maker cares for contributions. Section 4 analyses public goods provision by a single supranational policy maker. Section 5 shows the equilibrium levels of public goods provision and contributions for intergovernmental cooperation. Section 6 investigates the effects of enlargement. Finally, section 7 concludes.

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[4]There are several well know objections to the Grossman-Helpman approach. First, it is unclear why the policy maker values contributions, or how the weighting of these contributions vis-a-vis social welfare comes about. The overall picture of politics becomes quite cynical when one assumes that policies are simply for sale to the highest bidder. A second limitation of the approach is the absense of an electoral process. The policy maker is an incumbent who possibly faces electoral competition of potential but unspecified opponents. Third, it is unclear how lobbies can commit to their contribution schemes, and thus why the policy maker would care for them, although this may be saved by incorporating reputational concerns. Last, much of lobbying is done in the form of information exchange and other activities that do not involve the transfer of money. The Grossman-Helpman model is not well suited to incorporate these other forms of lobbying. Because we use the model, it means that we accept it's limitations, but still judge it sufficiently valid to analyse questions of centralization.

[5]Various models of legislative bargain are surveyed in Grossman and Helpman (2001) and Persson and Tabellini (2000).

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2 The model

We consider M symmetrical countries index by $i = \{1, 2...m\}$, equally populated by N_i citizens j. In each country there are two regions where one region is organized in lobby group L_i and the citizens in the other region are not organized. Citizens differ in which country and region they are located, apart from that they are identical. In each country the government can provide a local public good g_i to the organized region only. The utility from consuming these local public goods for each individual is described by an increasing and concave utility function $b(g_i)$ with $b(0) = 0$. The cost of producing a unit of g_i are set at unity in term of the private good. Public good production is financed by a lump sum income tax $t_i^j = \frac{g_i}{N_i}$ that is equal for all citizens such that $N_i t_i^j = T_i = g_i$. Citizens in an organized region collectively can make a credible commitment to a contribution schedule $C_i(g_i)$ that they offer to the policy maker. Indirect utility of each citizen j living in i is then given by:

$$V_i^j = \gamma \left[b(g_i) - C_i(g_i) \right] + y_i^j - t_i^j \tag{1}$$

were γ takes the value of 1 if citizen j lives in the organized region and 0 otherwise. In (1) y_i denotes income (which is equal for all citizens) so that the term $y_i^j - t_i^j$ represents the utility from private goods consumption. Summing over all individuals, from the first-order condition of (1) it follows that the social optimum level of public goods g_i^s satisfies:

$$N_i^L b_{g_i}(g_i^s) - 1 = 0 \tag{2}$$

Here N_i^L are the number of citizens living in the organized region who belong to lobby L_i. First derivatives are denoted by the usual subscripts. From a social welfare perspective, the more citizens live in the organized region, the higher the optimal level of public spending.

In the following (2) serves as a benchmark against which to judge decentral and federal public goods provision. For future comparison, if the marginal costs of public goods provision becomes lower than marginal social costs - which in (2) shows up as something smaller than minus one - this increases public goods supply in country i.

3 Decentral Policy Making

Suppose that each of the countries is governed by a single policy maker whose objective function is given by:

$$V_i^P = \lambda \sum V_i^j + [1 - \lambda] C_i(g_i) \tag{3}$$

The parameter $\lambda < \frac{1}{2}$ measures the relative preference of the policy maker for social welfare and contributions. A familiar result from Gross-

man and Helpman (1994) is that this allocation maximizes:[6]

$$V_i^P = \sum_{j \in L} V_i^j + \lambda \sum_{j \notin L} V_i^j \tag{4}$$

Here it shows that the policy maker takes full account of the welfare of persons organized in the lobby and weights persons living in the non-organized region only by λ. After some rearranging, the first-order condition for optimal decentral public goods provision g_i^d is:

$$N_L b_{g_i}(g_d) - 1 + (1 - \lambda)\frac{N_i - N_L}{N_i} = 0 \tag{5}$$

If we compare (5) to (2) it shows that for each $\lambda < 1$ there is overprovision of the local public good if compared to the social optimum. In the limiting case where policy makers care for contributions only ($\lambda = 0$) the marginal benefits of g_i that accrue to the organized region are equal to the marginal cost that are bourne by that region; the taxes paid by other regions do not enter the objective function of the policy maker. In contrast, if policy makers are social planners ($\lambda = 1$) the level of g_i perfectly reflects the share of the organized region in total population and hence resembles the socially optimal allocation of public spending.

Central to the Grossman-Helpman approach is that the equilibrium allocation of public spending must be jointly efficient for the policy maker and the organized region. The linchpin of the model is that the organized interest group offers a contribution schedule (a credible promise of funding, support or costly endorsement) that leaves the policy maker indifferent between the optimum social allocation and a politically efficient allocation.[7] Thus, at the decentral level public goods provision g_i^d satisfies:

$$\lambda V_i(g_i^d) + (1 - \lambda)C(g_i^d) = \lambda V_i(g_i^s) \tag{6}$$

Which means that in equilibrium contributions are:

$$c_i^d = \frac{\lambda}{1 - \lambda}\left[V_i(g_i^s) - V_i(g_i^d)\right] \tag{7}$$

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[6]If we denote the allocation that maximizes social welfare as V_i^* contributions are:

$$c_i = \frac{V_i^*}{1 - \lambda} - \frac{\lambda}{1 - \lambda}\left[\sum_{j \in L} V_i^j + \sum_{j \notin L} V_i^j\right]$$

Substituting this in the objective function of the policy maker results in:

$$V_i^P = \sum_{j \in L} V_i^j + \lambda \sum_{j \notin L} V_i^j - \frac{V_i^*}{1 - \lambda}.$$

Recognizing that V_i^* is a constant, maximizing this is the same as maximizing (4).

[7]For a full explanation of deriving equilibria with locally truthful contribution schedules, the reader is referred to Grossman and Helpman (2001), chapters 7 and 8.

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To obtain a higher than socially optimum level of public goods provision, the contribution of the organized region has to be positive because at g_i^d because the welfare that the policy maker receives from public goods provision is lower if compared to the social optimal level g_i^s. The reason is that the increase in public goods increases tax cost more than in improves welfare in the organized region.
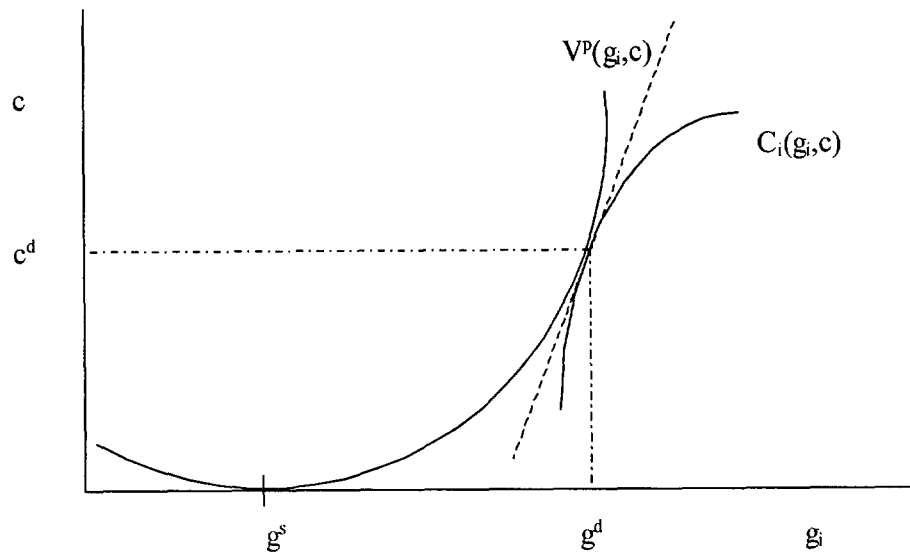

Figure 1 above offers a graphical exposition of the decentral equilibrium. The curve V^p shows the objective function of the politician (the agent) and C_i is a truthful contribution schedule of the lobby group (the principal) of region i. The decentral equilibrium level of public goods and contributions are denoted by g^d and c^d. The equilibrium contributions are compensating because the politician is indifferent between the decentral allocation (g^d, c^d) en the social optimum allocation ($g^s, 0$). In equilibrium, the relative "price" of public goods in terms of contributions is shown by the dotted line. Lower marginal costs of public goods supply shift the V^p curve to the right and thus ceteris paribus reduce contributions. Higher net marginal benefits of public goods (benefits minus tax costs of extra units of g_i) steepens the contribution schedule and hence the relative price in equilibrium which results in higher contributions. Further, note that there are many truthful contribution schedules so that the level of contributions itself is determined by the objective function of the policy maker (which serves as a "budget restriction" for the lobby in obtaining public goods). If the marginal costs of public

goods supply to the national policy maker are very low, for instance because a large share is paid for by the EU, the actual contributions may be very small for similarly shaped truthful contribution schedules as the one shown in the figure.

4 Federal Policy Making

Suppose that the M countries form a federation and appoint a central policy maker to allocate public spending.[8] The federal policy maker's objective function is:

$$V_f^p = \lambda \sum_i \sum_j V_i^j + (1 - \lambda) \sum_i C_i \tag{8}$$

In contrast to the decentral case, the policy maker serves as a common agent to the lobbies. To find the equilibrium level of contributions, recall that this allocation must be jointly efficient for the federal policy maker and the organized region in country i. This efficient level of g_i is found by maximizing the objective function of the policy maker:

$$\frac{\partial V_f^p}{\partial g_i} = \lambda \left[N_L b_{g_i}(g_i^f) - 1 \right] + (1 - \lambda) \left[\frac{\partial \sum_i C_i}{\partial g_i} \right] = 0 \tag{9}$$

In this first-order condition it is important to note that provision of public goods to the organized region in country i does not only influence the contributions from that region, it also affects the contributions received from other regions (see the last term). Because public goods to region i are financed by central taxation, increasing them is costly to other organized regions in other countries and the public at large. Hence, these competing organized interests are inclined to offer less contributions to the central policy maker if she increases public goods supply to region i. The lobby of the organized region in country i maximizes:

$$\sum_{j \in L} V_i^j = N_i^L b(g_i) - \frac{N_i^L}{MN_i} T^f - C(g_i) \tag{10}$$

where it is useful to note that $T^f = \sum g_i$. Also, equation (10) shows that the marginal cost to the organized region of providing a unit of public

[8]This section resembles the analysis of Persson and Tabellini (1994). We differ from their approach by allowing for lobbying in the decentral policy making case. The Persson and Tabellini model can be interpreted in two ways. First, it describes *public lobbying* at the central level by national policy makers on behalf of all citizens in their country. Because the country is organized as a single lobby, there are no reasons to lobby the policy maker in the decentral case. Alternatively, it can be interpret as the situation where the country as a whole acts as a lobby group to influence the central policy maker. In our paper, comparing the outcomes of federal to decentral policy making describes the situation where national special interest shift their activities from the local to the federal political arena.

goods to them increases in the number of countries that belong to the union. The first-order condition for the optimal provision of public good from the perspective of the lobby reflects this increased common pool effect:

$$\frac{\partial C(g_i)}{\partial g_i} = N_i^L b_{g_i}(g_d) - \frac{N_i^L}{MN_i} = 0 \tag{11}$$

Joint efficiency for the lobby in country i and the central policy maker is found by combining (9) and (11). The contributions must be truthful and hence reflect the trade off between contributions and benefits from public goods to the lobby group (equation 11) as well as compensate the central policy maker for the loss in welfare if she increases public goods in region 1 (equation 9). Some rearranging provides that the optimal provision of public goods to region i at the federal level satisfies:

$$N_L b_{g_i}(g_f) - 1 + (1 - \lambda) \left[\frac{M - 1}{M} \frac{N_i^L}{N_i} + \frac{N_i - N_i^L}{N_i} \right] = 0 \tag{12}$$

Comparing (12) to (5) it is immediately clear that creation of a federation ($M > 1$) increases the level of public goods in all regions.[9] In a federation, as the number of countries M rises, the tax cost of an extra unit of g_i become smaller from the perspective of the organized region in country i. Hence, this increases the incentive to lobby for local public goods. The contribution schedule (11) reflects this change in tax costs to the organized region. The federal policy maker, who is confronted with these contribution schedules, sees that the marginal rewards for local public goods supply to organized regions is higher that offered to a decentral policy maker. Thus, if she has the same preferences for contributions over social welfare, she responds by increasing the level of public goods to all regions if compared to decentral, national policy makers.

To find the contributions of the organized region in country i, recall that the contributions must leave the central policy maker indifferent between the allocation in which the lobby does contribute and the one in which the group does not contribute. Let g_i^{-i} be the level of public good supply in the organized region of country i that will result in the absence of contributions from lobby i. If there are, apart from country i, $M - 1$ countries $k \neq i$ in the union, the contributions of lobby i must then satisfy:

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[9]Note that in our model there are no normative reasons for centralization. For local public goods, well-known reasons for centralization may be externalities or economies of scale in producing them, of which both are absent in our model. This means that an underlying assumption is that centralization is justified for reasons outside the model. Benefits from coordinating the production of global public goods of which the benefits are very large (such as defense) is a possible candidate.

$$(1-\lambda)C_i(g_i^f) = \lambda \left[V_i(g_i^{-i}) - V_i(g_i^f) \right] + \lambda(M-1) \left[V_k(g_k^{-i}) - V_k(g_k^f) \right]$$
$$+ (1 - \lambda)(M - 1) \left[C_k(g_k^{-i}) - C_k(g_k^f) \right] \tag{13}$$

Going over the terms on the right hand side, contributions of lobby i must compensate the policy maker for the fact that (i) an increase in g_i affects welfare in i if $V_i(g_i^f) \neq V_i(g_i^{-i})$ (ii) an increase in g_i reduces welfare in $M - 1$ countries $k \neq i$ because $V_k(g_i^{-i}) > V_k(g_i^f)$ and (iii) lobbies in the $M - 1$ countries $k \neq i$ will contribute more in the absence of contributions of country i. Moreover, assume that the contributions of lobbies in k are truthful such that $C_k(g_k^{-i}) - C_k(g_k^f) = V_k(g_i^{-i}) - V_k(g_i^f)$. In that case, equation (13) reduces to:

$$C_i^f = \frac{(M - 1)}{(1 - \lambda)} \left[V_k(g_k^{-i}) - V_k(g_k^f) \right] + \frac{\lambda}{(1 - \lambda)} \left[V_i(g_i^{-i}) - V_i(g_i^f) \right] \tag{14}$$

If we compare federal to decentral lobbying expenditures in (6), there are two reasons why lobbying is higher at the federal level. First, the first term on the right shows the "competition" effect: the central policy maker has to be compensated more for public goods provision above the socially efficient level because she loses lobbying funds from other member states. Further, social welfare in other countries reduces because of the increase in tax costs, which is costly for the central policy maker. The second term on the right shows the "expansion" effect that comes about when the federally provided level of public goods is higher than the decentral level. Because of that, the central policy maker has to be compensated for a reduction in national welfare in country i if compared to the decentral case.

5 Joint Policy Making By National Officials

In this section we introduce joint policy making. Again, the M countries form a union in which they collect common taxes to finance regionally allocated public goods. In contrast to the previous section, the allocation of public goods is decided in a bargain among the officials of the member states at the central level. Each country delegates bargaining at the central level to a policy maker who has an objective function described by (3).

Suppose that the national officials form a central committee that decides unanimously on the provision of public goods to the individual

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states. The equilibrium allocation of public goods that the committee will set as well as contributions received by the committee members depend on the rules of the negotiating process. When, as in our model, both sides are fully informed about the (political) costs and benefits of public goods provision, most models predict that the allocation has the property that is jointly efficient for all bargaining participants. Thus, the central bargaining procedure will maximize:

$$V^c = \sum_m V_i^P = \lambda \sum_i \sum_j V_i^j + (1 - \lambda) \sum_i C_i \qquad (15)$$

Note that the bargaining outcome for public goods mirrors the one that a single central policy maker would set, as the first-order conditions for maximizing (15) equal those of (8) for each region. With joint decision making, the national policy maker sits at the bargaining table with two objectives. First, providing public goods to "his" organized region increases the contributions from the lobby at home, but is costly to the public at large in his home country. However, because the costs can be spread among the member states, the optimal level of public goods provided to his region increases. Second, providing public goods in other countries reduce national social welfare and contributions from the organized region.

We assume that all participants have perfect information on the contribution schedule that is offered to other committee members. The contribution schedule then serves as a commitment device for the national policy maker in the committee. If a policy maker has rejected the offer from the domestic lobby, this is common knowledge to the others. As a result, a policy maker without a contribution schedule will find it much harder to obtain public goods for her region. The equilibrium allocation in which all national policy makers accept contributions from their lobbies maximizes the weighted sum of social welfare in all member states and the contributions received from those lobbies. Hence, the incentives to provide public goods for the committee of national officials maximizing their joint welfare equal the incentives of a single policy maker.

Truthful contribution schedules (but not their actual levels!) still require (11), so that the incentives to the lobby group for obtaining more public good increase if compared to decentral decision making. Again, the reason is that the tax costs of public goods are shared among the member states.[10] Concluding, if compared to a single central policy

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[10] In many area's of joint policy making, policies are coordinated only. This means that the costs of the policies are not shared among the member states of the union. In our set up there is no normative reason to form the union, because there are neither spill over effects of local public goods nor economies of scale.

maker the committee system provides the same trade off between contributions and the net benefits of public goods for both the lobby group and the committee. Therefore, the level of public goods provision in both political systems will be similar, satisfying (12).

The truthful contribution *schedule* does not tell which *amount* of contributions the organized region must make for the national policy maker to accept the federal proposal to set g_i^f in all countries in the federation. Contributions must make the national policy maker indifferent between the allocation that would result if the lobby were not to offer any contributions and the allocation g_i^f plus contributions. Hence, if we assume that the national policy maker can only attract funds from the domestic lobby, compensating contribution are:

$$c_i^c = \frac{\lambda}{1-\lambda} \left[V_i(g_i^{-i}) - V_i(g_i^f) \right] \tag{16}$$

Comparing lobbying expenditures in (16) to those made to a single federal policy maker in (14) it shows that the lobby expenditures with joint decision are lower. The reason is that the national policy maker does not care for welfare in other countries and for contributions from lobbies in those countries. Although the shape of the truthful contribution schedule to the national policy maker equals the one for a single federal policy maker, in equilibrium the national policy maker can be rewarded with a smaller contribution than the single federal policy maker.

Interestingly, if we compare (16) to decentral lobbying in (7), the difference between federal and decentral contributions is:[11]

$$c_i^c - c_i^d = \frac{\lambda}{1-\lambda} \{ \left[V_i(g_i^{-i}) - V_i(g_i^s) \right] + \left[V_i(g_i^d) - V_i(g_i^f) \right] \} \tag{17}$$

The first term on the right hand side is the "threatening" effect of centralization: the policy maker can be offered a lower contribution because rejection would hurt the national welfare.[12] The reason is that in the central committee bargain the policy maker can not credibly commit to a high level of public goods if the others know that she has rejected the

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[11] In equation (17) global truthfulness does not require $c_i^f - c_i^d = V_i(g_i^d) - V_i(g_i^f)$ because the shape of the contribution schedules are different for decentral and federal lobbying.

[12] We assume that $V(g_i^{-i})$ equals the fall back position of the national legislator. Under perfect information, the other member states legislators have no incentive to offer a supply of public goods in excess of g_i^{-i}. This means that we assume that the country can not "leave" Europe, or alternatively, that the fall back position of not agreeing to g_i^{-i} would result in such bad policy outcomes (for instance missing out on other public goods with large economies of scale) that blocking indefinitely is not credible.

offer by the domestic lobby group. In that case, the organized region has the same weighting as non-organized citizens and hence receive the social welfare maximizing level of $g_i^{-i} = g_i^s$. However, this level comes at high costs to the national policy maker, as all other countries receive g_i^f of which the costs are shared with country i. Hence, $V_i(g_i^{-i}) < V_i(g_i^s)$, which lower the contributions than must be paid to the national policy maker. The second term on the right is the "expansion" effect of federalism: the policy making must be offered a higher contribution to compensate for welfare losses caused by higher public goods provision in all countries, of which she pays her equal share.

Substituting cost and benefits of local public goods in (17) we obtain the condition for which centralization reduces contributions:

$$N_i^L \left[b(g_i^f) - b(g_i^d) \right] + \frac{M-1}{M} \left[g_k^{-i} - g_i^{-i} \right] > g_i^f - g_i^d \qquad (18)$$

The first term on the left hand side hand side shows the benefits of centralization because it increases public goods to the organized region in country i. The second term on the left is the threat effect. Because $g_k^{-i} > g_i^{-i}$, withholding contributions from the politician is more costly to her as it increases the tax cost to finance high public spending in other countries. Although these tax costs can be spread over M-countries, they increase for $M - 1$ countries in the union. The right hand side shows the increase in tax costs of public goods provision due to the rise in public goods allocated in country i.

In equation (18), all other things equal, centralization reduces lobbying if countries form large unions. The reason is that the increase in costs that the country must pay to service tax costs in case the policy maker does not accept the contribution $(g_k^{-i} - g_i^{-i})$ are larger than the increase in tax costs due to accepting the contributions $(g_i^f - g_i^d)$. Hence, for large unions the threatening effect larger than the expansion effect, hence reducing lobbying expenditures.

The analysis in this section may also have normative implications. In our model, contributions are a lump sum transfer of net benefits from lobby groups to policy makers, leaving social welfare unaltered. A somewhat looser interpretation may be that centralization reduces rent seeking costs by special interest groups. The social cost-benefit analysis then comes down to trading off reduced economic efficiency because of higher spending on local public goods to improved political efficiency because of falling rent-seeking costs.[13]

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[13] We assume that there are no cost involved in committee decision making. Alternatively, our analysis so far can also be interpret as shifting private lobbying efforts to national public agencies. Because in our set up there is no single central pol-

6 Enlargement

In the previous section we have seen that lobbying costs are likely to fall if countries join large unions. To find the effect on contributions of enlargement, substitute the benefits and costs of the policy maker in (16), and recognize that the social optimal level of public goods $g_i^s = g_i^{-i}$ as well as the decentral supply g_i^d is independent of the number of countries joining. Hence:

$$\frac{\partial c_i^c}{\partial M} = \frac{\lambda}{1-\lambda}\{-\left[(N_i^L b_{g_i} - 1)\frac{\partial g_i^f}{\partial M}\right] + \left[\frac{1}{M^2}(g_i^{-i} - g_k^{-i})\right] - \left[\frac{M-1}{M}\frac{\partial g_k^{-i}}{\partial M}\right]\}$$

(19)

The three terms on the right hand side show the effects of enlargement of the union on lobby contributions. By the first term, enlarging the union leads to a higher provision of public goods to each member state. Because this reduces welfare from the viewpoint of the national policy maker (the increase in tax cost is higher than the rise in welfare of the organized region), she needs to be compensated for this by higher contributions from her domestic lobby. The second term shows that enlargement means that the costs of public goods provision can be shared among more members, which reduces the contributions for the domestic lobby. Third, withholding contributions by the national lobbies is more costly to the national policy maker because this increases the level of public goods in more countries and hence tax costs. This increased "threat-effect" reduces equilibrium contributions by the domestic lobby.

Further, all things equal, lobbying expenditures decline if new members join already large unions. The reason is that the national policy maker recognizes that because all tax costs are shared, the national tax savings of withholding public goods to the domestic lobby become negligible as a share in total tax costs. Thus, in larger unions the national policy maker has less incentive to withstand offers from domestic lobbies. Because lobbies anticipate this, in large unions, further enlargement reduces equilibrium contributions.

In contrast, from (19) it is clear that with a single federal policy maker enlargement increases lobbying expenditures. The reason is that enlargement adds members that resent the public goods being allocated

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icy maker, we therefore implicitly assume that there are no cost of public lobbying. However, in practice intergovernmental policy making is costly to tax payers as considerable efforts must be undertaken by public officials to reach consensus. Hence, centralization may shift cost from special interest groups to the tax paying public at large.

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to country i and whose lobbies make their contributions contingent on that. Thus, from the point of view of the federal policy maker, enlargement makes it more costly in forgone political contributions to provide public goods to country i. Hence, the lobby from country i must compensate the policy maker by offering a higher contribution.

7 Conclusion

In a theoretical model we have shown that centralization and enlargement may not necessarily lead to increased lobbying expenditures to obtain centrally financed public goods. If decisions at the central level are made by consensus bargaining between national officials from the member states, centralization may cause lobbying expenditures to fall. The reason is that the common pool increases the incentives for national policy makers to stand up for domestic special interest groups which in turn reduces the equilibrium contribution for domestic lobbies.

Further, we have argued that enlargement magnifies the common pool problem. Hence, the cost of lobbying fall as national policy makers become even more instrumental to special interest groups. This effects may arise for existing members of the union, but is expected to be particularly large for new members who move from national policy making into a large union.

The objective of our analysis has been to extend the standard approach to include intergovernmental policy making. This is important because many commentators agree that bargaining between governments in the EU indeed is an important method of making policy. Moreover, national officials serve as important transmitters of domestic interest in Brussels. The main point of this paper challenges the view that centralization results in more funds being allocated to lobbying activities and influencing policy decisions.

Two extension of the model easily come to mind. A first is to loosen the assumption of unanimity voting, as more and more policy issues in the EU are decided upon by qualified majority which would potentially incorporate more insights from the legislative bargaining theory. A second is to take account of the complex structure of checks and balances in the EU. In most cases, lobbying the EU is a hybrid process that involves influencing officials from the member states as well as central policy makers at the Commission. For instance, Mazza and Van Winden (2002) take account of the different role of the Council (tax setting) and the Commission (allocation of spending) in the presence of Grossman-Helpman lobbies. However, in their model both the Council and the Commission are modelled as single agents. It comes naturally to interpret budget setting by the member states as joint policy making

by national officials, whereas allocation by the European Commission resembles much closer policy making by a single agent.

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