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*International Organization*, Vol. 50, No. 1 (Winter, 1996), 1-33.

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*International Organization* is currently published by The MIT Press.

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# **Anarchy, hierarchy, and the variety of international relations**

David A. Lake

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Following World War II, the United States entered into an alliance with the countries of Western Europe. At the same time, the Soviet Union created an informal empire in Eastern Europe. America's alliances were anarchic in character. While each partner agreed explicitly and implicitly to defend the others, all retained substantial discretion over the implementation of this agreement. The Soviet Union's informal empire was more hierarchic. Not only were the parties committed to mutual defense but the Soviet Union intruded deeply into the internal political, economic, and social affairs of its partners in order to enforce their allegiance.

Realism cannot explain this difference in relations. Two countries occupying similar positions within the international system should adopt similar strategies for building power or security. The nature of the political regimes in the two superpowers provides at best only a partial explanation. Regime type cannot explain Soviet restraint in areas it might have dominated, such as Finland or Yugoslavia, or American informal imperialism in the Caribbean and Central America.<sup>1</sup> Nor are ideological or cultural approaches—whether primordial, instrumental, or constructivist in nature—particularly promising alternatives.

Earlier versions of the essay were presented at the annual meeting of the American Political Science Association, Chicago, 3–6 September 1992, and in seminars at Indiana, Princeton, and Columbia Universities; the University of California, Berkeley, Los Angeles, Santa Barbara, and San Diego; and the University of Chicago. Numerous colleagues have provided many helpful suggestions and criticisms. I would like to acknowledge the especially important guidance of Jeff Frieden, Joanne Gowa, Robert Keohane, Wendy Lake, John Odell, Robert Pahre, Paul Papayoanou, Robert Powell, Beth Yarbrough, and several anonymous reviewers. Ellen Comisso, Matthew Evangelista, Peter Gourevitch, Jack Snyder, and Celeste Wallander were kind enough to comment on the penultimate draft on short notice. Scott Bruckner, Risa Brooks, Kathleen Hancock, and Adam Stulberg provided research assistance. This research has been supported by the Academic Senates of the University of California at Los Angeles (UCLA) and at San Diego (UCSD), the Center for International Relations and the Office of International Studies and Overseas Programs at UCLA, and the Institute on Global Conflict and Cooperation at UCSD.

1. On the essential similarity between relations in the Soviet and U.S. spheres of influence, see Triska 1986.

Marxism-Leninism is ambiguous on this score, both promising an anarchic withering away of the state and excusing a hierarchic dictatorship of the proletariat at home and, by extension, abroad. In the United States, the prevailing foreign policy ideology, rooted in George Washington's Farewell Address, explicitly eschewed "entangling alliances," yet these became the instrument of choice after 1945. The difference in paths chosen by the two superpowers remains a genuine analytic puzzle.

This essay draws upon theories of relational contracting, first developed in economics but now finding increasing application in political science, to examine the alternative relations available to all states.<sup>2</sup> The theory presented below is informed by a central metaphor, specifically, that the state is a firm producing security.<sup>3</sup> Whenever a state chooses to manufacture security in association with another, it must choose a relationship—ranging from an anarchic alliance to a hierarchic empire—to govern interactions with its partner. In this metaphor, an alliance is analogous to an arm's-length contract between separate firms, while an empire is akin to integration within a single firm. The choice between these alternatives, I posit, is a function of two main variables: the expected costs of opportunism, which decline with relational hierarchy, and governance costs, which rise with relational hierarchy. After a brief review to locate my approach within the broader international relations literature, I define the dependent variable and develop the theory at some length. The theory is self-consciously general and designed to apply in a variety of circumstances. To explicate the central logic and assess the initial plausibility of the theory, however, I close by examining briefly the alternative paths selected by the Soviet Union and the United States and unraveling the analytic puzzle posed by their contrasting choices.

### **The logic of security**

Grand strategy has been the topic of considerable scholarly debate. Defined by Barry Posen as "a state's theory about how it can best 'cause' security for itself," the subject is, appropriately, nearly synonymous with the study and practice of international relations.<sup>4</sup> As a field, we have made substantial progress in understanding the sources and variations of grand strategy.<sup>5</sup>

2. For an example from economics, see Williamson 1985. For a review of the economic literature, see Eggertsson 1990. For an application to American politics, see Weingast and Marshall 1988. Robert Keohane was the first to employ this approach in international relations; see Keohane 1983 and 1984. For applications, see Frieden 1994 and Simmons 1993. For a view from two economists who speak directly to the concerns of international relations, see Yarbrough and Yarbrough 1992.

3. This metaphor has been employed with great effect in economic history. See Lane 1979 and North 1981.

4. The quotation is from Posen 1984, 13.

5. For reviews, see Walt 1991; and Nye and Lynn-Jones 1988.

Nonetheless, two related problems remain. While these problems are natural consequences of the magnitude of the subject and will not be remedied fully here, they continue to limit further progress.

First, while scholars have given much attention to the many techniques for causing security, they typically fail to consider adequately the alternatives available to states. In other words, the range of possible variation in strategy—the dependent variable—commonly is abridged.<sup>6</sup> For example, scholars focus on alliances or empires but fail to ask how, in what ways, and to what extent these relationships are substitutes for one another.<sup>7</sup> When states choose to seek empire, for instance, they are simultaneously choosing not to form an alliance. The net benefits of imperialism by themselves do not explain action; rather, it is the net benefits of the alternatives relative to one another that drive state choice. Any full explanation of grand strategy must therefore compare all alternatives.<sup>8</sup>

Second, analysts continue to work within what Benjamin Most and Harvey Starr describe as separate “islands” of theory and fail to appreciate or build upon common political problems and independent variables.<sup>9</sup> This is true even in the comparatively well-developed literatures on alliance formation and imperialism. The standard international relations texts, for instance, nearly always discuss alliances and empires in separate chapters and often in very different theoretical contexts: the first tend to be covered under the headings of realism, systems-level theories, or the balance of power; the second under Marxism, unit-level theories, or North–South relations. Yet in practice, all states are concerned with problems of aggregating and pooling resources—building power—and coping with opportunism by their partners—restraining self-seeking actions. These practical problems are also central independent variables in our theories of international politics, even if they are often implicit. Without seeking to minimize differences in the research agendas that have grown up around these and other topics, I want to suggest that a theoretical core does exist—a core that informs the theory discussed in the remainder of this article.

The current literature on alliance formation is dominated by a “capability aggregation” model. As Bruce Russett and Harvey Starr write in their widely used text, “Throughout history the main reason states have entered into

6. Among the best recent efforts to elucidate the full range of strategies are Friedberg 1988; Snyder 1991; and Morrow 1993. Emerson Niou and Peter Ordeshook ask similar questions, but take a different approach than discussed here. See Niou and Ordeshook 1994.

7. See Walt 1987; and Doyle 1986.

8. David Baldwin suggests that international political economists may not be sufficiently attentive to this fundamental tenet of rational choice theory either. See Baldwin 1985, 8–18 and 29–40. Much of the work on trade policy, for instance, has proceeded without sufficient reference to exchange rate manipulation as an alternative to tariff protection. For a typical example of this failing, see Lake 1988.

9. Most and Starr 1984. See also Siverson and Starr 1991.

alliances has been the desire for the *aggregation of power*.”<sup>10</sup> In this model, states form alliances primarily to counter common threats larger than each individually.

Within this model, the costs of alliances—and the reasons why states sometimes eschew foreign entanglements—are understood to be reduced autonomy and freedom of action. Glenn Snyder has explicated these costs more fully. In the “alliance dilemma,” he writes, states may be “abandoned,” defined broadly to include both free riding on the efforts of others and shirking on agreements, and “entrapped,” or embroiled in conflicts they might otherwise avoid. More recently, Thomas Christensen and Jack Snyder have termed these respective costs “buck passing” and “chain ganging.”<sup>11</sup>

The literature on imperialism, on the other hand, has long been rent by three competing perspectives: metrocentric theory focuses on dispositional features of imperial states, systemic theory highlights competition between the great powers, and pericentric theory emphasizes conditions in peripheral states and territories. In several recent studies, scholars have succeeded in integrating these approaches into a consistent and powerful explanation of imperialism.<sup>12</sup>

With obvious differences, metrocentric and systemic theories of imperialism share with theories of alliance formation an emphasis on capability aggregation. At the most basic level, both hypothesize that states form empires to capture important resources—raw materials, manpower, markets, strategic locations—otherwise unavailable to groups at home or the polity in general. Although many theories of imperialism emphasize the domestic implications of expansion, explanations of alliance formation and imperialism share a common focus on capability aggregation.

More than the other approaches, pericentric theories attempt to explain the form of imperialism and in turn focus on opportunism. Following the pioneering work of John Gallagher and Ronald Robinson, such theories hypothesize that dominant states prefer informal empire when possible but create formal empires when local elites are either unwilling or unable to provide acceptable domestic political orders; in other words, formal empires are created when local rulers possess different policy preferences or lack the ability to carry out the interests of dominant states.<sup>13</sup> Whether emphasizing intent or ability, the failure to comply with or carry out the desires of the core

10. Russett and Starr 1989, 91 (emphasis original). For reviews of the voluminous literature on alliances, see the essays collected in Friedman, Bladen, and Rosen 1970; and in Holsti, Hopmann, and Sullivan 1973. Another explanation of alliance formation focuses on national attributes, such as ideology or regime type. For that view, see Barnett and Levy 1991; David 1991; and Siverson and Emmons 1991. The historical literature also points to the desire to control partners as a motivation for alliances, but this empirical insight has not been incorporated into the theoretical literature; see Schroeder 1976. For an alternative approach, see Morrow 1991.

11. See Snyder 1984 and 1990; and Christensen and Snyder 1990.

12. See Doyle 1986; Smith 1981; and Cain and Hopkins 1993. The labels for the three theories are from Doyle 1986, 22–30.

13. Gallagher and Robinson 1953. On the ensuing debate, see Louis 1976.

state in pericentric theories is functionally equivalent to abandonment in alliance theories. Within this parallel, however, lies an apparent contradiction, resolved in the theory below: whereas the potential for opportunism thwarts alliances, it stimulates formal empires.

In both alliances and empires, then, our dominant theories understand states as being motivated by the desire to aggregate capabilities. Both literatures also view problems of opportunism as determinants of behavior. This should not be surprising, given the need to build power and manage relations between partners in the conduct of international relations. This common theoretical core is central to the approach developed below. In this way, the theory builds upon existing approaches in the field of international relations. Yet, because scholars fail to appreciate this common practical and theoretical core, they have not made a sufficient effort to explicate the continuum underlying alternative relations or identify how opportunism varies across these options. While clearly building on and indebted to the existing literature, the theory developed here seeks to explain better these variations in relations across partners and over time.

This common core also ignores the important role of governance costs, which have made a significant contribution to the theory of international regimes and form a necessary part of the analysis below.<sup>14</sup> A second goal of the theory is thus to incorporate into the core a focus on issues of international governance—a topic often believed to be empirically or theoretically unimportant to security studies.<sup>15</sup> As seen below, governance, broadly conceived as the management of relations between actors, is carried out through a range of alternative policies. As a generic problem of politics, it has a wide variety of possible solutions. While international organizations and regimes may be of marginal importance for security issues—itself a debatable proposition—governance costs are necessary to any explanation of grand strategy.

## **The variety of international relations**

Security, the starting point for any discussion of grand strategy, is too often undefined, and when it is defined, it is usually tailored either to the specifics of time and place or the idiosyncratic preferences of the author.<sup>16</sup> I define security here as the ability to consume, invest, or otherwise use national wealth as a polity sees fit. In other words, a country is secure to the extent that its wealth cannot be coerced or otherwise extorted from it. It follows from this definition that a polity will be concerned with two essential national freedoms: the freedom to possess wealth, traditionally associated with the territorial integrity

14. On regimes and transactions costs, see Keohane 1984.

15. See Jervis 1983; and Mearsheimer 1994–95. For alternative views, see Wallander and Keohane 1995; and Lipson 1994 and 1995.

16. On the concept of security, see Buzan 1991.

of the nation-state, and the freedom to choose its own form of rule, embodied in constitutional independence and a defining characteristic of sovereignty.<sup>17</sup> Central to the latter freedom is the country's ability to decide autonomously how to accumulate and use its wealth, which requires that the collective choice mechanism be free from foreign control. So defined, security is aspired to rather than realized; it is a continuous rather than a dichotomous variable. A country is more secure the lower the probability that other states can seize or constrain effectively the disposition of its wealth.

Security is a complex phenomenon, dependent upon a state's assessment of the likely behavior of another. The behavior of the threatening state is in turn a function of its intentions and military capabilities, which for simplicity are assumed to be exogenous throughout this essay (see below), and the first state's own defense efforts and security relations, which it can alter in response to changing preferences or circumstances. A state's defense effort is influenced by many factors, including threats from others, the aggregated preferences and risk propensities of its constituents, and the costs of producing defense relative to other goods in the economy. These factors are captured in the traditional guns or butter trade-off, which reflects the willingness of the polity to trade other valued goods for increased defense effort and, in turn, security.

When confronted by a common threat, a state and its partner may choose to pool their resources, abilities, and efforts with one another in what I call here a security relation.<sup>18</sup> Security relations can take a variety of forms and can vary by dyad. The dyadic nature of these relations is particularly important. Each state has many potential partners, and there are many degrees of hierarchy within each possible relationship (see below). Accordingly, relations can differ across dyads, taking one form with one partner and another with its neighbor, depending on circumstances. In the early postwar period, for example, the United States entered into an alliance with Australia and New Zealand but, in the same general region, expanded its imperial outpost in Guam to include all of Micronesia.

Security relations vary along a continuum defined by the degree of hierarchy between the two parties (see Figure 1).<sup>19</sup> The degree of hierarchy is in turn

17. James 1986. Today, as factors of production become more mobile internationally, the traditional concern with territorial integrity may be less central; see Rosecrance 1986.

18. States also possess the option of unilateralism, in which they choose not to pool resources and efforts in the joint production of security. Prior to 1945, this was the prevailing policy of the United States, and it is the principal alternative to alliances today. In addition to the expected costs of opportunism and governance costs, the choice between unilateralism and the "relational" alternatives discussed in this article is also influenced by scale economies in producing security. More specifically, the analysis must expand to include the division of labor between the parties, the technology of production, and positive externalities in the unilateral and relational alternatives. For reasons of space, I do not develop this additional dimension of policy or set of causal variables in this article. As scale economies are important only for the choice between unilateralism and the optimal relationship between parties defined below, the analysis presented here stands on its own. For a full treatment, however, see Lake forthcoming. I also do not address alternatives to balancing, such as appeasement or detente with threatening states.

19. Although relationships may be hierarchic, the international system remains anarchic. See Waltz 1979.



FIGURE 1. *A continuum of security relations*

defined by the locus of rights of residual control.<sup>20</sup> All relationships, whether entered into voluntarily or as a result of coercion, can be considered as based upon some “contract” between the two parties specifying explicitly or implicitly the terms under which they will pool their defense efforts and the residual rights of control retained by each. Contracts are, simply, self-enforcing agreements that define the terms of the relationship between two parties. Parties can completely or incompletely specify their contracts. Completely specified contracts detail numerous contingencies and set forth appropriate responses by the parties; incompletely specified ones contain holes that are filled in by the parties as necessary. In other words, the parties may either “contemplate all conceivable bridge crossings in advance, which is a very ambitious undertaking,” as Oliver Williamson notes, or address actual bridge crossings as events unfold.<sup>21</sup> With costly information (see below), no contract can address all contingencies in all possible states of the world. In practice, all contracts are specified imperfectly and thus possess a varying “residual” of unspecified rights, obligations, and actions. Which party has the ability *de jure* or *de facto* to make decisions in this residual defines the rights of control. The term “right” does not necessarily imply a *de jure* and formal recognition by both parties of their authority to exercise control over the residual. The term can simply reflect a *de facto* and informal ability of one state to control the behavior of the other over some areas. Rights differ from mere influence, however, by constituting an enduring pattern of control within an ongoing relationship.

In anarchy, each party to the relationship possesses full residual rights of control; while constrained by its environment, each state is master of its own fate in that area of rights not previously ceded in the contract. In hierarchy, one party—the dominant member—possesses the right to make residual decisions, while the other party—the subordinate member—lacks this right. Thus, the dominant state possesses control over all resources and assets of the subordinate actor that have not been specifically reserved to the latter in the contract. Whether the parties have entered into the relationship voluntarily or through the pain of battle is irrelevant to the definition of hierarchy; the process of its creation does not define a relationship’s degree of relational hierarchy.

20. Surprisingly, economists typically fail to define hierarchy in a formal way. The definition used here follows most closely from Grossman and Hart 1986.

21. Williamson 1985, 20.



As Figure 1 illustrates, the range of relations is continuous in principle. When relations move from anarchy to hierarchy, the rights of residual control possessed by the subordinate party decline. Nonetheless, certain salient relational forms have been observed historically. The placement of these forms along the continuum is only approximate.<sup>22</sup>

In an alliance, which lies at the anarchic end of the continuum, states pool resources in pursuit of some common objective while retaining complete rights of residual control. Most modern defense alliances, including the Rio and Australia–New Zealand–United States pacts formed after World War II, take this form. The North Atlantic Treaty Organization (NATO) is also essentially anarchic except for the position of the Supreme Allied Commander, Europe and the special provisions governing Germany, both of which were added later as the organization matured and reflect some transfer of residual rights to the organization itself or between states within the alliance.

Empire lies at the hierarchic end of the continuum and occurs when one partner cedes substantial rights of residual control directly to the other. Yet, imperial amalgamations are seldom complete and vary considerably in form and extent; the locus of residual control need not reside completely in the dominant unit for us to regard the new entity as hierarchic.<sup>23</sup> As implied above, imperialism can be freely negotiated—as in the recent merger of the German Democratic Republic into the Federal Republic of Germany—or coerced, as witnessed in the late nineteenth-century scramble for Africa and in Germany's quest in the first half of this century for a continental empire; under both circumstances, it is the reduction in the rights of residual control that defines the hierarchic relationship.

Between these extremes lie at least two intermediate relationships. In a protectorate, one state cedes control to another over important areas of national policy, most notably foreign affairs. Although the terms vary, such grants of control are typically broad, made for extended periods of time, and are not revocable. Such delegations of authority transfer residual rights of control in the designated areas from the “protected” state to the “protector” and severely constrain the former's ability to influence the policy choices the latter makes for it. Britain extended a *de jure* protectorate over the so-called native states of India and a *de facto* protectorate over what is now the United Arab Emirates during the nineteenth and early twentieth centuries. The United States has transformed parts of its Trust Territory of the Pacific Islands, established as U.S. empire under United Nations auspices in 1947, into protectorates; under “free association” agreements adopted in 1986, the United States now recognizes the Federated States of Micronesia and the Republic of the Marshall Islands as sovereign states but continues to accept

22. One of the best, if dated, sources on relational forms is Willoughby and Fenwick [1919] 1974.

23. Compare the discussion of the United States in Waltz 1967 with that of hierarchy in Waltz 1979.

responsibility for their defense. Relations between Russia and several of the Soviet successor states also appear to be evolving into protectorates.<sup>24</sup>

Informal empire exists when one state controls indirectly substantial residual rights in the other; this typically occurs through a nominally sovereign but functionally dependent and therefore controllable agent in the subordinate state. Informal empire differs from formal empire, according to Michael Doyle, principally in the mechanism of control, “which informal imperialism achieves through the collaboration of a legally independent (but actually subordinate) government in the periphery.” This creates the reality of empire without the form.<sup>25</sup> In this sense, informal empire is rule by proxy or, more meaningfully, a form of delegated authority. To the extent that the local government is dependent upon the dominant state, it must obey the latter’s commands and anticipate its wishes. This dependence effectively, if not legally, transfers broad residual rights of control to the dominant state. The greater the dependence of the local government upon the dominant state and the less costly it is for the latter to replace the former, the greater the transfer of rights.

An informal empire is difficult to recognize, though, since the exercise of imperial power is evident only in “out-of-equilibrium” behavior. When the dependence of the client and costs to the patron of changing local rulers are well understood by both parties, no resistance occurs, no overt coercion is necessary, and the local government complies with the wishes of the dominant state as if in an alliance. Only if the client tests its dependence or the patron’s patience will the imperial controls become manifest. As a result, and as Doyle suggests, informal empire can be distinguished from other relations only by observing interactions over some extended period, thereby increasing the chances for encountering anomalous behaviors.<sup>26</sup>

The most striking modern example of an informal empire was the Soviet bloc established in Eastern Europe following World War II and subsequently embodied in the Warsaw Pact. As events attested, the local communist governments were fundamentally dependent upon Soviet backing; once President Mikhail Gorbachev withdrew that support, the regimes quickly toppled. Moreover, the subordinate peoples consistently tested the limits of informal Soviet rule, sparking suppressions of local dissent in East Germany in 1953, Hungary in 1956, Czechoslovakia in 1968, and (indirectly) Poland in 1981. In this example, recurring out-of-equilibrium behavior clearly affirmed the existence of an informal empire. As recent out-of-equilibrium events in Haiti, Nicaragua, and Panama also suggest, many states in the Caribbean and Central America are similarly caught in an informal U.S. empire.

While the lines between these historical forms may be difficult to discern in the absence of attempts by subordinate actors to assert their independence, the

24. Roeder 1995.

25. Doyle 1986, 38 and 42.

26. Doyle 1986, 39 and 43.

distinctions nonetheless capture important differences in relations. Not all relevant relations are anarchic and, despite their nominal sovereignty, not all countries have the same freedom of residual choice. “Pure” cases of anarchy or hierarchy seldom exist. Even in what are mostly consultative relations between allies some degree of control may be exercised over residual choices. And in empire, local officials often are given some independence in responding to local conditions. In the following, the terms “alliance” and “empire” are used as shorthand for policies that lie closer to the anarchic or hierarchic end of the continuum, respectively.

### **Contracting for security**

To explain the choice of relations by states, I build upon theories of relational contracting. Analysts first used these theories to explain the institution of the firm, but they constitute an approach to understanding social organization more generally. The key insights of the relational contracting approach are, first, that the transaction is the unit of analysis—in the case here, the pooling of efforts to produce security—and, second, that transactions can be carried out in a variety of governance structures, or what I have called relations above. Stated another way, the structures in which particular transactions occur are variable and endogenous. The approach is highly suggestive for the kinds of comparative analyses of grand strategy now lacking in international relations.

Transactions in turn are embodied in contracts between the relevant parties. As noted above, contracts vary in both their specificity and the rights of residual control possessed by each member; indeed, the latter is the defining attribute of relational hierarchy. Contracts also contain safeguards created by the parties to ensure mutual compliance. As Williamson suggests, such safeguards typically include: (1) actions designed to modify opportunity costs (sanctions for failing to perform the required actions, the exchange of hostages, side-payments), (2) “specialized governance structure(s) to which to refer and resolve disputes,” and (3) “regularities that support and signal continuity intentions.”<sup>27</sup> More generally, the degree of relational hierarchy and coercion can be considered to be safeguards. In constructing contracts, states are defining the terms of their transaction; the potential for cheating, defection, and other forms of opportunism; and the means for controlling one another’s behavior. In this approach, contracts are instruments through which to control the behavior of others.

The central hypothesis of the contracting approach is that parties choose relations to economize on resources—in other words, to maximize benefits from exchange and minimize transaction costs. In short, actors choose the relationship that is most efficient for conducting the transaction. By doing so, the parties maximize the resources that can be used for other valued purposes;

27. Williamson 1985, 34.

for firms, this implies profit maximization and for states (under assumptions to be discussed shortly), cost minimization. At a general level, this implication—while clearly artificial—is nonetheless plausible. When decision makers are perfect agents for their principals, whether these be shareholders in a firm or voters in a democracy, they have no incentive to conduct relations in ways that intentionally waste resources. Yet at this level, the implication is also a virtual truism, as it is relatively easy to concoct post hoc stories about why any observed relationship is efficient for the parties involved; indeed, this is perhaps the most common criticism of the approach. The true test of a theory of relational contracting comes from specifying more concretely the range of alternatives and the determinants of efficiency—issues scholars continue to debate, thus yielding multiple theories united by a common approach.

Below, I develop a theory of relational contracting tailored to international security affairs. As we shall see, the optimal relationship is principally a function of the expected costs of opportunism, which decline with relational hierarchy, and the governance costs of creating and maintaining the relationship, which increase with hierarchy.

### *Assumptions and limitations*

In the following theory, I make several assumptions, which I will note here but not defend at length. First, actors are rational, but information is costly and therefore limited. The first part of this assumption is common but frequently criticized in theories of international politics. By rationality, I mean simply that actors possess transitive preferences and act purposively. While states may know their own defense effort with certainty, they can observe features of their environment—including their partner's defense effort—only at some cost. Due to diminishing marginal returns, states never acquire complete or perfect information about their partners. Rather, they estimate probabilities of certain behaviors and update their beliefs as they receive new information. In short, states are Bayesian decision makers and choose relations on the basis of expected utility calculations.<sup>28</sup>

Second, security is a single dimension of policy; the relevant “selectorate” (whether voters or Politburo members) possess single-peaked preferences; and the government is a perfect agent for its selectorate. These are the familiar conditions behind the median voter theorem, applied here more generally to a wider variety of domestic choice mechanisms.<sup>29</sup> This assumption produces a highly stylized view of domestic politics in which policy always reflects the position of the median selector and allows us to treat states as unitary actors. In

28. For an introduction to Bayesian decision making in a fully strategic setting, see Morrow 1994, 161–87.

29. For a good introduction to public choice models, see Schwartz 1987. For applications of the concept of selectorate to nondemocratic polities, see Roeder 1993, 24–27; and Shirk 1993, 71–72. For a related approach, see Achen 1988.

making this assumption, I do not intend to imply that domestic politics are unimportant. Rather, I want to focus attention on relations between rather than within states. I have addressed some consequences of relaxing this assumption elsewhere.<sup>30</sup>

Third, states do not possess preferences over particular relations; that is, the selectorate does not innately prefer alliances or imperialism but values these alternatives only as instruments toward some other, unspecified but valued ends. States may be expansionary or status quo powers, power-seeking or wealth-seeking; this assumption merely restricts states from having preferences for or against particular instruments of policy. Like the second, this assumption is often violated in reality, but its effect is to concentrate our attention on the environment of states rather than their dispositions. Whether environmental theories, such as this, or dispositional theories prove more useful is an empirical question not addressed here.

Together, these first three assumptions imply that states choose the relationship that minimizes their costs of producing a desired level of security. By so choosing, states and their selectorates maximize their utility by conserving resources that can then be used to obtain other valued ends.

Fourth, the threats faced by dyads are exogenous. Positing exogenous threats is an analytic convenience that produces a point of entry into the ongoing cycle of action and reaction in international politics. Phrased differently, the theory begins with the existence of a security threat from a third party and seeks to explain how the members of a dyad choose a particular response. As noted above, the threat from others is a complex phenomenon, driven by the third party's goals and risk propensities, the state's own goals, the security dilemma, and many other factors. Without explaining where threats originate, it is nonetheless appropriate to ask how others respond.

Finally, when members of a dyad would otherwise choose different relations, the stronger of the two parties prevails by coercing the weaker party into accepting its preferred alternative. The current theory is decision theoretic rather than game theoretic in construction. In essence, states are understood as playing against "nature" when in fact they are interacting with other strategic actors. This construction is problematic when coupled with the assumption of costly information, as there is then no guarantee that actors will share identical estimates of the probability distributions of the variables in the model—although over time we may expect these estimates to converge. As a result, states in the same dyad may choose different relations, a problem that arises in the real world as what I have above called out-of-equilibrium behavior. This assumption is, admittedly, rather severe—especially in dyads where the actors are of relatively equal strength and, if locked in a coercive struggle, might logically become caught in an infinite spiral. It is less problematic in the unequal dyads, such as those between the superpowers and their respective

30. Lake 1992.

partners, that motivate this article; in very practical ways, the superpowers were relationship “makers” and others relationship “takers.” Recognizing that this is an important limitation, I nonetheless offer the current theory for consideration and, in the spirit of ongoing debate, invite readers to challenge, extend, and possibly refine its logic.

### *Opportunism*

As discussed above, opportunism is commonly understood to be ubiquitous in international relations—and, in the relational contracting approach, in other areas of social life as well. It is defined by Williamson as self-seeking behavior “with guile” and is assumed to be a trait common to all actors.<sup>31</sup> Opportunistic actors do not honor contracts out of a sense of obligation but press for individual advantages whenever possible. Opportunism by partners—whether intentional or not—is always a costly possibility. It is also a major determinant of the choice of relations.

States face three kinds of opportunistic behavior by their partners. As Glenn Snyder has posited, they may be abandoned. More generally, partners may shirk by formally or informally abrogating agreements. In ways large and small, partners may fail to fulfill their commitments. States may be entrapped by their partners into undesired conflicts and wars.<sup>32</sup> As such, entrapment is often a problem of moral hazard where commitments, once issued, cause the partner to act in a more risky, negligent, or aggressive fashion than before. Finally, states may be exploited—a closely related form of opportunism not addressed by Snyder. Having settled on an initial division of the benefits and costs of the relationship, partners can subsequently seek to alter the terms of agreements and obtain more favorable distributions of the joint gains.

When it occurs, opportunism is costly to the state. Its partner either contributes less to the joint enterprise than promised, forces the state to divert its own resources toward undesired ends, or seizes a greater share of the joint gain than anticipated. Abandonment, for instance, not only reduces the contribution of the partner but it can also reduce the efficacy of the state’s own defense efforts; if the state has specialized in a land-based army and its partner has agreed to provide the complementary naval defense, for instance, opportunism by the latter may leave the former more vulnerable than if it had produced both an army and navy of its own.

The cost to the state of such behavior is determined by the state’s opportunity cost. When it possesses alternatives that it values almost as much as the one in question, a state’s opportunity cost is relatively low; it can shift from relationship to relationship easily and without a significant loss in welfare. When it has no attractive alternatives, the state’s opportunity cost is high, and

31. Williamson 1985, 30.

32. On abandonment and entrapment, see Snyder 1984.

changing relations is a more consequential decision with more deleterious welfare implications. The greater the state's opportunity costs, the greater is the harm—or actual cost—the partner can inflict upon it.

Opportunity costs are determined by the degree to which assets are relationally specific, or possess more value in one use and relationship than in others.<sup>33</sup> Assets can be highly flexible and easily transferred from one application to another or highly specialized and difficult to redirect. The more relationally specific the asset, the greater are the opportunity costs incurred by the state. In security affairs, relationally specific assets range from military forces requiring large investments in dedicated infrastructure or hardware (e.g., heavily armored divisions designed for a land war against the former Soviet Union or U.S. intermediate-range missiles developed for overseas deployment) to ports uniquely located in strategic areas (e.g., Guam). Nearly all divisions of labor entail some asset specificity; moving from specialized and integrated forces to an autonomous military necessarily requires retooling, retraining, redeployment, and time. In sum, the more specific the asset, the greater the state's opportunity costs and thus the greater the costs inflicted by the partner's opportunistic behavior.

The probability that the partner will act opportunistically, in turn, is a function of the governance structure that the actors choose to construct. If actors have safeguarded the provisions of the contract adequately (that is, if the provisions are self-enforcing), their ability to act opportunistically is determined by their rights of residual control. The greater the residual rights, the greater the discretion of the actor to behave in ways that may—intentionally or unintentionally—undermine the joint defense effort. Thus, by implication, the probability that the partner will engage in opportunistic behavior decreases with relational hierarchy.

In an alliance, for instance, the partner retains complete residual rights and thus wide discretion. Even though it may agree to declare war if a third state attacks the first, the partner nonetheless retains the right to decide who attacked and how many resources it will actually commit to the conflict. In anarchic relations, *ceteris paribus*, the probability that the partner will behave opportunistically is comparatively high. In an empire, at the other extreme, states merge their formerly autonomous decision-making processes and transfer rights of residual control to the dominant member. The dominant state now decides—to continue with the same example—who is the victim of any attack (presumably itself), who is the aggressor, and how many resources its partner must mobilize. In practice, however, even in imperial relationships, localities may possess some decision-making authority and, thus, some potential for opportunism. Nonetheless, the tighter the imperial relationship and the more

33. This is also known as the asset's quasi-rent; see Klein, Crawford, and Alchian 1978. The more specialized the asset, the greater are its quasi-rents. Asset specificity can also be understood to affect the transactions costs of changing relations.

integrated the amalgamated territories, the smaller the probability that the subordinate partner will act opportunistically.

The expected cost of opportunism is a function of its actual cost, if it occurs, and its probability. Expected costs can be absorbed directly by the state; here, the state simply accepts some opportunism by its partner as a necessary evil. Conversely, the state can deploy some of its own resources as a hedge against possible opportunism. Even when a partner has agreed to help protect it, for instance, the state may maintain redundant forces for fear that the partner will not produce the promised benefits. The state may also forgo the most efficient technology—or continue to use a less efficient technology in some portion of its forces—for fear that its partner will renege on necessary basing rights or other matters. Or, the state may waive some degree of specialization for fear that the other will not live up to the terms of the agreement. Hedging is a form of insurance against opportunism. Like actual opportunism, it is costly to the state.

In principle, the expected costs of opportunism can be measured by the resources necessary to hedge completely against this possibility, given existing information. This conversion provides a useful metric and allows us to map the resources required to produce a constant level of security onto the degree of relational hierarchy, creating an “isosecurity” contour that reflects the change in costs as a function of the probability of opportunism. This is illustrated in the *O* contour in Figure 2. The shape of the contour reflects the probability that the partner will act opportunistically. Following from the arguments above, it is negatively sloped throughout. The more effectively hierarchical governance structures control opportunism, the steeper the contour will be. The height of the contour in turn is positively related to the state’s opportunity costs; *O'* represents either an exogenous increase in the state’s opportunity cost or, comparatively, another dyad with higher costs of opportunism.

All other things considered, states should prefer to bind their partners in more hierarchic relations. The fewer the residual rights of control retained by the partner, the lower the potential for opportunism and thus the expected costs. The specific relationship chosen, however, also depends upon governance costs.

### *Governance costs*

States incur governance costs in creating and maintaining relations. These costs take three distinct forms: distorted incentives in the subordinate partner, safeguards on the dominant state, and coercion. Despite the prominence attached to coercion in international relations—defined broadly to include all threats or actions designed to reduce the welfare of the partner unless certain actions are performed (compellence) or not performed (deterrence)—its role and importance are more easily understood once the logic of voluntary contracting is explicated. Where opportunism declines with the degree of



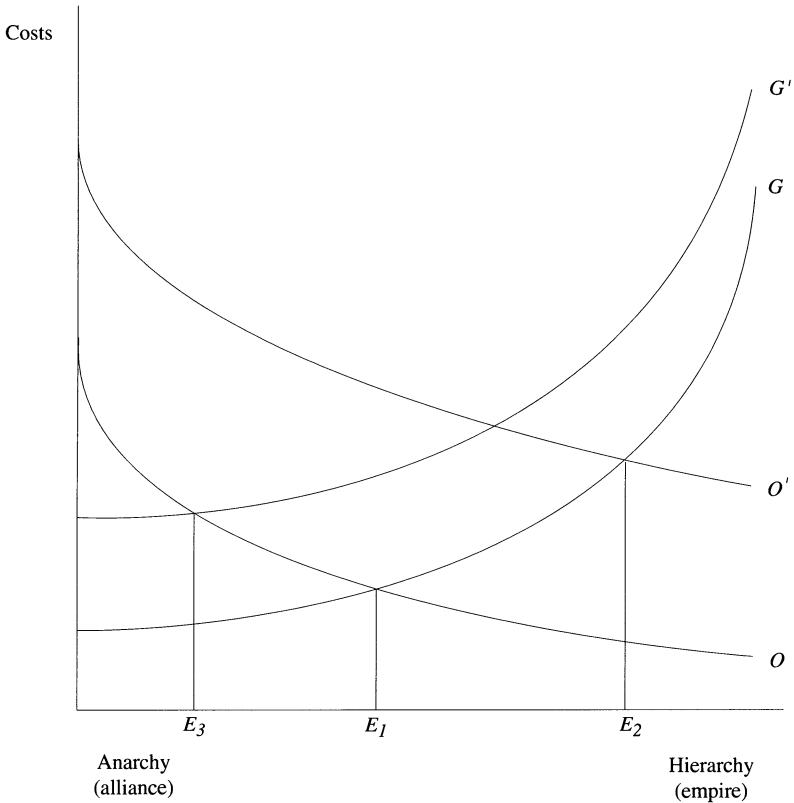


FIGURE 2. *Optimal security relations as a function of expected costs of opportunism ( $O$ ) and governance costs ( $G$ )*

relational hierarchy, governance costs increase with relational hierarchy. As a result, governance costs deter states from pursuing more hierarchic relations.

*Distorted incentives in the subordinate partner.* The shift of residual control from one partner to the other distorts incentives for the efficient use of resources in the subordinate member of the dyad. In a purely voluntary relationship, this creates for the dominant state both additional costs of monitoring and control and the need for greater side-payments.

With complete residual control, as in anarchy, parties to an agreement are motivated to produce security in the most efficient manner possible, as the resources thereby saved from less productive alternatives can be used for other valued purposes. Just as individuals are best motivated when they are claimants on the profits of a firm, so are states best motivated by the freedom to use their resources in any way they choose. As the subordinate party's residual control shrinks, its incentives are altered; the resources released by efficient production

are subject to increasing control by the dominant state and, thus, are less valuable to the subordinate. As the subordinate party's residual control recedes, incentives in other areas of economic and political life are also distorted. By definition, as residual rights decline, the dominant state exercises control over a greater range of behavior and, by implication, directs resources to uses the subordinate party would not choose on its own. As the residual rights of control shift from one party to the other, distortions in the subordinate member multiply.<sup>34</sup>

These distortions—both in the production of security and other areas—can, in part, be corrected by additional contractual provisions that mandate certain specified actions by the subordinate party. When states adopt this contractual solution, however, the dominant state must employ additional resources to monitor and safeguard the new provisions. As the distortions increase with relational hierarchy, the resources employed by and therefore the costs to the dominant state must increase as well.

Contracting cannot remove distortions entirely. Monitoring and safeguarding additional areas of behavior are subject to diminishing marginal returns. It is also efficient to shift the locus of residual control from one party to the other precisely when it is difficult to specify future contingencies; as a result, it is very costly to safeguard against all possible distortions. Because of its inherent and uncorrectable distortions, increasing hierarchy—*ceteris paribus*—reduces the welfare of the subordinate party. To gain the subordinate party's willing consent to a hierarchic relationship, the welfare losses created by these distortions must be compensated by some transfer or side-payment from the dominant state—increasing costs to the latter. As the subordinate partner's residual control declines and the distortions increase, so must the compensation package offered by the dominant state.

*Safeguards on the dominant state.* Relational hierarchy shifts the locus of opportunism from the subordinate partner to the dominant state. As the partner's rights of residual control decline, the rights of the dominant state over it expand—thereby increasing the potential that the latter will act opportunistically toward the former.<sup>35</sup> Especially important here is the enhanced ability of the dominant state to exploit the subordinate party; by using its enhanced rights of residual control, the state can alter the terms of the initial contract to its advantage. In the absence of coercion, the subordinate partner will not submit to this vulnerable position unless the behavior of the dominant state is adequately safeguarded in the agreement.<sup>36</sup>

34. This argument has a direct analog in the case of private firms; see Grossman and Hart 1986.

35. On opportunism by hierarchical authorities, see Dow 1987.

36. Safeguards render the dominant state's commitment not to exploit the subordinate partner credible. On the problem of credible commitments in international relations, see Powell 1990; Bueno de Mesquita and Lalman 1992; Fearon 1992; Papayouanou 1992; and Cowhey 1993. James Fearon focuses on precisely the problem here—that after consolidation the weaker party will

Central to any contract are safeguards employed by both parties to protect their interests, ensure compliance, and thereby render the agreement enforceable. Safeguards can apply both to the items agreed to in the contract and the residual rights of control. They impose costs on states directly by committing them to particular undertakings designed to modify opportunity costs and signal continuity intentions—such as deploying troops in exposed “tripwire” positions to assuage allied fears of abandonment. Safeguards also produce costs through the creation and maintenance of specialized governance structures, ranging from, say, NATO today to Britain’s imperial apparatus at home and abroad in the nineteenth century. The more extensive and severe the safeguards, the more costly they are; the greater the safeguards, in other words, the greater the resources that are employed to alter opportunity costs, signal continuity intentions, and create and maintain specialized institutions.<sup>37</sup>

Any partner will insist upon adequate safeguards against future opportunism prior to entering voluntarily into a relationship. Given the shift in the locus of residual control, subordinate partners will be increasingly attentive to this need as the degree of relational hierarchy increases. As a result, dominant states must undertake costly actions to bind themselves to the terms of the contract and, especially, must commit to exercise their expanded residual control in a nonopportunistic manner. Again, the latter requirement is particularly difficult to meet, as it is most efficient to shift rights of residual control from one state to another under conditions of uncertainty; if future contingencies cannot be specified in the contract, neither can those circumstances under which safeguards would be employed. By their very nature, safeguards on the enhanced ability of the dominant state to exploit its subordinate partner will tend not to be credible—suggesting why coercion, discussed immediately below, is so prevalent in relational hierarchies. Nonetheless, the relationship between increasing hierarchy and increasing safeguards on the dominant party is continuous; the greater the relational hierarchy, the greater the safeguards the dominant state must accept in order to gain the voluntary compliance of the subordinate partner.

This insistence on increasing safeguards can be demonstrated amply by a comparison of alliances and federal states. Alliance treaties, at most, obligate states to come to one another’s aid under some specified circumstances and, at a minimum, oblige them only to consult with one another. Such treaties typically contain few safeguards other than the right of withdrawal. Alliance treaties contrast with, say, the Constitution of the United States, which embodies one of the great voluntary amalgamations of previously or at least potentially sovereign states. While it contains some specific provisions, the framers of the American Constitution made no attempt to mandate actual

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become even weaker—and finds that under a wide range of circumstances the weaker side will choose to fight rather than accept an incredible agreement. See Fearon 1993.

37. Safeguards may also create maladaptation costs, which arise when circumstances change and render existing contracts less appropriate. See Williamson 1985, 21; and North 1990.

behaviors; rather, the agreement focuses on the design of institutions—the separation of powers, the composition of the Senate, the creation of a nonpartisan Supreme Court—to safeguard the important interests of the constituent states within the new hierarchy and, especially, the rights of the smaller members who might otherwise be overwhelmed by their larger and more powerful neighbors. As relational hierarchy increases, the safeguards on the dominant state and the governance costs it incurs must increase as well.

*Coercion.* Although it fits awkwardly within the neoclassical economic approach that informs relational contracting theories, coercion is a fact of life in international relations (and elsewhere). The governance costs incurred in correcting and compensating distortions in the subordinate party and safeguarding against the potential for exploitation by the dominant party both are rooted in problems of contracting under costly information. Coercion is a substitute for contracting. It can be used by the dominant state to correct distortions by eliciting appropriate behaviors from the subordinate party in difficult-to-specify contingencies. Likewise, it can be used to secure compliance with a hierarchical relationship without granting compensation for the resulting distortions. It also can be used in lieu of effective safeguards on the dominant state. Rather than binding itself to costly actions that alter opportunity costs, demonstrate commitment, or create specialized governance structures, the dominant state can force its partner to accept a contract that lacks the safeguards that would be necessary in a purely voluntary relationship. In short, coercion is an alternative to the concessions and compromises that would normally be required in any voluntarily negotiated contract between two parties.

Coercion also can enable states to overcome differences in their preferred relations by forcing the weaker party to acquiesce to the wishes of the stronger (this underlies the fifth assumption above). Just as muggers force their victims to choose between their money and their lives, so powerful states can force less powerful ones to choose between a subordinate position in a hierarchic relationship and enormous harm. The asymmetrical ability to use coercion often leaves the weaker party with only the illusion of choice—and sometimes not even that. Nonetheless, the alternative relations and determinants described in the theory remain salient, defining both the advantages to the weaker party of not conceding to the other and the amount of force the stronger must employ. Given the difficulty of safeguarding against the potential for future exploitation of the subordinate party by the dominant state, coercion may be the only means of effectively establishing informal and formal empires. Throughout history, the terms of the peace have been written by the victors, not the losers—the powerful, not the weak. The same holds for hierarchical contracts.

Like contracting, coercion requires the use of scarce resources and, therefore, is costly to countries that use or threaten to use it. This is clearly true for

direct military action, but it holds equally for other sanctions, such as trade embargoes (which, if effective, reduce the sanctioning country's terms of trade). States will choose between contracting and coercion according to their relative costs. Countries that possess a comparative advantage in coercion—whether from sheer size, military prowess, resource endowments, or whatever—will tend to rely upon this instrument. Coercion does appear to be the more cost-effective and, at least for hierarchic relations, the more frequently used instrument. The process of consolidating political authority into larger territorial units, the state-building process that produced the modern nation-states in today's developed world, frequently was violent.<sup>38</sup> Likewise, the threat of coercion by technologically superior European states was key to the process of empire building in the periphery of the global system.

As with the other governance costs, the costs of creating and maintaining a relationship through coercion typically increase with hierarchy. The more hierarchic the imposed relationship, the smaller the subordinate actor's rights of residual control, and therefore the more it can be expected to resist its loss of freedom both at the outset and throughout the course of the relationship. The greater the resistance, the greater the coercion necessary to support a given relationship.

Thus, the governance costs of acquiring control over others and maintaining a relationship either by contract or coercion increase as relations move from anarchy to hierarchy. As Figure 2 illustrates, defined in terms of the resources used in correcting and compensating distortions, safeguarding against the potential for exploitation by the dominant state, and coercing the subordinate party, these costs aggregate into a positively sloped governance schedule (*G*). I assume here that such costs rise at an increasing rate and that each move toward hierarchy becomes progressively more expensive to the dominant state. The absolute quantity of resources devoted to governance determines the height of the *G* schedule. Its shape is derived from the relative costs of alternative governance structures.

### *Optimal relations*

The expected costs of opportunism vary over time and across countries depending upon the opportunity costs of the state and its partners. They also vary across alternative relations, declining with hierarchy. Governance costs vary across time and space as well, depending upon the ease of safeguarding against and coercing partners. These costs rise with the degree of relational hierarchy, deterring states from imperialism.

Together, the expected costs of opportunism and governance determine the optimal relationship between a state and its partner.<sup>39</sup> For any dyad, this

38. On state building, see Tilly 1990.

39. Optimal relations are also influenced by feedback effects, which occur when relations in one

relationship is defined by the intersection in Figure 2 of the isosecurity contour and the governance cost schedule. At the point of intersection, one factor of production devoted to increasing hierarchy releases one factor from hedging against the risk of opportunism. To the left of this point, an additional factor devoted to governance releases more than one unit from hedging. To the right, an additional factor spent on hierarchy releases less than one unit from hedging. Exogenous increases in the expected costs of opportunism raise the isosecurity contour and shift the equilibrium toward greater hierarchy ( $E_2$ ). Likewise, exogenous increases in governance costs shift the schedule upward and move the equilibrium toward greater anarchy ( $E_3$ ). Changes in the shapes of the curves produce analogous effects (see Figure 3 below for examples). States possess unique sets of curves for each partner, suggesting that optimal relationships will differ across dyads.

In equilibrium, we should observe anarchic relations most commonly when the expected costs of opportunism are low or governance costs are high, and hierarchic relations when the expected costs of opportunism are high or governance costs are low. These equilibrium conditions reconcile the apparent contradiction revealed in the discussion of opportunism in the literatures on alliance formation and imperialism above.

The common core in international relations, focusing on capability aggregation and opportunism, is central to the relational contracting theory developed in this article. In producing security, states aggregate resources and worry about opportunism by their partners. The expected costs of opportunism play an important role in determining the choice of relations, leading states to prefer more rather than fewer hierarchic alternatives. In a way not sufficiently appreciated in the common core, however, the risk of opportunism is partly endogenous. The expected costs of opportunism are influenced by circumstances, but they are also a function of the relations states choose, declining with the degree of hierarchy. States mold their relations to control this risk, pursuing greater hierarchy when it increases and less hierarchy when it decreases.

Missing from the common core identified above are governance costs, which rise with relational hierarchy and constrain states from pursuing more imperialist alternatives. The importance of these costs is evident from the counterfactual: in their absence or if instead of rising they declined with relational hierarchy, we would observe an inevitable trend toward empire in most dyads—a trend clearly at variance with reality. Somewhat counterintuitively, relational hierarchy is costly to dominant states. They must safeguard distortions or offer side-payments to their subordinate partners, expend resources to limit their own ability to exploit their partners in the future, or

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dyad allow third parties to update their prior beliefs about the expected costs of opportunism or governance of their relations with the members of that dyad, and scale economies in governance costs, which may promote multilateral relationships. For reasons of space, these extensions of the basic model are not developed here. See Lake forthcoming.

coerce their partners. In the end, states weigh the efficacy of hierarchy against increasing governance costs when choosing their security relations.

### **Superpower strategies**

Assessing the theory developed above faces three major hurdles. First, the independent variables are not easy to operationalize. The expected costs of opportunism and governance costs both are difficult to measure precisely; in turn, we lack systematic data. This same problem also has bedeviled tests of relational contracting theories in economics. Direct tests of the theory based on good proxies for these variables will be nearly impossible for the foreseeable future.

Second, and relatedly, both variables actually are defined as probability distributions: states do not know the expected costs of opportunism or governance costs with certainty but base their decisions on some set of prior beliefs that they update as they receive new information. The probabilistic nature of the variables makes definition and measurement difficult. Case selection, then, is extremely consequential. For example, focusing on prominent historical events—especially noteworthy policy failures where the strategies employed performed far under expectations—risks limiting analysis to cases with extreme values for one or both variables. Deterrence failures resulting from buck passing or entrapments from chain ganging, often described as pathologies resulting from dysfunctional political or cognitive biases, may simply be the result of unfortunate events drawn from the “unlucky” tails of the probability distributions.<sup>40</sup> Fortunately, the dyadic nature of the present theory multiplies the number of possible cases.

Third, and most important, we can observe the relationship chosen within a dyad, but we cannot observe the relationships not chosen and the costs and benefits associated with those counterfactuals.<sup>41</sup> In other words, we can observe, presumably, the intersection of the isosecurity and governance cost contours, but we cannot observe directly the height and shape of the curves themselves. Yet these unobservable relationships are central to the theory and, as argued above, structure the choice of relations by states.

All three of these problems are quite common in the social sciences but typically are glossed over; they certainly are not unique to the current theory. Given these problems, one appropriate research strategy is to use historical episodes in which there were relatively clear differences in the independent variables to compare the static predictions of the theory. Through such cases, we can observe the direction of the independent variables and predict the

40. Christensen and Snyder 1990, 138 and 141.

41. This is a form of the fundamental problem of causal inference. See King, Keohane, and Verba 1994, 79.

range of possible variation in relations even if we cannot assign precise values or fully explicate the counterfactuals. Predictions can then be assessed against the record. In advocating this strategy, I am not suggesting that we should abandon scientific criteria or eschew systematic large- $n$  research designs. Rather, I suggest that carefully selected historical cases are a necessary first step in assessing a theory with difficult-to-measure variables.

In the remainder of this essay, I undertake a preliminary and highly tentative assessment of the theory, contrasting U.S. and Soviet relations with their partners in Western and Eastern Europe, respectively, in the years immediately after World War II.<sup>42</sup> This assessment is necessarily abridged, but it suggests that the theory can usefully illuminate empirical puzzles. In turn, the thumbnail sketches offered do not appear to disconfirm the theory. For brevity, I use Western and Eastern Europe as the units below; this is acceptable given the broad similarities in circumstances and policies within each region. For reasons of space, I cannot develop the interesting within-region variations. Nonetheless, it is important to remember that—despite this shorthand—this assessment is based on a series of dyadic observations, increasing the number of cases and consequently our confidence in the initial fit between theory and history.

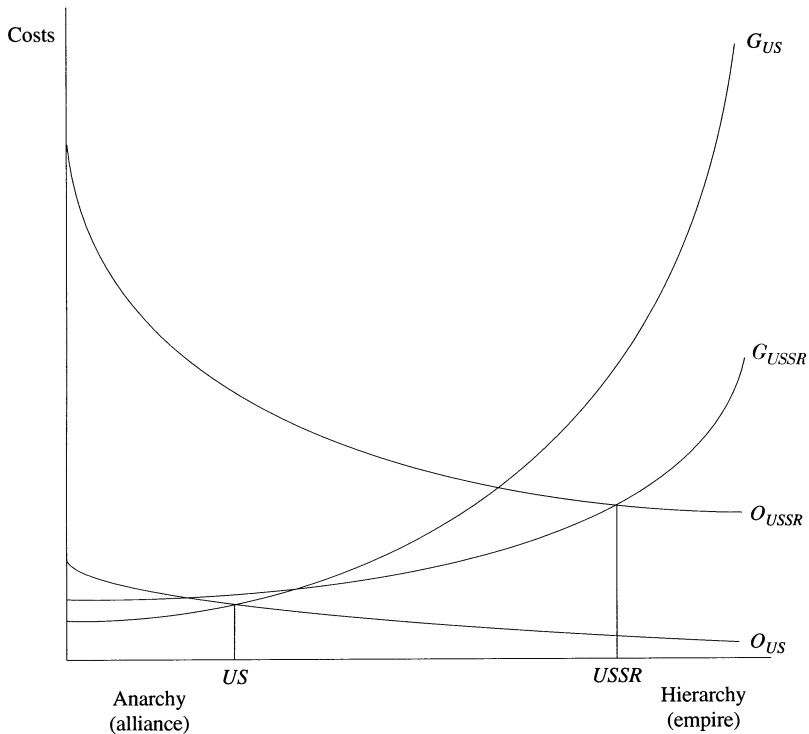
As Figure 3 illustrates in brief, the United States faced a comparatively low risk of opportunism by its partners after World War II, even in anarchy ( $O_{US}$  in Figure 3), and rapidly escalating governance costs ( $G_{US}$ ), implying that a relatively anarchic relationship would be adopted between the United States and Western Europe (such as that at  $US$ ). By comparison, the Soviet Union confronted a higher risk of opportunism ( $O_{USSR}$ ) and lower governance costs ( $G_{USSR}$ ), suggesting that a more hierarchic relationship with Eastern Europe would be selected ( $USSR$ ). Though speculative, the isosecurity contours and governance cost schedules in Figure 3 illustrate how the variables combine to predict broad patterns of relations. I begin with an overview of the relations chosen and then briefly discuss each variable.

### *Anarchy versus hierarchy*

In 1948, the United States began negotiations with Britain (and Canada) over what would eventually become NATO. The treaty was signed in April 1949 and ratified three months later. Although the Korean War heightened America's commitment to Europe, deepened its involvement, and institutionalized the alliance, the basic direction of U.S. foreign policy already had been determined prior to June 1950. Article 5, the core of the treaty, simply states that "the Parties agree that an armed attack against one or more of them in

42. For an extended treatment of the U.S. case and more complete citations, see Lake forthcoming, chapt. 4. For the Soviet case, the single best source remains Brzezinski 1967. Other noteworthy studies include Holden 1989; Jones 1990; Mastny 1979; and Ulam 1974.





**FIGURE 3.** *Optimal security relations for the United States and Soviet Union during the early postwar period, where  $O$  = expected costs of opportunism, and  $G$  = governance costs*

Europe or North America shall be considered an attack against them all” and calls upon each member to “assist the Party or Parties so attacked by taking forthwith . . . such action as it deems necessary, including the use of armed force, to restore and maintain the security of the North Atlantic area.” Article 3 specifies that the member states should engage in “continuous and effective self-help and mutual aid.”<sup>43</sup> While based on mutual defense and assistance, each state is free under the treaty to interpret circumstances and choose its response according to its own designs. Each remains in control of its own policy not only in all areas outside the alliance but in virtually all areas covered by the agreement as well.

The Soviet Union’s informal empire in Eastern Europe was more opaque. While each state remained nominally sovereign, the Soviet Union exerted control over significant areas of political, economic, and social activity in Eastern Europe through two principal means. First, the Soviet Union imposed

43. The treaty is reprinted in Kaplan 1984, 227–28.

ideologically compatible states on the local populations, acting under the general rule that noncommunist regimes meant anti-Soviet governments.<sup>44</sup> More important than ideology, however, these regimes typically lacked popular support. As a consequence, the new communist leaders in Eastern Europe were dependent upon Moscow for continued rule. Rather than serving as agents of their local populations, these leaders served more or less at the behest of Moscow and as agents of their Soviet principals. The structural weakness of the East European regimes gave the Soviet Union substantial de facto residual rights of control over those areas in which it chose to exercise those rights.<sup>45</sup> Second, the Soviet Union partially integrated the economies of Eastern Europe into its own centralized command economy. Over time, the political dependence of the local communist rulers was reinforced by the economic dependence of the state and society. The command system and economic dependence further solidified and, indeed, institutionalized the transfer of residual rights to Moscow.<sup>46</sup>

In Western Europe, as many revisionist historians have argued, the United States also was concerned about the composition of local governments and patterns of economic transactions.<sup>47</sup> Yet, the U.S. role in Europe tended to be proscriptive rather than prescriptive. The United States was involved in the internal politics of several European states after the war. It worked against communism in France, Greece, and Italy, but it did not typically support domestic elites who lacked substantial indigenous support. It also sought to prevent economic dependence on the Soviet Union, to destroy existing imperial economic systems, and to strengthen the international market economy in which it was the dominant competitor. But, in all cases, the United States cultivated a more diversified and diffuse form of economic dependence that stopped short of dictating patterns and levels of exchange. As the entire theory above suggests, residual control is a question of degree rather than kind. Without denying the importance of the United States in European politics after 1945, it is nonetheless apparent that the Soviet Union exercised far greater residual control over Eastern Europe.

### *Opportunism*

The risk of opportunism by America's partners in Western Europe was relatively low. In the security arena, the Europeans were challenged by the Soviet Union, dependent upon the United States, and limited in their

44. Campbell 1984.

45. Others emphasize direct control through the secret police, Soviet ambassadors, and other forms of monitoring and control. See Brzezinski 1967, 116. While important, the effectiveness of these instruments depended upon the structural weakness of the East European regimes.

46. Brzezinski 1967, 99–100.

47. The classic statement of the revisionist position is Williams 1972. For a more nuanced revisionist account, see LaFeber 1993. The revisionist perspective has generated a large counterliterature, including the voluminous history by Leffler 1992.

alternatives. The United States also promised to be the postwar center of economic dynamism, and Europe's recovery was closely tied to access to the American market. With high political and economic opportunity costs, the Europeans were fixed in the American orbit, and the United States rested secure that it was unlikely to be abandoned by its partners—even in a relatively anarchic alliance. The United States was concerned with free riding by its smaller partners and possible entrapment by its more adventurous or revanchist allies. Such forms of opportunism, however, could be effectively safeguarded at minimum cost through creative institutional solutions within NATO (see below).

The potential for opportunism in the Soviet sphere in Eastern Europe, on the other hand, was quite high. As a great power, the Soviet Union had long been a regional threat and it had a demonstrated record of aggrandizement against its neighbors. Indeed, before and during the war many in Eastern Europe perceived Germany as the lesser of two evils and sought to use the German reich as a counterweight to an even more distasteful Soviet imperialism.<sup>48</sup> The Soviet Union's regional dominance only increased with the defeat of Germany. Rather than emerging as a "good neighbor," the Soviet Union exited the war as a revisionist regional power against whom the East Europeans would normally balance rather than bandwagon.

Similarly, the East Europeans, and particularly the northern tier states of Czechoslovakia, East Germany, Hungary, and Poland, had been previously integrated into the European market economy. Economically, as well as politically and socially, these states were part of "Europe," and the economic turn toward the Soviet Union was, to put it simply, unnatural. The attraction of the West, moreover, was reinforced by America's postwar economic vitality. Czechoslovakia and Poland's initial interest in participating in the Marshall Plan provided continuing evidence to the Soviet Union of the pull of the Western economic and political systems. Russia was justifiably concerned that the states of Eastern Europe would abandon it at the first opportunity—as indeed they did some forty years later.

### *Governance costs*

The conduct of the war left the Soviet Union and United States with dramatically different governance costs in their respective spheres in Europe. The United States fought alongside its Western allies during the war and, with the exception of its occupation zone in Germany, did not claim exclusive areas of jurisdiction upon victory. To assert control over the areas it liberated would have forced the United States either to forfeit the considerable gains it acquired from pooling resources with its partners during the conflict or to turn its war machine against its allies. The Soviet Union, conversely, fought by itself

48. Dallin 1942, 242.

on the eastern front. While they cooperated with local resistance groups, often communist, Soviet troops liberated most areas from Axis control, directly occupied them after the war, and—in the ensuing flux—ensured that communists and other pro-Soviet groups formed important parts of every postwar government. As a result, the costs of establishing control over and coercing their postwar partners were absorbed in the defeat of Germany. From the perspective of postwar relations these costs were “sunk.” In other words, finding themselves in a dominant position in Eastern Europe at the close of the war, past costs of coercing partners were not factors in the choice of future relations. The costs that theoretically—and in the West, practically—impeded the pursuit of hierarchy dropped out of the Soviet calculus. All the Soviets needed to consider were the future costs of governing territories they already effectively controlled.

The governance costs of maintaining hierarchic relations also differed between the Soviet Union and the United States. For the United States, the costs of an alliance were small but rose rapidly with relational hierarchy. In this regard, the U.S. occupation of Germany provides a useful case through which to probe the relevant counterfactual. Even though the defeat of Germany left U.S. troops dominant in their zone and thus in a position similar to that of their Soviet counterparts, the ongoing costs of the occupation were prohibitive, suggesting that greater hierarchy elsewhere also would have been extremely costly. The Germans were expected to pay all costs associated with the occupation, and they bore a substantial burden during a period when many were living below subsistence levels: between 1946 and 1950, for instance, between 42 and 26 percent of all tax revenues collected in Germany were used to pay for the occupation.<sup>49</sup> Yet, the United States maintained that it was spending far more than it received from Germany in reimbursements—and may have been spending four times more for the occupation than the Germans themselves. Even in 1946, during the initial, punitive peace phase when little sympathy was shown the defeated Germans and before Marshall Plan and other forms of aid began to flow to the war-devastated state, the occupation of the then-consolidated Anglo-American zone was costing taxpayers in Britain and the United States over \$600 million per year.<sup>50</sup>

Closer to its occupied territories, less attentive to local needs, and more willing to use coercion as a substitute for voluntary compliance, the costs to the Soviet Union of its informal empire were relatively low in the early postwar years—taking the form mostly of low paid occupation troops.<sup>51</sup> Moreover, these

49. Grosser 1955, 90. See also Davidson 1961, 261, 265, and 297.

50. Botting 1985, 216 and 110.

51. For suggestive evidence that leaders within the Soviet Union considered the maintenance costs of the informal empire and decided nonetheless to continue the relationship, see the growing literature on the so-called Beria Affair, especially Richter 1993, in which the secret police chief appears to have proposed loosening Soviet control over East Germany—possibly to the point of allowing reunification.

direct governance costs were offset by substantial resource extractions from Eastern Europe. In the period 1946–56, reparations paid to the Soviet Union totaled \$14–20 billion. Substantial implicit trade subsidies added to this amount. By one estimate, the Soviet Union extracted on net \$1 billion per year from Eastern Europe until 1956, when the rebellion in Hungary forced a dramatic reversal in policy.<sup>52</sup> Even if it did not produce a profit in the early postwar years, the informal empire clearly did not constitute a significant drain on Soviet coffers.

Finally, U.S. fears of entrapment and exploitation could be safeguarded at relatively low cost within the alliance. The United States avoided any automatic commitment to Europe in NATO, retaining instead its freedom to respond at the time and in the manner of its own choosing even to direct attacks on the territories of its allies. And as its original role deepened with the outbreak of the Korean War, the United States also secured a commitment from its allies that the expanded and newly integrated forces in NATO would be led by a U.S. general directly responsible to the U.S. President. The ability of the Europeans to entrap the United States was thereby limited. The United States also emphasized the importance of mutual aid within NATO. Embodying this emphasis, Article 3 of the treaty was used with some effect to pry greater (in-kind) contributions out of Europe than might have occurred without the treaty—including base rights and, despite France's opposition, the eventual rearmament of Germany. This emphasis on mutual aid also signaled to the Europeans that they would be expected to carry a greater share of the burden once they had recovered from the war. In short, the institutionalization of the alliance within NATO and the safeguards thereby created served to reduce the risks of opportunism by the Europeans at little cost to the United States, increasing the attractiveness of more anarchic relations. Safeguards against free riding and entrapment were also available at similar costs to the Soviet Union—and in some cases were taken up, as when Soviet officers served in military command and advisory positions in Eastern Europe—but they were largely inadequate for solving the more thorny problem of potential abandonment.<sup>53</sup>

I have painted this initial assessment in broad brush strokes, losing subtlety and masking local variations in the process. Nonetheless, the evidence is broadly consistent with the theory. The theory, in turn, helps unravel the empirical puzzle that began this article. Facing relatively low expected costs of opportunism and escalating governance costs, the United States opted for anarchic alliance-based relations. With comparatively high expected costs of opportunism and lower governance costs, especially as the costs of coercion

52. The net extraction estimate is from Brzezinski 1967, 285–86. The debate over implicit price subsidies is large; see Marrese and Vanous 1983; Marer 1984a; 1984b; van Brabant 1984; Crane 1986; and Poznanski 1988. On the politics of implicit trade subsidies, see Stone forthcoming. The history of Soviet–East Europe economic relations is surveyed in Bunce 1985.

53. Brzezinski 1967, 122, 173, 459.

were sunk, the Soviet Union chose more hierarchic relations in Eastern Europe. While the evidence is supportive, it provides only a preliminary and tentative assessment of the theory. I have neither explicated fully the variables, probed within-region variations, nor controlled for plausible rival hypotheses—such as regime type. Even so, the broad fit provides a source of optimism for the likely success of more extensive tests.

## Conclusion

Grand strategy must be understood as a choice across alternative relations, not as the choice of a single policy. Relations vary along a continuum from anarchy to hierarchy, or alliance to empire. The choice across alternative relations, I have argued above, is a function of the expected costs of opportunism and governance.

The theory developed above and the difference in relations it explains are not simply of academic or historical interest. The concerns central to the variation in superpower relations are central to every state's foreign policy—especially for those seeking their way in the post-cold war world. Whenever they seek to cooperate, states must invest in governance structures designed to hedge against the expected costs of opportunism by their partners, with important consequences for themselves and others.

Although the theory is explicated here only for international security issues, the approach and the kinds of trade-offs it identifies are more general. States worry about opportunism, create safeguards, and coerce others in all of their interactions—including trade and financial relations, international resource and environmental negotiations, and human rights disputes. Indeed, international relations in general can be considered as a network of transactions embodied in implicit and explicit contracts and possibly modeled in ways similar to those here. By emphasizing the contractual nature of international relations, the theory calls to our attention the ways in which states shape their environments, choose whether or not to invest in greater safeguards, and decide how much “cheating” they are willing to accept. Where current theories of international cooperation tend to emphasize exogenously given circumstances, the approach developed here highlights the endogenous nature of institutions and relations. And where the present literature sees institutions as facilitating cooperation, they are also seen here as instruments of control.<sup>54</sup>

In recent years, the discipline of international relations has focused too much on the fact of systemic anarchy and has been insufficiently attentive to variations in hierarchy among polities. The systemic condition has blinded scholars to variations in dyadic forms.<sup>55</sup> Once central, theories of imperialism

54. See Stein 1990; Martin 1992; and Keohane 1984.

55. This is true even for critics of neorealism who challenge Waltz's view of structure. See Ruggie 1983 and Wendt 1992.

have all but disappeared from the field. With the current movement toward political integration in Europe, and the ongoing dissolution of the Russian empire, it is time that we reclaimed hierarchy as an interesting and variable characteristic of international relations.

More generally, focusing on transactions rather than actors may even allow international relationists to begin probing the rapidly changing patterns of political authority within the present global system. The breakup of the postwar communist empire, the formation of the European Union, and the rise of global markets and firms are momentous events that are defining, for better or worse, our new world order. Changing forms of relational contracting may well be creating, in John Ruggie's words, a postmodern, multiperspectival world.<sup>56</sup> But the concerns of international relations properly understood endure and are shaping the actors now emerging on the world stage.

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56. Ruggie 1993.

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