

Centre for Law, Economics and Society

Research Paper Series: 2/2011



**Trust, Distrust and Economic Integration.
Setting the Stage**

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CLES Working Paper Series

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April 2011

This is a pre-edited version of a chapter forthcoming at Ioannis Lianos and Okeoghene Odudu (eds.), The Regulation of Trade in Services in Europe and the WTO: Trust, Distrust and Economic Integration (Cambridge University Press, forthcoming 2011).

Trust, distrust and economic Integration: setting the stage

Ioannis Lianos* and Johannes Le Blanc**

I. Introduction

The concept of integration, the dependent variable of this study, has received different interpretations by lawyers, political scientists and economists. Lawyers generally understand the concept as referring to “legal integration”, which is defined as “the gradual penetration” of EU law “into the domestic law of its member states”¹. Economists prefer the concept of “economic integration”, defined as “the elimination of economic frontiers between two or more economies”². The removal of trade impediments between participating nations and “the establishment of certain elements of cooperation and coordination between them” characterizes the process of economic integration, as opposed to other forms of international cooperation³. Political scientists have been more reluctant to provide a ready-made definition of “integration” and have focused their analysis on the “political context in which integration occurs”⁴, the dependent variable being generally conceived in broad and descriptive terms, as the transfer of authority to a supranational level⁵.

The relatively recent emergence of the concept of “integration”⁶, owes a lot to functionalist theories, which were the first to break away “from the traditional link

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¹ A.-M. Burley & W. Mattli, ‘Europe Before the Court: A Political Theory of Legal Integration’, *International Organization*, 47 (1) (1993), 41-76, 43.

² J. Pelkmans, ‘The Institutional Economics of European Integration, in *Integration Through Law: Europe and the American Federal Experience A General Introduction*’, in Mauro Cappelletti, Monic Secombe & Joseph Weiler (ed.) *Integration Through Law*, Vol. 1, Methods, Tools and Institutions, Book 1, A Political, Legal and Economic Overview (de Guyter, 1986), p. 318.

³ A. M. El-Agraa, *Regional Integration- Experience, Theory and Measurement*, 2nd ed. (Macmillan, 1999), p. 1.

⁴ W. Mattli, *The Logic Of Regional Integration – Europe and Beyond* (Cambridge University Press, 1999), p. 19.

⁵ See, for instance, W. Mattli, above, p. 1, defining regional integration schemes as “cases that involve the voluntary linking in the economic and political domains of two or more formerly independent states to the extent that authority over key areas of national policy is shifted towards the supranational level”.

⁶ On the emergence of the theory of international economic integration see, Fritz Machlup, *A History of Thought on Economic Integration*, Macmillan Press, 1977), noting that economists in the inter-war era employed the negative noun of “disintegration” of the world economy, probably as a consequence of the national protectionist legislation that followed the economic crisis of 1929. The positive noun of “integration” was first employed after the Second World War in order to provide a conceptual vehicle

between authority and a definite territory by ascribing authority to activities based in areas of agreement”⁷. States exercise several functions (activities), some of which require action at the international level. This transfer initiates the process of integration, which is driven by the continuous pursuit of these functions, in the context of an international institution created to that effect. According to functionalism, “(e)very function is left to generate others gradually; in every case the appropriate authority is left to grow and develop out of actual performance”⁸. Based on this approach, neo-functionalism was able to construct a theory of regional integration employing the model of European integration as the archetypical paradigm of the concept. The functionalist approach and the concept of integration are profoundly interlinked: without the functionalist emphasis on the existence of separate functions, where authority can be transferred, there can be no integration, in the sense political scientists give to this term.

The aim of this chapter is to challenge this view. This can be done, first, by showing that the separate-spheres approach, the distinctive characteristic of functionalism and of its neo-functional progeny, does not hold in the current state of the European integration process. As it has been explained elsewhere, we are witnessing a gradual transformation from a process of “economic integration” in the traditional sense of the word to a “holistic approach”, where economic, social and political dimensions are profoundly intertwined⁹. Secondly, the European competences have been expanding continuously to areas previously subjected to the exclusive competence of the Member States. It is thus extremely difficult to distinguish between the different dimensions and impact of the process of integration and the functional boundaries of EU and state competences¹⁰. Third, the “legitimacy” or democratic deficit critique to the process of European integration has shown the limits of breaking the link between authority and territory, and the fact of ascribing

for the efforts of “integration of the Western European economy”, the substance of which “would be the formation of a single large market within which quantitative restrictions on the movements of goods, monetary barriers to the flow of payments and, eventually, all tariffs are permanently swept away”: *Ibid.*, p. 11, referring to Paul Hoffmann’s official pronouncement to the Council of the Organisation of European Economic Co-operation on October 31, 1949

⁷ W. Mattli, *The Logic Of Regional Integration – Europe and Beyond* (Cambridge University Press, 1999), p. 21.

⁸ W. Mattli, *The Logic Of Regional Integration – Europe and Beyond* (Cambridge University Press, 1999), p. 21-22 referring to the work of David Mitrany, *A Working Peace System* (Quadrangle Books: Chicago, 1966).

⁹ I. Lianos, ‘Shifting Narratives in the European Internal Market: Efficient Restrictions of Trade and the Nature of “Economic” Integration’, *European Business Law Review*, 21(5) (2010), 705-760.

¹⁰ R. Schütze, *From Dual to Cooperative Federalism – The Changing Structure of European Law* (Oxford University Press, 2010), pp. 190-213.

authority to activities. However, each process has different implications as to the actors involved: while the functionalist logic can accommodate the participation of stakeholders in the process (industry, labour, consumers), it is doubtful that it can extend to all the affected constituencies, as would have required the principle of democratic representation¹¹.

The shortcomings of the current state of integration theory, including the dependent variable selected, will be examined in the first part of this study. Our focus will be on the limits of the functionalist logic and on the alternatives suggested by competing theories of international relations. We will conclude that the main premises of functionalism have been seriously challenged. However, none of the competing theories has proposed a new conceptualization of “economic integration” nor have they suggested a more precise definition of the dependent variable. This situation is unsatisfactory, as without a clear definition of what is entailed by the concept of integration, the boundary between regional integration and international economic cooperation or other forms of international economic interaction is blurred.

Once the need for a new approach on the concept of integration is recognized, the second part proceeds in exploring two alternatives. The first one – economic integration as efficient organizational creation – perfects the dependent variable suggested by functionalism, extending it this time to authority-legitimacy transfers and elaborates a sophisticated typology of different degrees of integration. The second one – the trust theory of integration – chooses instead to abandon the definition of the dependent variable suggested by functionalism and to focus on a different dimension that would represent the turn towards a holistic, as opposed to a functionalist, approach of integration, where the social, economic and political dimensions are embedded to each other. In our view, the trust theory of integration provides a promising platform of reflection, not only for the European project of integration but for all other projects of regional integration. It can also clearly illustrate the important differences, as to the degree of integration, between the European integration project, for example, and the World Trade Agreement framework, without, however, establishing a clear demarcation line between them.

¹¹ G. Majone, ‘Transaction-cost efficiency and the democratic deficit’, *Journal of European Public Policy*, 17(2) (2010), 150-175 noting that the democratic deficit of European integration can be explained by the EU leaders propensity to avoid political transaction costs.

II. “Economic integration” beyond functionalism

The study of the concept of economic integration post second world war has been profoundly linked to the analysis of the phenomenon of regional integration¹². Heavily inspired by neo-functional theory, the studies of regional integration in the 1950s and 1960s emphasized the different dimensions of the integration process and their interaction with each other¹³.

The concept of political integration was the main focus, the economic and social dimensions of integration being “causally connected with political integration”¹⁴. Political integration was defined as

“the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities, towards a new centre, whose institution possess or demand jurisdiction over the pre-existing national states. The end –result of a process of political integration is a new political community superimposed over the pre-existing ones”¹⁵.

This framework relied on the following conceptual core: a process of “functional spill-over” and “political spill-over”, the two being interrelated¹⁶. Functional spill-over referred to a process of sector integration, starting with low profile economic and technical sectors and progressively expanding to the whole economy¹⁷. Political spill-over described “the incremental shifting of expectations, the changing of values and the coalescing at the supranational level of national interest groups and political parties in response to sectoral integration”¹⁸.

Regional integration could thus be distinguished from international trade liberalization, occurring almost during the same period, with the establishment of the General Agreement on Trade and Tariffs (GATT). Regional economic integration was perceived as an exception to the multilateralism of the GATT system, which did not

¹² E. B. Haas, ‘The Study of Regional Integration: reflections on the joy and anguish of pre-theorizing’, *International Organization*, 24(4) (1970), 607-646.

¹³ J. Nye, ‘Comparative Regional Integration: Concept and Measurement’, *International Organization*, 22(4) (1968), 855-880, p. 865 and 868, distinguishing between “economic integration” (formation of transnational economy), “social integration” (formation of a transnational society) and “political integration” (formation of transnational political interdependence).

¹⁴ E. B. Haas, ‘The Study of Regional Integration: reflections on the joy and anguish of pre-theorizing’, above, p. 632, footnote 31.

¹⁵ E. B. Haas, *The Uniting of Europe* (Stanford University Press, 1958), p. 16.

¹⁶ A.-M. Burley & W. Mattli, ‘Europe before the Court: A Political Theory of Legal Integration’, *International Organization*, 47 (1) (1993), 41-76, p. 55.

¹⁷ E. B. Haas, *The Uniting of Europe*, above, p. 297.

¹⁸ A.-M. Burley & W. Mattli, “Europe before the Court: A Political Theory of Legal Integration”, above, p. 55.

include any preferential regime at the time of its conclusion¹⁹. Only, Article XXIV of GATT contained an exception to the most favored nation (MFN) principle of Article I GATT, thus preventing multilateralism from operating in the specific setting of regional integration. The mechanism of spill-over, the constitution of supra-national institutions where experts, rather than diplomats, played a central role, was largely absent from the GATT scheme, whose nature was purely inter-governmental.

The topic of this volume being the regulation of trade in services at the regional (EU) and international (WTO) level, it is important to examine the basic tenets of neo-functionalism, before moving to other approaches that have challenged its assumptions. Our aim is to uncover the theoretical underpinnings of “economic integration”, by looking to the actors involved, as these are defined by each theoretical framework, their motivations or their ways of operation.

A. The rise and the fall of neo-functionalism

Neo-functionalism’s starting point is social differentiation: society is carved in various specialized and autonomous sectors, operating independently but gradually in more intensive cooperation with each other, as a consequence of the spill-over effect. Technocratic economic issues are perceived separately from contentious political or social ones. At the same time, they are profoundly interlinked within the same *continuum*. According to Haas, the initiator of the theory, “the supranational style stresses the indirect penetration of the political by way of economic because the ‘purely’ economic decisions always acquire political significance in the minds of the participants”²⁰. At the same time, “the measure of political success inherent in economic integration lies in the demands, expectations and loyalties of the political actors affected by the process, which do not logically and necessarily follow from statistical indices of economic success”²¹. It is clear in neo-functionalist theory that a “purely” economic scheme “does not by itself answer the basic political question

¹⁹ Article XXIV of GATT illustrates that regional integration was perceived as an exception to multilateralism. Preferential regimes were introduced in the GATT system with the Enabling Clause in 1979. See, GATT BISD 26S 1980, 203-205.

²⁰ E.B. Haas, “Technocracy, Pluralism and the New Europe”, in in. Joseph S. Nye, ed., *International Regionalism: A Reader* (Boston: Little, Brown, 1968), 149-166, p. 152.

²¹ E. B. Haas, *The Uniting of Europe*, above., p. 13.

whether the unified economy meets with the satisfaction of people active within it”²². The political and the economic dimension of integration are profoundly interlinked.

The main actors in the process of integration are experts operating independently from their national political constituents but who are at the same time checked by “equally prescient national actors”²³. They aim to promote, first, sectoral economic integration and, following “spill-over”, other forms of integration. The process of decision-making is incremental.²⁴

The dependent variable of integration is the concept of “authority-legitimacy transfer or sharing”²⁵. Possible independent variables are institutionalization and the attitudes of actors²⁶. Remarkably, neo-functionalism does not focus on the flow of goods, services, people across Member States as independent variables of integration²⁷. The dependent variable chosen is, of course, highly general and moving; hence, it does not relate to the existence of a holistic end-state or terminal condition: that of the “amalgamated” variety, such as the federal union, or of the “pluralistic” variety, such as a confederation. Domestic politics, the different dimensions of integration (economic, political and social) and the perception of States as multiple actors, active in the global as well as in the regional sphere, provide the matrix of the process of integration.

Although not necessarily limited to the study of European regional integration²⁸, the process of European integration has profoundly influenced neo-functionalism. Eventually, the credibility of the theory was affected by its perceived inability to explain the difficulties faced by the European project in the 1970s²⁹, following the “*chaire vide*” crisis and the opposition of General de Gaulle to British accession. The increasing role of “national actors” challenged the neo-functionalist’s belief that the integrated institutions were able to cope with the spill-over effect and

²² Ibid., p. 284.

²³ E.B. Haas, ‘The Study of Regional Integration – Reflections on the joy and Anguish of Pretheorizing’, *International Organization*, 24(4) (1970), 607-646, p. 627.

²⁴ Ibid.

²⁵ Ibid., p. 633.

²⁶ Ibid., p. 636.

²⁷ Ibid., p. 610, “(t)he study of regional integration is concerned with explaining how and why states cease to be wholly sovereign, how and why they voluntarily mingle, merge, and mix with their neighbors so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflict between themselves”. See also, Ibid., p. 628.

²⁸ See, for a study of Haas’ influence on the study of Latin American integration, W. Mattli, ‘Ernst Haas’s evolving thinking on comparative regional integration of virtues and infelicities’, *Journal of European Public Policy*, 12(2) (2005), 327-348.

²⁹ E.B. Haas, *The Obsolescence of Regional Integration Theory* (Institute of International Studies: University of California, Berkeley, 1975).

consequently the possible “collapse of legitimacy”, caused by the absence of a clear central authority able to cope with “complexly linked and highly controversial issues in the European agenda”³⁰. Following this crisis, the process of integration seemed to arrive to a stalemate, thus questioning the predictions of neo-functional theory.

At this point, a new “heroic actor”, which remained ignored so far by neo-functional theory, made its entrance: the European Court of Justice (now Court of Justice of the EU)³¹. The Court initiated a “constitutional framework for a federal type structure in Europe”³², by developing the building blocks of European constitutionalism (direct effect, supremacy, general principles and protection of fundamental rights). Away from the conceptual fuzziness of neo-functionalism, where no clear indication was given on the dependent variable of integration³³, the Court of Justice’s rhetoric of legal coherence, “*effet utile*” as well as its federal understanding of the relation between the centre and the periphery provided a clear view of what the process of integration entailed. An additional advantage of the Court was that its legal-technical rhetoric was largely immunized by the risks of political spill-over and the reaction of national actors. Indeed, the Court had previously taken care to ally national judges to its cause, by empowering them to act independently from their domestic executive and, to a certain extent, legislative powers and to move away, in matters of European law, from their limited interpretative margin in civil law jurisdictions. Teleological interpretation became akin to “functional spill-over”, without its political inconvenience, so to speak.

The emergence of the Court as the principal actor in the integration process had profound implications on the type of dominant rationality that emerged. This was economically oriented towards the constitution of a “Single market” but heavily relied on a legalistic approach, the content of which was progressively defined by the jurisprudence of the ECJ. Legal integration, “the gradual penetration of (EU) law into the domestic law of its member states”³⁴, was examined exclusively from a legal

³⁰ E.B. Haas, ‘Turbulent Fields and the Theory of Regional Integration’, *International Organization*, 30(2) (1976), 173-212.

³¹ J.H.H. Weiler, ‘The Transformation of Europe’, *Yale L. J.*, 100 (1991), 2403-2483, 2409.

³² E. Stein, ‘Lawyers, Judges, and the Making of a Transnational Constitution’, *American Journal of International Law*, 75 (1981), 1-27, p. 1.

³³ See, E.B. Haas, ‘The Study of Regional Integration – Reflections on the joy and Anguish of Pre-theorizing’, *International Organization*, 24(4) (1970), 607-646, p. 628, admitting that “neo-functionalists do not agree on a dependent variable and therefore differ with each other on the point in time at which a judgment of how much successful integration is to be made”.

³⁴ A.-M. Burley & W. Mattli, ‘Europe before the Court: A Political Theory of Legal Integration’, above, p. 43.

coherence perspective, with little emphasis given to external (to the legal system) sources of rationality³⁵. Theoretical perspectives advocating an “integration through law” approach adopted a more contextual perspective but still fell short of providing an overall conceptual framework that would explain the process of European integration³⁶.

To cite an example, the broad definition of measures equivalent to quantitative restrictions adopted by the Court (in what is now Article 34 TFEU), the Member States incurring the burden to prove that the restriction of trade is justified by public interest objectives, can be explained by a specific conception of economic integration emphasizing regulatory uniformity across Member States or the absence of national trade barriers to the operation of the “single market”. From this perspective, the position of the Court can be compared to neo-functionalism, where spill-over leads inevitably to full economic unity³⁷. Yet, it is important to note that neo-functionalists did not equate economic integration to regulatory sameness, but emphasized instead the progressive transfer of demands, expectations and loyalties of the political and economic actors to a new centre³⁸. The Commission saw the opportunities offered by a broad definition of the concept of trade restriction and rushed to interpret the Court’s jurisprudence as reinforcing its own powers³⁹.

The legalistic approach followed by the Court led to a disconnection between the legal/narrow economic integration and its broader political and social dimensions. This is particularly apparent if one adopts a narrow definition of “legal integration” or “integration through law”, accounting for a positivistic understanding, where law is hard and involves sanctions, in case of non-compliance. In contrast to the purely economic dimension, the social dimension of integration has been notoriously left outside. Yet a broader understanding that would emphasize social practice and that would involve additional actors than courts⁴⁰, may provide a slightly different account of the evolution of European integration and the emergence of social regulation at the

³⁵ K. Kaiser, ‘L’ Europe des Savants – European Integration and the Social Sciences’, *JCMS*, (1965) 4(1), 36-46, pp. 39-40.

³⁶ A.-M. Burley & W. Mattli, “Europe before the Court: A Political Theory of Legal Integration”, above, pp. 46-48.

³⁷ E. B. Haas, *The Uniting of Europe*, above, p. 283.

³⁸ *Ibid.*, p. 13.

³⁹ Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in Case 120/78 (‘Cassis de Dijon’) [1980] OJ C-256/2.

⁴⁰ G. de Búrca, ‘Rethinking law in neofunctionalist theory’, *JEPP*, 12(2) (2005), 310-326, p. 318.

EU level⁴¹. The open method of coordination and other new methods of governance are the means through which the social dimension has been introduced in the economic integration project. The social dimension is now hardening with the development of a legislative programme that allegedly takes stock of the embeddedness of the economic and the social dimensions⁴². This leads to a more holistic approach towards the Internal Market project⁴³, which inevitably challenges the role of experts, the “heroes” of integration for neo-functionalists, and re-emphasizes the role of national political actors in the process. The role of the latter has been the focus of realists/neo-realists approaches.

B. Realist and neo-realist approaches: the return to national actors

The resurgence of realism, after the perceived failure of neo-functionalism to explain the role of national actors in the integration process had important effects on the binary opposition between the European and the national levels that underpinned neo-functionalism. Moving away from this opposition, the realist view perceives the process of European integration as a “rescue” of the Nation State⁴⁴. The theory insists on the complex bargaining between different States and the opportunity of side-payments as the driving forces of integration. In the realist’s worldview, the European integration is a multi-level system of actors with different preferences aiming to the preservation of their sovereignty. The supra-national institutions, such as the European Commission or the Court, are secondary actors that intervene to mobilize coalition of governments for specific projects⁴⁵, for instance the establishment of the Common Market⁴⁶. While neo-functionalists stress the supranational authorities and international expert’s role in promoting integration, a realist perspective on European integration focuses on the role of States.

⁴¹ D. Ashiagbor, *The European Employment Strategy: Labour Market Regulation and New Governance*. (Oxford: Oxford University Press, 2005).

⁴² M. Monti, ‘A New Strategy for the Single Market at the Service of Europe’s Economy and Society’, Report to the President of the European Commission, 9 May 2010; Communication from the European Commission, “A Single Market for the 21st Century”, Brussels, 20 November 2007 COM(2007) 724 final.

⁴³ I. Lianos, ‘Shifting Narratives in the European Internal Market: Efficient Restrictions of Trade and the Nature of “Economic” Integration’, above..

⁴⁴ A.S. Milward, *The European Rescue of the Nation State*, 2nd ed. (Routledge: London & New York, 2000), p. 4.

⁴⁵ D. Puchala, ‘Domestic Politics and Regional Harmonization in the European Communities’, *World Politics*, 27(4) (1975), 496-520.

⁴⁶ W. Sandholtz & J. Zysman, ‘1992: Recasting the European Bargain’, *World Politics*, 42 (1989), 95-128.

According to realists, the international system is characterized by anarchy and the relations between States are governed by the “law of the jungle⁴⁷.” Nation-states, not international organizations or transnational organizations, are the primary actors in this system⁴⁸. Every State has to take care of its interests by itself. Vital interests for a State are the protection of its territory and the independence in its political decision-making from external powers, which might also relate to economic capabilities and its ability to deal effectively with poverty, diseases, natural disasters and other threats⁴⁹.

For realists, an increase of resources and capabilities by one State creates a dilemma for all members of the system and is easily perceived as a threat by its neighbors, which thereupon increase their own capabilities. The result is a never ending struggle for power⁵⁰. The most powerful states resulting from this rivalry for might are of course the most relevant ones in the international system. These dominant powers, the “hegemons”⁵¹, organize weaker states and enforce peace among them. This constellation lasts until the tide turns and formerly weak states may increase their might, finally challenging the hegemon. International organizations are only seen as a mere instrument by which powerful States attempt to defend and advance their national interests⁵².

International cooperation is possible as long as it leads to gains for the States involved. Realists agree that cooperation is more feasible when:

“[...] large transactions can be divided up into a series of smaller ones, if transparency can be increased, if both the gains from cheating and the costs of being cheated on are relatively low, if mutual cooperation is or can be made much more advantageous than mutual defection, and if each side employs

⁴⁷ R. Aron. ‘The Anarchical Order of Power’, *Daedalus*, 95(2) (1966), 479–502, at 480

⁴⁸ J. H. Herz. ‘Political Realism Revisited’ *International Studies Quarterly*, 25(2) (1981), 182–197, at 183

⁴⁹ S. M. Walt. The Renaissance of Security Studies. *International Studies Quarterly*, 35(2) (1991), 211–239, p 213; R. Niebuhr. *Moral Man and Immoral Society* (New York: Charles Scribner’s Sons, 1947), p 15

⁵⁰ John H. Herz. Political Realism Revisited. *International Studies Quarterly*, 25(2) (1981), 182–197.

⁵¹ Hegemony relation is according to John H. Herz. Political Ideas and Political Reality. *The Western Political Quarterly*, 3(2) (1950), 161–178, p 167, are constellation in which “[...] one or a few of the members of sectional interests concerned “leads” the others.”

⁵² H. J. Morgenthau, ‘The Yardstick of National Interest’, *Annals of the American Academy of Political and Social Science*, 296 (1954), 77–84.

strategies of reciprocity and believes that the interactions will continue over a long period of time⁵³.”

Diplomats play a key role in negotiations over cooperation. Their task is to mitigate the States’ concerns and to increase the gains from cooperation. States will be more inclined to cooperate the better they understand the behavior of their opponents. Open exchange of information and the creation of transparency of the domestic processes are key factors for successful cooperation among States. An alternative strategy of a State fearing a potential turnaround of a current partner in the future is to integrate the opponent and itself into a cooperative structure in order to reduce the incentives of renegeing in the future⁵⁴.

Neo-realists share the realist view on the unimportance of international organizations and other sub-national actors. They leave no doubt that it is the State and by no means other organizations that are capable of performing all crucial social, economic and security functions that nation-states need in order to survive⁵⁵. International organizations⁵⁶ are in neo-realist thought merely instruments by which powerful States realize their interests. These institutions have only limited independent effects since they are created, shaped and kept alive by States. The survival of international organizations therefore reflects more the power and influence of major States than the independent power of institutions themselves⁵⁷.

The establishment of cooperation among States is seen in neo-realism as highly difficult and restricted by the States struggle about the distribution of gains from cooperation⁵⁸. Due to their preoccupation with their own relative position in the international system, the main objective of States is not the maximization of their gains from interaction but the prevention of other States from increasing their

⁵³ R. Jervis, ‘Realism, Neoliberalism, and Cooperation: Understanding the Debate’, *International Security*, 24(1) (1999), 42–63, at 52.

⁵⁴ R. Jervis, ‘Realism in the Study of World Politics’, *International Organization*, 52(4) (1998), 971–991, at 986–987.

⁵⁵ K. N. Waltz. ‘Globalization and Governance’, *Political Science and Politics*, 32(4) (1999), 693–700, at 697; K. N. Waltz. Structural Realism after the Cold War. *International Security*, 25(1) (2000), 5–41, p. 18

⁵⁶ R. O. Keohane and J. S. Nye. *Power and Interdependence*, 2nd (ed.) (New York: HarperCollins Publishers, 1989), p 54.

⁵⁷ S. D. Krasner, ‘Global Communications and National Power: Life on the Pareto Frontier’, *World Politics*, 43(3) (1991), 336–366; J. J. Mearsheimer, ‘The False Promise of International Institutions’, *International Security*, 19(3) (1995), 5–49, p. 13; K. N. Waltz, ‘Structural Realism after the Cold War’, *International Security*, 25(1) (2000), 5–41, p. 20

⁵⁸ K. N. Waltz, *Theory of International Politics* (Boston: McGraw-Hill, 1979), p 105.

capabilities relative to their own ones. States will therefore defect from cooperation as soon as they perceive the relative gains of partners are exceeding their own⁵⁹.

Alliances are possible, but only under specific circumstances. They are feasible in a multi-polar system in which States interact closely in order to balance a major State or another alliance of States. In such a setting, each State is vitally dependent on the other and the defection of one member would jeopardize the security of all the other members of the alliance. The situation changes somewhat in a bipolar environment in which two major powers provide most of the security. Defections of minor partners in this case have only minor impact upon the alliance as a whole. Since States find themselves in a self-help system in which each unit is required to look after itself, the most likely constellation that results is a balance of power. This is a direct consequence of the nature of the system itself and is most likely to perpetuate as long as at least some States try to preserve themselves⁶⁰. But the international system is by no means static. It is a dynamic system in which “structures shape and shove; they encourage States to do some things and to refrain from doing others”⁶¹. As a result, States permanently have to reconsider their own position relative to other States. This constant dynamic change “stimulates States to behave in ways that tend toward the creation of balances of power”⁶². The problem of a self-help system can be overcome in a situation of hegemony of one powerful state which will prevent other States from defecting from negotiated conditions and, more generally, will regulate interaction among States⁶³.

This theory of international relations has important implications on the theorizing of European integration.

First, the realist and neo-realist turn in international relations has shifted the focus of integration theory towards domestic interests and interstate bargaining, that is, domestic politics, rather than structural factors such as the position of the State in the international power distribution. The realist view questions the role of transnational elites or experts in the process of “integration” and emphasizes instead the

⁵⁹ J. M. Grieco, ‘Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism’, *International Organization*, 42(3) (1998), 485–507, pp. 498-499.

⁶⁰ K. N. Waltz, *Theory of International Politics* (Boston: McGraw-Hill, 1979), p. 118.

⁶¹ K. N. Waltz, ‘Evaluating Theories’, *The American Political Science Review*, 91(4) (1997), 913–917, p. 915.

⁶² K. N. Waltz, *Theory of International Politics* (Boston: McGraw-Hill, 1979), p. 118

⁶³ B. Buzan, ‘Economic Structure and International Security: The Limits of the Liberal Case’, *International Organization*, 38(4) (1984), 597–624, at 607; J. J. Mearsheimer, ‘Back to the Future: Instability in Europe after the Cold War’, *International Security*, 15(1) (1990), 5–56, p. 47.

differences that exist between States and the subsequent regulatory pluralism that reflects their very different domestic political structures⁶⁴. Integration is not automatic; it can be perceived instead as a form of instable cooperation and inter-governmental bargaining between sovereign States, each following its own fixed preferences. To the integrationist logic of neo-functionalists, one could thus oppose the “state-centred pluralistic and structured” approach of realists/neo-realists⁶⁵.

Secondly, in the realist/neo-realist tradition, the aim pursued by international organizations is to reduce the transaction costs emanating from the interaction between States. For neo-realists, States face two options in order to ensure their security: bandwagoning and balancing. Bandwagoning is the strategy of choice for weak states which are unable to balance against their stronger neighbors. Instead of increasing their own capabilities they seek protection by strong States in exchange of important opportunities of “voice” within the organization⁶⁶. Stronger State entities choose the balancing strategy⁶⁷. The continuity between the technical/economic and the political dimensions of integration through the operation of the spill-over effect could thus be questioned⁶⁸. In this tradition, the “progress” of European integration is not due to a spill-over effect but constitutes an epiphenomenon of the emergence of the hegemonic power of the United States, which pushed the medium and declining Western European powers to a strategy of “balancing” by constituting the European Communities⁶⁹.

Thirdly, these approaches presuppose a strong entanglement between domestic and international politics, the latter influencing the formation of national preferences⁷⁰. One could employ the analogy of two-level games, where processes occurring in the international level (high politics) influence considerably domestic

⁶⁴ S. Hoffmann, *Organisations Internationales et Pouvoirs Politiques des États* (Armand Colin : Paris, 1954).

⁶⁵ S. Hoffmann, ‘Reflections on the Nation State in Western Europe Today’, in S. Hoffmann (eds.), *The European Sisyphus. Essays on Europe, 1964-1995* (Westview Press: Boulder, 1995), pp. 215-219.

⁶⁶ A. Hirschman, *Exit, Voice, Loyalty: Responses to Decline in Firms, Organizations and States* (Harvard University Press: Cambridge, 1970).

⁶⁷ K. N. Waltz, ‘Evaluating Theories’ *The American Political Science Review*, 91(4) (1997), 913–917, p. 915.

⁶⁸ S. Hoffmann, ‘The European Community and 1992’, in S. Hoffmann (eds.), *The European Sisyphus. Essays on Europe, 1964-1995* (Westview Press: Boulder, 1995), p. 235.

⁶⁹ J. Grieco, ‘Anarchy and the Limits of Cooperation: A realist Critique of the Newest Liberal Intergovernmentalism’, *International Organization*, 42(3) (1988), 485-507.

⁷⁰ R. Putnam, ‘Diplomacy and Domestic Politics. The Logic of Two-Level Games’, *International Organizations*, 42(3) (1988), 427-460.

politics and the formation of preferences at the national level (low politics)⁷¹. The inverse syllogism is also true: domestic politics and economic interests largely explain national preferences represented at the international level⁷². For example, States delegate powers to international organizations with the aim to strengthen the authority of the executive branch, in particular as many of the domestic political constraints may not affect the international level⁷³. Delegations of authority to international organizations become thus largely compatible with neo-realists theories. For comparison, neo-functionalists would have emphasized the technical nature of decision-making in certain international cooperation settings, which would have required delegation to international experts and consequently the development of technocratic consensus.

The role of States being reaffirmed, it became difficult for neo-functionalists to argue that experts and/or the “heroic” Court were running the show. However, the progress of economic integration post Single European Act could not be adequately explained by the realist/neo-realist perspective as well, despite the best efforts made by some commentators⁷⁴. The theory of federalism offers an alternative perspective.

C. Federalism

The federalist view highlights the transfer of authority and competences from the State level to the federal level as an important indication of integration⁷⁵. Only significant transfers of sovereignty count. Federalism may take different forms: dual federalism is based on the idea that the federal level and the State have equal sovereignty (they are “co-equals”) and they exercise mutually exclusive competences

⁷¹ P. Gourevitch, ‘The Second Image Reversed: the International Sources of Domestic Politics’, *International Organization*, 23(4) (1978), 881-912.

⁷² A. Moravcsik, ‘Negotiating the Single European Act. National Interests and Conventional Statecraft in the European Community’, *International Organization*, 45(1) (1991), 19-56; A. Moravcsik, ‘Preferences and Power in the European Community: A Liberal Intergovernmentalist approach’, *Journal of Common Market Studies*, 31(4) (1993), 473-524.

⁷³ A. Moravcsik, ‘Why the European Community strengthens the state: international co-operation and domestic politics’, *Center for European Studies Working Paper Series No. 52* (Cambridge, MA: Harvard University, 1994), also available at <http://www.ces.fas.harvard.edu/publications/docs/pdfs/Moravcsik52.pdf>

⁷⁴ See, G. Garrett, ‘International Cooperation and Institutional Choice: the European Community’s Internal Market’, *International Organization*, 46(2) (1992), 533-560.

⁷⁵ W. van Gerven, *The European Union. A Polity of States and Peoples*, (Stanford University Press and Hart Publishing: Oxford, 2005); K. Lenaerts, ‘Constitutionalism and the many faces of federalism’, *American Journal of Comparative Law*, 38 (1990), 205-63; K. Nicolaidis & R. Howse, *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press, 2001).

in their own spheres; cooperative federalism supposes power sharing between the federal and the State level in order to provide solutions to social problems⁷⁶. This definition assumes that cooperative federalism lends itself to hierarchy, while dual federalism to heterarchy. Such dichotomy may seem, however, simplistic and does not exhaust the different meanings of the concept of federalism. Indeed, some authors have advocated a “federal vision beyond the state”, “articulated around the concepts of mutual tolerance and empowerment”⁷⁷. Kalypso Nicolaidis notes that the distinguishing feature of “federalism”

“[...] lies precisely in *not* resolving the tensions which exist between the two poles: the One and the Many. In a federation, each part is itself a whole, not a part of a whole, and the whole itself is more than its parts. Neither is the One a simple expression of the Many—collaboration—nor are the Many simply components of the One—hierarchy. Instead, like fractals in our mental and material maps, each exhibits in its own scale its own version of a familiar pattern; each level operates as a whole albeit with multiple and subtle connections with other levels. Federalism in its essence does not mean bringing together different polities as one—however decentralized—polity. It means instead retaining what is separate *in spite of* all that is common”⁷⁸.

This “federal vision” is characterized by a shift to “open ended dynamics”, “shared competences” (including their exercise) arranged around principles of “networked cooperation” and proportionality, the emergence of “power checks” through “mutual control” and “federalism safeguards”, the turn to “multi-centred governance” achieved through “non-hierarchical models of governance”, the respect of principles of “constitutional tolerance”, mutual recognition and more broadly the existence of shared identities⁷⁹. Nicolaidis observes,

“(t)his implies *inter alia* a shift in focus in the competence debate away from allocation of competences per se towards granting centre stage to the processes of change themselves and the mechanisms that make them sustainable, including governance structures and the many mechanisms of control among the actors involved at different levels, democratic input in the

⁷⁶ R. Schütze, *From Dual to Cooperative Federalism – The Changing Structure of European Law* (Oxford University Press: Oxford, 2009).

⁷⁷ K. Nicolaidis, ‘Conclusion: The Federal Vision Beyond the Federal State’, in K. Nicolaidis & R. Howse, *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press, 2001).

⁷⁸ *Ibid.*

⁷⁹ *Ibid.*

joint management of shared competences, and strategies of mutual empowerment between levels and actors involved in governance. In the end, it calls for a move 'beyond hierarchy' from vertical paradigms of multi-layered governance to more horizontal ones of multi-centred governance where the legitimacy of the system as a whole is grounded in mutual tolerance, mutual recognition, and mutual empowerment rather than in the design of common structures and the pursuit of homogenous practices"⁸⁰.

This conceptualization has important implications on the concept of integration:

"Integration can be more about sustainable decentralization than centralization, horizontal mutual inclusiveness rather than vertical delegation of authority, and managing differences rather than engineering convergence"⁸¹.

The "federal vision" breaks with the uni-dimensional view of "legal integration" and the latter's focus on regulatory sameness. Regulatory pluralism becomes essential in order to provide the necessary degree of flexibility, political inclusiveness and empowerment to the individual parts forming the "federal" unit. Although, this "federal vision" may be relevant, if not applicable, to governance at the world level, the main thrust of the theory focuses, as it was the case for neo-functionalism, on the European experiment of regional integration and looks unlikely to be applied as such at the WTO level.

D. Liberal regime theory (institutionalism and governance theory)

The narrow conceptual focus of "legal integration" is also at odds with the recent emphasis on the study of "institutions" and "governance". The positive influence of institutions, in particular in overcoming the problems arising from an anarchic international system, is the core subject of "liberal institutionalism". Liberal approaches differ from the realist school in that they reject the idea of States as the most important actors in international relations. The main premises of this theory are that States are not understood as unitary or rational agents; power is pushed into the background by economic interests; and international institutions are believed to

⁸⁰ Ibid.

⁸¹ Ibid.

promote cooperation among States⁸². The liberal schools of thought, as the realist ones, do not represent a homogeneous theory but consist of several approaches, each one contributing to the understanding of the nature of inter-state relations⁸³.

The study of international institutions and organizations becomes even more central in neo-liberal institutionalism (neoliberals). Although in agreement with the core assumptions of neo-realism, which regards States as the most important actors pursuing their own interests, assumes rational behavior by the actors and notes the anarchical character of the international system, neoliberals believe that cooperation between states is possible⁸⁴. Since cooperation does not arise automatically, as it always remains overshadowed by the fear of cheating, transaction costs may rise and the returns from the interaction are uncertain, institutions play a central role⁸⁵. Institutions can “reduce the uncertainty about the reliability of other States and, once in place, they lower the costs of securing specific agreement⁸⁶”.

However, States are not perceived as unitary actors. Both the national and international levels impact on decision-making in international relations⁸⁷. Multiple channels link societies. Not only do official interstate relations count but also trans-governmental and trans-national relations. These relations lead to strong transnational ties with high transaction rates, making States or sub-national actors in different countries economically dependent on one another. In contrast to interconnectedness, interdependence is always related to symmetric or asymmetric “costly effects of transactions”, since it restricts autonomy. The asymmetries in dependence allow an actor to influence the counterparts he is interacting with⁸⁸. There are two dimensions of interdependence: sensitivity and vulnerability. In a stable framework, sensitivity refers to “degrees of responsiveness within a policy

⁸² J. M. Grieco, ‘Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism’, *International Organization*, 42(3) (1988), 485–507, pp. 489-490.

⁸³ According to Andrew Moravcsik, ‘Taking Preferences Seriously: A Liberal Theory of International Politics’, *International Organization*, 51(4) (1997), 513–553, at least three variants can be differentiated: “Ideational liberalism focuses on the compatibility of social preferences across fundamental collective goods like national unity, legitimate political institutions, and socio-economic regulation. Commercial liberalism focuses on incentives created by opportunities for transborder economic transactions. Republican liberalism focuses on the nature of domestic representation and the resulting possibilities for rent-seeking behavior.”

⁸⁴ R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2nd ed. (Harper Collins Publishers: New York, 1989), p xi describe the two schools as “complimentary.”

⁸⁵ J. Ikenberry, ‘The Future of International Leadership’, *Political Science Quarterly*, 111(3) (1996), 385–402, p. 392.

⁸⁶ *Ibid.*, p. 392.

⁸⁷ R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2nd ed., (Harper Collins Pub.: New York, 1989), p xi.

⁸⁸ *Ibid.*, pp 9-11

framework - how quickly do changes in one country bring costly changes in another, and how great are the costly effects⁸⁹?” Sensitivity of interdependence describes the costs that an actor has to bear if no action is taken in response. Vulnerability, however, “rests on the relative availability and costliness of the alternatives that various actors face⁹⁰”. The dimension of vulnerability stands for the costs that the actor faces by adapting to the changes.

This complex interdependence has important implications on political processes. First, States are most likely to use asymmetrical interdependence, international organizations and transnational actors to attain their goals. Secondly, under complex interdependence there is no difference between high and low politics. This leads to a situation in which “[d]iscontented domestic groups will politicize issues and force more issues once considered domestic onto the interstate agenda”⁹¹. Thirdly, multiple channels of contacts among societies form and exercise strong influence “on the ability of statesmen to calculate the manipulation of interdependence or follow a consistent strategy of linkage”⁹². Numerous non-state actors, as well as state bureaucracies interact permanently across borders. Fourthly, international organizations and institutions grow more important. Institutions can help “set up the international agenda, and act as catalysts for coalition-formation and as arenas for political initiatives and linkage by weak states”⁹³. By congregating representatives of different actors, international organizations can initiate coalitions of interest. In particular, weak states profit from their equal participation in organizations which provide these states with a forum for dialogue and cooperation.

The consequence of interdependence for political strategy is that the activities of all actors in the international system cause costs that other actors have to bear. Those actors, affected by the activities of others, will try to avoid having the burdens of adjustment forced upon them. The challenge is to “generate and maintain a mutually beneficial pattern of cooperation in the face of competing efforts by governments (and nongovernmental actors) to manipulate the system for their own benefit⁹⁴”.

⁸⁹ Ibid., p 12

⁹⁰ Ibid., p 13.

⁹¹ Ibid., p 33

⁹² Ibid., p 34.

⁹³ Ibid., p 35.

⁹⁴ R. O. Keohane and J. S. Nye, ‘Power and Interdependence revisited’, *International Organization*, 41(4) (1987), 725–753, p. 730.

Closely intertwined with interdependence is the concept of “regimes”. Regime theory is a reaction to and at the same time a correction of the theory of hegemonic stability of the realist school⁹⁵. According to Keohane and Nye,

“relationships of interdependence often occur within, and may be affected by, networks of rules, norms, and procedures that regularize behavior and control its effects. We refer to the sets of governing arrangements that affect relationships of interdependence as international regimes⁹⁶.”

The authors portray regimes as an important alternative tool to facilitate interaction among States. In the absence of authoritative institutions and therefore “pervasive uncertainty” in the international system, regimes facilitate creating mutually advantageous agreements among several actors where *ad hoc* interaction would yield less efficient results⁹⁷. Specific sets of regulations and procedures are developed to coordinate the interaction of States and transnational actors in multiple areas. Regimes order international behavior and reduce conflict in the international system, they empower new groups to fight for their cause, they may increase the acknowledgement of common interests and they might initiate new policies⁹⁸. While acknowledging the anarchical structure of the international system, neo-liberals claim that its negative effects can, at least partly, be overcome by this instrument⁹⁹.

Regimes come in profoundly different shapes. They can either be formal or informal and can even be incorporated in interstate agreements and treaties. Keohane and Nye differentiate between “structure” and “process”: while structures focus on the distribution of capabilities among states, process refers to bargaining behavior within a power structure. Regimes take an intermediate position between the international power structures and the bargaining processes among the players, that is, on the one hand, the regime is profoundly shaped by the distribution of power in the system, while, on the other hand, it has impact on the bargaining process inside the system¹⁰⁰.

⁹⁵ R. O. Keohane, *International Institutions and State Power* (Westview Press: Boulder, 1989), p 101.

⁹⁶ R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2nd ed. (Harper Collins Pub.: New York, 1989), p 19.

⁹⁷ R. O. Keohane, *International Institutions and State Power* (Westview Press: Boulder, 1989), pp 106-108.

⁹⁸ P. M. Haas, ‘Do Regimes Matter? Epistemic Communities and Mediterranean Pollution Control’, *International Organization*, 43(3) (1989), 377–403, pp. 401-403.

⁹⁹ J. M. Grieco, ‘Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism’, *International Organization*, 42(3) (1988), 485–507, p 486.

¹⁰⁰ R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2nd ed. (Harper Collins Pub.: New York, 1989), pp 20-21.

Regimes are formed by States to diminish risks and conflicts of interest by coordinating the behavior of actors¹⁰¹. They might also increase the efficiency of interstate transactions by making agreement easier as they provide frameworks for establishing legal liability, “they improve the quantity and quality of information available to actors” or they reduce other transaction costs, such as costs of organization or of making side-payments¹⁰².

Regimes are set up when organizational costs are lower than the expected return from the cooperation. The costs of setting up a regime need to be weighted to the costs of *ad hoc* decisions. If the latter is higher, the likelihood of the establishment of a regime is high. This is most likely to happen in environments where the “issue density” is high, that is, in policy spaces where a high number of important issues arise¹⁰³. Making agreements on certain issues in dense policy spaces tends to have a spill-over effect on neighboring issues, because of the subsequent economies in organizational costs involved in reconciling distinct objectives. Regimes bringing together actors to discuss a wide range of issues also have a side effect in the form of side-payments. While side-payments usually raise transaction costs, these might be lowered by regimes because “[...] expectations that an integration arrangement can be expanded to new issue-areas permit the broadening of potential side-payments, thus facilitating agreements”¹⁰⁴.

The central idea of regime functioning is that repeated interaction between states makes it possible to surmount the uncertainties arising from the prisoners dilemma¹⁰⁵. The “shadow of the future” allows for a continuous interaction among players in an anarchical environment¹⁰⁶. Assuming that players not only take short, but also long term benefits into account in an indefinitely repeated interaction,

¹⁰¹ R. O. Keohane. *International Institutions and State Power* (Westview Press: Boulder, 1989), p 107.

¹⁰² *Ibid.*, p 111.

¹⁰³ R. O. Keohane, *After Hegemony* (Princeton University Press: Princeton, 1984), p 79; R. O. Keohane, *International Institutions and State Power* (Westview Press: Boulder, 1989), p 112.

¹⁰⁴ *Ibid.*, p 113.

¹⁰⁵ States may behave according to the tit-for-tat. States stick to rules they agreed upon as long as their counterparts do: see, J. M. Grieco, ‘Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism’, *International Organization*, 42(3) (1988), 485–507, p. 493.

¹⁰⁶ R. Axelrod and R. O. Keohane, ‘Achieving Cooperation under Anarchy: Strategies and Institutions’, in D. A. Baldwin (ed.), *Neorealism and Neoliberalism: The Contemporary Debate*. (Columbia University Press: New York, 1993), p. 91: “In Prisoner’s Dilemma, concern about the future helps to promote cooperation. The more future payoffs are valued relative to current payoffs, the less the incentive to defect today – since the other side is likely to retaliate tomorrow”.

permanent cooperation without an enforcing power is possible even among egoistic actors¹⁰⁷. However,

“(f)or cooperation to prove stable, the future must have a sufficiently large shadow. This means that the importance of the next encounter between the same two individuals must be great enough to make defection an unprofitable strategy¹⁰⁸.”

The prospect of future interaction is not, however, the only element determining cooperation. According to the “sanctioning problem”, the number of players in the game and their stance towards each other also matters. Three conditions decide whether an interaction is effective: “(1) players can identify defectors; (2) they are able to focus retaliation on defectors, and (3) they have sufficient long-run incentives to punish defectors”¹⁰⁹. The higher the number of actors, the harder it gets to fulfill all three conditions; the incentive for free-riding increases. The stronger the sanctioning problem, the more likely it is that cooperation among the actors will break down. A possible scenario in which this problem may be overcome is when one powerful actor takes the initiative and rebuilds the system in a way that sanctions become possible¹¹⁰.

In regime theory, neo-liberalism’s stance towards the importance of the presence of a powerful hegemon to facilitate cooperation comes to light. Regimes, it is argued, can supplement a powerful player as a facilitator of cooperation among states. The positive effects of a regime hold even in the absence of a hegemon. It is therefore possible to create and maintain such institutions among comparably strong States¹¹¹. To be sure, this does not mean that hegemony is antagonistic to regimes. The two models are often found in symbiotic relationship with one another. Hegemony in the context of regimes stands for a specific pattern of “asymmetrical cooperation, which successful hegemons support and maintain”¹¹². What appears to

¹⁰⁷ A. Hasenclever, P. Mayer, and V. Rittberger, *Theories of International Regimes* (Cambridge University Press, 1997), p. 34.

¹⁰⁸ R. Axelrod, *The Evolution of Cooperation* (Basic Books: New York, 1984), p. 174.

¹⁰⁹ R. Axelrod and R. O. Keohane, ‘Achieving Cooperation under Anarchy: Strategies and Institutions’, in D. A. Baldwin (ed.), *Neorealism and Neoliberalism: The Contemporary Debate*, (Columbia University Press: New York, 1993), p. 94.

¹¹⁰ *Ibid.*, pp 95-96.

¹¹¹ R. O. Keohane, *After Hegemony* (Princeton University Press: Princeton, 1984), p. 50; R. O. Keohane, *International Institutions and State Power* (Westview Press: Boulder, 1989), p. 121; R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2nd ed. (Harper Collins Pub.: New York, 1989), pp 42-46; see also: A. Hasenclever, P. Mayer and V. Rittberger, *Theories of International Regimes* (Cambridge University Press, 1997), pp 86-104.

¹¹² R. O. Keohane, *After Hegemony* (Princeton University Press, 1984), pp 46 and 49.

be a convergence of neo-realist and neo-liberalist theory is, in reality, a profoundly different perspective on hegemony and cooperation. The hegemon has to invest in the establishment and maintenance of institutions in order to make sure that those rules and norms are followed by other countries¹¹³.

E. Conclusions

Starting from similar assumptions about the nature of the international system, liberals and neo-liberals come to surprisingly different conclusions than their neo-realist counterparts. In contrast to realist thinking, liberals assume that actors, out of self interest, interact closely and realize common interests. By interacting in regimes they develop trust over time, although cheating is always a viable option¹¹⁴. By taking more actors, a wider time horizon, multiple channels of interaction and an increasing relationship of interdependence into account, (neo-)liberalism provides a highly complex and useful approach for the understanding of the relations among States and other actors. The theory assumes that in order to realize their shared interest, States interact closely, form institutions to reduce transaction costs, and by cooperating permanently under the “shadow of the future”, establish international regimes (of economic integration). The realist perspective in which power determines all interaction among States appears reductionist from this point of view since it ignores the complexity of inter- and transnational connections among them. Several aspects remain, however, disputed. In particular, neo-realists argue that institutions, regardless of how well they interconnect actors, do not solve the threat of cheating and the concerns over higher relative gains of the other States involved¹¹⁵.

In conclusion, one could distinguish between approaches that recognize the specificity of the regional integration phenomenon, considered as *sui generis* to other forms of cooperation between States, from approaches that can easily be transposed to the global context. Neo-functionalism and federalism seem appropriate candidates for the first type, as they both pre-suppose the development of common understandings and shared meanings between elites of experts (neo-functionalism) or governments (federalism). On the contrary, realist/neorealist approaches and

¹¹³ Ibid., pp 38-39 and 46.

¹¹⁴ A. A. Stein, *Why Nations Cooperate* (Cornell University Press: Ithaca, 1990), p 53.

¹¹⁵ J. M. Grieco, ‘Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism’, *International Organization*, 42(3) (1988), 485–507, p 487.

liberal institutionalism or regime theories emphasize external factors to the individual motives of the actors involved, such as the nature and occurrence of the transactions, the development of interdependence or competition between the different States and the interests they represent.

These intellectual perspectives set important challenges to the traditional concept of “economic integration”. Integration cannot refer simply to an erosion of regulatory differences by the application of negative integration rules prohibiting national regulations or the European (federal) harmonization of national regulatory standards, as it was thought by the “legal integration” approach. As previously explained, the “legal integration” approach does not transpose the full complexity of the integration phenomenon. This is recognized by all the different approaches examined in the previous paragraphs, including the neo-functionalist one which, at the difference of the “legal integration” approach that partially emanates from it, emphasizes the political as well as the social dimension of integration.

Once the “legal integration” view is rejected, it is difficult, however, to find an answer to the question of what is entailed by the concept of economic integration. A possible way out is provided by the contextual framework of the “integration through law” perspective: integration constitutes the transfer of legitimacy or authority across different political entities. The approach collapses the concepts of political and economic integration to “a reciprocal relationship between the legal and political spheres” of European integration¹¹⁶; Yet, as Burley and Mattli observe these approaches

“suffer generally from two problems: first, the nature of the relationship is often fuzzy and claims of cause and effect are qualified so as to be rendered almost empty. Second, the incentives for action are not spelled out”¹¹⁷.

One could also add the relative small importance granted by these theories to soft law, the bulk of the literature being on the role of the courts and legislative harmonization. In other words, the problem we suddenly face is the same that the one Haas identified as the main concern for “pre-theories” of regional integration: what is the dependable variable that we are trying to explain? Is this always the one Haas once identified: the “transfer of legitimacy-authority”? How this could be operationalized in the context of the different approaches examined in this study?

¹¹⁶ A.-M. Burley & W. Mattli, “Europe before the Court: A Political Theory of Legal Integration”, above, p. 46.

¹¹⁷ Ibid.

What would be the measure of success of “integration” if one adopts a more holistic perspective than that of “legal integration”, one that accepts regulatory pluralism and diversity?

In the next section, we will provide two alternative accounts of the concept of integration that may accommodate the recent turn to a holistic view of economic integration and the increasing role of soft law norms in the integration process.

II. Two views on economic integration: efficient organizational creation and increasing levels of trust

Whatever theory of international relations one is adopting; it is clear that for all of them the dependent variable of integration is the same. This is because the theories attempt to explain why integration happens but are relatively silent, to the exception of neo-functionalists, on the dependent variable of integration as well as on the independent variables one should take into account in order to identify and measure the degree of integration. In his seminal contribution on *The Study of Regional Integration* Haas noted the existence of two competing “pre-theories” of integration to neo-functionalism, each focusing on different variables: the federal approach assumed the transferability of the unitary framework of the State from the national to the regional level (the beyond-the-state version of federalism was not represented at the time); the communications approach focused on the relations between groups of people and the existence of important rates of transaction as measured by trade, mail and tourist flow indicators and by the rate of supranational group formations¹¹⁸. Each of the approaches proffered its own dependent variables: the federalist approach was the least ambiguous, the achievement of a federal union among the units studied being its “terminal condition”¹¹⁹. Nonetheless, such an end-state is highly improbable in the context of international economic relations and, as we have explained, varies, according to the type of federalism adopted (dual federalism, cooperative federalism, the “federal vision”)

The question of the dependent variable of integration remaining unresolved, it is important to examine possible alternatives to the “master concept” of “authority-

¹¹⁸ E. B. Haas, ‘The Study of Regional Integration: reflections on the joy and anguish of pre-theorizing’, *International Organization* 24(4) (1970), 607-646, p. 626-627.

¹¹⁹ *Ibid.*, p. 630.

legitimacy transfer” leading to different types of “terminal condition”¹²⁰. For Haas, “institutionalization” constituted an indicator for authority and legitimacy¹²¹. We will take this as the starting point of our quest for a dependent variable. A first option is to focus more precisely on the nature of the process of institution (organization) creation: integration could denote a process of efficient organizational creation. A second option is to surpass the concept of institution, which might appear formal and lead to a straitjacket effect, and adopt instead a broader concept, that of “trust”. In our view, the latter option has a lot of potential to accommodate different forms of economic integration, while preserving the specificity of the concept, with regard to international cooperation.

A. Integration as a process of efficient organizational creation

According to the first approach, integration should be understood as a process of efficient organizational creation. Efficiency can be broadly defined as the satisfaction of the preferences of the constitutive units of an entity. The assumption is that any autonomous unit aims to satisfy its utility function and thus to promote efficiency. Autonomy refers to the decision-making capacity of the unit for the future. In international law, this autonomous unit refers essentially to the State. The preferences of these autonomous units are taken as a given. Preferences set the utility function of the actors and also affect their pay-off matrix.

The different autonomous units may interact with each other. Their interaction takes one of the following three forms: competition (when the unit attempts to maximize its utility to the expense of the utility of another unit), cooperation (when the unit maximizes its utility jointly with another unit) or co-opetition (where the unit develops a mixed strategy of competition in some areas and cooperation in other areas with other units).

The continuous interaction between autonomous entities requires the institution of some type of governance mechanisms in order to organize the transactions between them. The choice of a specific governance mechanism by these autonomous units is function of the mechanism’s comparative utility. We usually oppose markets to hierarchies, each forming the pole of a *continuum* that

¹²⁰ Ibid., p. 633.

¹²¹ Ibid.

regroups different organizational forms, what Oliver Williamson calls “hybrids”¹²². Starting with the assumption that the basic unit of our analysis is a unit capable of autonomy, the costs of transacting would refer to how much the autonomous unit is willing to trade its autonomy (decision-making capacity for the future) in order to obtain welfare benefits (higher satisfaction of preferences). The transactions in which the autonomous units collect information on the amount of welfare benefits they might gain, in case they relinquish some degree of their autonomy, take place in the context of a market. The market is perceived as an institution facilitating the exchange of autonomy for welfare. In international society, “the equivalent of the market is simply the place where states interact to cooperate on particular issues – to trade in power – in order to maximize their baskets of preferences”¹²³. Joel Trachtman explains that “the assets traded in this international market [...] are peculiar to states: components of power, or jurisdiction”, conceived as the “institutionalized exercise of power”¹²⁴.

The choice of the adequate institutional framework is function of a comparison between the transaction costs of using the market mechanism versus the “agency costs” involved in the governance of a more elaborate institution than the market¹²⁵, such as a long-term bilateral agreement or an international regime, if we accept Robert Keohane’s distinction between international regimes and international agreements¹²⁶. The occurrence of significant transaction costs might lead the autonomous entity, after a comparative institutional analysis which would consider the transaction and agency costs, to opt for an international regime instead of an international agreement¹²⁷. As Trachtman observes,

“there appears to be little difference in theory between this question and the question of subsidiarity: once an international organization exists, and has plenary power [...] what powers should it exercise at the center, and what powers should it devolve to decentralised units? All other things being equal, the question remains, where should responsibility be lodged? Thus, the

¹²² O. Williamson, “The Economics of Governance”, *American Economic Review*, 95 (2005), 1-18.

¹²³ J. P. Trachtman, *The Economic Structure of International Law* (Harvard Univ. Press 2008), p. 10

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*, p. 158, “agency costs may be viewed as the costs of organization within an institution”.

¹²⁶ R. O. Keohane, *The Demand for International Regimes*, in B. A. Simmons & R. H. Steinberg (eds.), *International Law and International Relations* (CUP, 2007), pp. 18 & 29.

¹²⁷ J. P. Trachtman, *The Economic Structure of International Law*, above, p. 159.

transaction cost approach [...] is applicable to the question of centralization or decentralization within an international organization”¹²⁸.

Transaction costs are significant if the complexity and the uncertainty of the subject matter make it difficult to write a complete treaty. Parties make agreements to apply and adapt broad “rules of the game” (incomplete contracts). A dispute resolution mechanism and significant judicial practice may reduce uncertainty and enhance the possibility of writing as comprehensive contracts as possible. The existence of a clear legal framework establishing liability for actions might facilitate that task. From this perspective, the choice of an international organization over an international agreement appears not motivated by some form of inability of states to satisfy their utility functions in the area covered by the agreement, for example for trade agreements the promotion of inter-state trade. The constitution of an international organization is instead the result of a comparative institutional analysis: “international organizations are formed to establish a set of relationships more efficiently than the equivalent of the market (or agreement) in international society”¹²⁹. The outcome of the comparative institutional analysis varies depending to the issues arising within a given policy space. Transactions characterized by a high degree of asset specificity are associated with higher degrees of transfer of authority to international organizations. Asset specificity refers, in our context, to the degree of reliance on other states “to carry out their end of the bargain”¹³⁰.

Joel Trachtman provides a “matrix of institutional choice” that goes from the pole of regulatory competition involving externalization to majority voting within an international regime. Between them, he includes the intermediary categories of international agreements and dispute resolution (within the regime or outside it, i.e. arbitration)¹³¹. Each of these forms of governance relates to a specific degree of integration. In most circumstances, the governance mechanism operates within a specific cluster of issues forming part of a distinct policy space. Of course, it is possible to link different issues clustered separately, but that would require side-payments (in order to modify the pay-off matrix of the other states, thus inducing cooperation) and eventually a revised comparative institutional analysis of the transaction and agency costs.

¹²⁸ Ibid., p. 176.

¹²⁹ Ibid., p. 164.

¹³⁰ Ibid., p. 167.

¹³¹ Ibid., p. 182.

But what is the measure of efficiency if the focus is on the choice of the most optimal organizational structure for the accomplishment of States' preferences? For Trachtman, the success of an international regime depends on "the (tautological) fact of political acceptance of a particular set of rules"¹³², which becomes the ultimate test of efficiency. The success of the organizational structure of dispute resolution is, however, more difficult to measure. One could, of course, focus on compliance. But how compliance would be measured if one takes a broad conception of efficiency as it is entailed by the concept of holistic integration? Efficiency is not limited to the narrow promotion of intra-community trade. If the state pursues the satisfaction of its utility function, any constraint on the set of preferences of the State might theoretically lead to an inefficient outcome. For example, if a State is found liable for a restriction on intra-community trade, that would automatically frustrate the specific value, from those included in its' set of preferences the specific State was aiming to satisfy by adopting this measure. This would be unmistakably inefficient. Most often, the problem is accentuated by the relative fragmentation of policy areas, because of the distinction between the economic and the social dimensions of integration, and the impossibility of side-payments between areas included in the international regime and areas outside it.

The main flaw of this conception of integration is, however, that the main unit of analysis is the State: "efficiency is defined in terms of maximization of state government preferences, without regard directly to the preferences of individual constituents"¹³³. The citizens' preferences are aggregated at the level of the State. States serve as agents of the individuals in entering into international relations¹³⁴. Furthermore, this approach does not take into account the transformative effect of integration on individual preferences. The approach neglects the formation of individual preferences, as it focuses only on the interaction between States. States attempt to maximize the aggregated exogenously given individual preferences of their constituents. Preferences are nevertheless constantly altered by individual internal responses to an external (social) environment in evolution. Preferences are relentlessly reconstructed during this interaction. Integration constantly shapes and transforms this external (social environment) of the constituents of the State. The purpose of integration should thus not only be confined to efficiency, perceived as the

¹³² Ibid., p. 164.

¹³³ Ibid., p. 195.

¹³⁴ Ibid., p. 162.

satisfaction of revealed/given preferences. Its aim is also to contribute to the process of preference-formation of the States and the constituents of the States.

It is well known that individual preferences may be influenced by legal norms. The “market building” theory of the free movement rules of the European Internal Market¹³⁵ illustrates this process of destruction of any path-dependence on national rules, political processes, national economic markets, national products. Individual preferences cannot be an exception. Public choice theory also sheds light onto how the internal political processes and the aggregation of individual preferences at the state level might be biased by interest group politics. States do not behave, in reality, like unitary actors responding to international circumstances in an effort to maximize the relative gains of their constituents (citizens).

B. Integration as a higher intensity of institutional-based trust between actors interacting across national boundaries

An alternative conceptualization of “integration” should aim to open the black-box of the State, by taking into consideration its constitutive elements. This will add an additional layer in the consideration of preferences, this time inside the State. It would also recognize the endogenous character of individual preferences. Our suggestion is to define integration as the process of building increased levels of “institutional-based” trust (or “system trust”) between actors interacting across national boundaries. This theory does not neglect the concept of the State, which is still present, as it sets the national boundaries defining the interactions between actors that are of interest for scholars of international/regional exchanges of jurisdiction. Interactions between these actors within the boundaries of a State are excluded from consideration. But the concept of the State is not as omnipresent as it was in the previous conceptualization of “integration”.

Let us first define the term “actor”. Actors are not only States, but also entities operating inside the black-box of the State: the national legislature, judiciary, national regulators and central administration, firms, consumers, citizens... In short, any entity

¹³⁵ The European Internal market is more a project of “market building” than one of “market maintenance”. Indeed, in contrast to the “market maintenance” logic “market building” intervenes at the level of preference formation in an attempt to break up past path-dependencies and established national habits. Compare D. Regan, “The Supreme Court and State Protectionism : Making sense of the Dormant Commerce Clause”, *Michigan L Rev* , 84 (1986), 1091-1287 with M. Poiares Maduro, *We, The Court* (Oxford: Hart Pub., 1998), p. 98

that operates within the given policy space open to the type of interaction that is of interest counts. Each individual actor has a utility function based on a certain set of preferences that, in the case of “public actors” (e.g. regulators) might be institutionalized and in some cases explicitly provided for in their constitutive charters (i.e. constitutions, regulatory statutes). These actors operate within a specific (social) environment, which can be characterized by principal-agency relations, relations of competition, cooperation and co-opetition. Actors do not behave or decide as atoms outside the social context: their action is instead, embedded in concrete, ongoing systems of social relations. They dispose of the power to interact with other public or private actors across jurisdictions. Power relies on material and institutional (competence) capabilities and is subject to broad (social) environment constraints (interaction power).

We turn now to the concept of “trust”. The term is employed in economics, organization theory and sociological literature in different ways.¹³⁶ One could define trust as “an attitude involving a willingness to place the fate of one’s interests under the control of others”¹³⁷. Repeated interaction forms the primary basis for trust.

Andrew Kydd explains that

“trust is a belief that the other side prefers mutual cooperation to exploiting one’s own cooperation, while mistrust is a belief that the other side prefers exploiting one’s cooperation to returning it. In other words, to be trustworthy, with respect to a certain person in a certain context, is to prefer to return their cooperation rather than exploit them. [...] Cooperation between two actors will be possible if the *level of trust* each has for the other exceeds some threshold specific to the situation and the actors”¹³⁸.

Increasing the intensity (level) of trust refers “to the amount of discretion trustors grant trustees over their interests”¹³⁹. Indeed, “cooperation is possible when the level of trust for the other exceeds a minimum trust threshold for each party”, which “will

¹³⁶ See, N. Luhmann, *Trust and Power* (New York: John Wiley, 1979) for a discussion of trust from the point of view of systems theory; J. Coleman *Foundations of Social Theory* (Harvard Univ. Press, 1990) for a discussion of trust from a rational theory perspective; O. Williamson “Calculativeness, trust, and economic organization” (1993) *J. Law & Econ.* 453 for an economic perspective on trust. For sociological accounts of trust see, R. Hardin *Trust* (Russel Sage, 1998) ; R.M. Kramer & T.R. Tyler (eds.) *Trust in Organizations* (Sage, 1996) ; B. Barber *The Logic and Limits of Trust* (Rutgers Univ. Press, 1983); For the role of trust in international relations see, A. H. Kydd, *Trust and Mistrust in International Relations* (Princeton University Press, 2005).

¹³⁷ A. M. Hoffman, “A Conceptualization of Trust in International Relations”, (2002) 8(3) *European Journal of International Relations* 375, 376-377.

¹³⁸ A. H. Kydd, *Trust and Mistrust in International Relations* (Princeton University Press, 2005), at 6.

¹³⁹ *Ibid.*, p. 377.

depend on the party's own tolerance for the risk of exploitation by the other side"¹⁴⁰. Consequently,

“to trust someone [...] is to believe it relatively likely that they would prefer to reciprocate cooperation. To mistrust someone is to think it is relatively likely that they prefer to defect even if they think one will cooperate”¹⁴¹.

The function of trust is to reduce uncertainty and complexity in social communication systems as “it allows for specific (rather than arbitrary) assumptions about other social actors' future behaviour”¹⁴². It could thus be seen as a communicative medium reducing complexity¹⁴³. Trust can take different forms: Luhmann distinguishes between “personal trust”, which is likely to develop when individual actors have frequent interactions and become thus familiar with each other's personal preferences and interests and thus indifferent to the institutional arrangements, and “system trust”, which relies on institutions to generate trust, rather than on personal interaction. Institutional-based trust constitutes a more “advanced stage of trust production”¹⁴⁴ as its function is to generate trust in a massive scale. But trust produces also risk, in particular if there is limited available information about the future behaviour of the trustee. Risk is an unavoidable feature of trust because trust can be disappointed. For example, an offer of cooperation may be exploited by free riding, or not be reciprocated. There are thus two inter-related conditions for trust: risk and interdependence between the actors. In order to minimize the risk of defect, actors may develop various strategies.

An alternative way, than trust, to reduce complexity and uncertainty is the exercise of interaction power. Power influences “the selection of actions in the face of other possibilities”¹⁴⁵. Power may not exclude risk but it may reduce it considerably: “a social actor who considers using power usually can refer to ‘authoritative’ and ‘allocative’ resources, which can be deemed likely to find recognition by the subordinate actor”¹⁴⁶ and thus affect its incentives to act. Hegemonic power by one State, or the fight for hegemony, has been a feature of many historical periods in

¹⁴⁰ Ibid.

¹⁴¹ Ibid.

¹⁴² R. Bachmann, “Trust, Power and Control in Trans-Organizational Relations”, (2001) 22 *Organization Studies* 337, also available at http://www.sase.org/oldsite/conf1999/papers/reinhard_bachmann.pdf, p. 8.

¹⁴³ N. Luhmann, *Trust and Power*, above, pp. 42-43.

¹⁴⁴ R. Bachmann, “Trust, Power and Control in Trans-Organizational Relations”, above, p. 12.

¹⁴⁵ N. Luhmann, *Trust and Power*, above, p. 112.

¹⁴⁶ R. Bachmann, “Trust, Power and Control in Trans-Organizational Relations”, above, p. 16.

human history¹⁴⁷. If powerful actors have few constraints on the exercise of their power, our capacity for trust in them is limited. Power is treated here as a relational construct, which connotes the degree of dependence of the actors on one another.

Actors are frequently found in situations where they have to decide if they would base their interaction/communication mostly on trust or on power and the proportions of trust and power which should govern their relationship.

Trust and power should not be exclusively viewed, however, as alternatives. It is possible that power appears in a “de-personalised” form as “system power”. System power can take the form of law, organization or a hierarchy which can develop shared meanings among the social actors and can thus “mass-produce” trust. Standards of expertise are the main sources of “system trust”: they are integrated in organizational routines that may take the form of institutions (formal or informal). Institutions are thus the central precondition rather than an alternative to “system trust”. The constitution of trust ultimately relies on the existence of strong institutions. As institutional-based or system trust is a condition for the efficient production of a high level of trust, the “trans-organizational relations can be reconstructed as being controlled by the patterns of trust and/or power mechanisms”¹⁴⁸.

It follows from this analysis that trust is a concept that takes significance in situations of uncertainty over the preferences or behaviour of interdependent actors in a specific social system. Its function is to reduce uncertainty and thus to induce welfare-enhancing cooperation between them. However, trust produces also risks when cooperation will be exploited or not returned. This will provoke mistrust, which could potentially dodge welfare-enhancing activity from happening. Power or hegemonic control would be the other side of the coin: it is alternative to trust and contributes to maintain control and avoid the slippery-slope to a Hobbesian state of anarchy. The establishment of informal or formal institutions constitutes another available option in order to mitigate the risk of distrust by creating “system trust”. Institutions will generate trust, as long as their constituents believe that they are effective in preventing situations of distrust. Institutions may also require the invention of a common grammar that will facilitate communication between the actors, the existence of a regime of sanctions for instances of mistrust or of a hierarchy that will

¹⁴⁷ See, the analysis of different models of international relations and trust in A. H. Kydd, *Trust and Mistrust in International Relations* (Princeton University Press, 2005).

¹⁴⁸ R. Bachmann, “Trust, Power and Control in Trans-Organizational Relations”, above, p. 24.

exercise control over the action of the actors and will ensure that they are trustworthy (“system power”).

In international trade regulation, trust can be considered as an objective concept describing a relationship between regulatory systems underpinned by a relationship between public and private actors¹⁴⁹. The starting point is that when States interact, they have incomplete information about the preferences and objectives of their counterparts, as well as their payoffs and domestic pressures that are not evident to a counter-party¹⁵⁰. As it is also the case for individual relations, relations between states are shaped by social networks. Actions are embedded in concrete, ongoing systems of social relations. Consequently, the behaviour of the actors is not only driven by a pure interest calculation (calculative trust) but also by social norms and formal and informal institutions that support the specific relationship.

An important source of trust in this context would be the long history of interaction between these actors and their collective memory. Geographic proximity, common language, shared values and preferences facilitate interaction and thus build a certain level of “personal trust” between the different actors¹⁵¹. The social network provides a source of information but at the same time it constitutes a mechanism that grants importance to “reputational sanctions”¹⁵². Reputation helps to determine whether an actor would risk cooperating with another one¹⁵³. To the extent that all actors are connected in a web of relations, even if there is no personal interaction, there is some assurance that the victim of a trust violation can take action to rectify the situation. The development of mutual dependence between exchange partners may, however, have ambivalent results as it may promote trust but also foster opportunistic behaviour (mistrust).

The network of social relations to which all actors belong provides not only a source of information about trustworthiness but also the opportunity for each actor to contribute to the reputation of another one, should other actors choose to provide information about a possible lack of trustworthiness. This reputational cost is

¹⁴⁹ K. Nicolaidis & G. Shaffer, “Transnational Mutual Recognition Regimes: Governance without Global Government”, *Law and Contemporary Problems*, 68 (2005), 263-317, p. 298.

¹⁵⁰ A. T. Guzman, *How International Law Works – A Rational Choice Theory* (OUP, 2008), p. 92.

¹⁵¹ See the study by P. Mavroidis and J. Marchetti in this volume.

¹⁵² A. T. Guzman, *How International Law Works – A Rational Choice Theory*, above, p. 33.

¹⁵³ On the value of reputation in international law see, A. T. Guzman, *How International law Works – A Rational Choice Theory* (OUP, 2008), pp. 71-117.

particularly effective in closed social systems with membership, as is the European Union.

There is, however, a point where “personal trust” is not sufficient to promote welfare-enhancing cooperation. The reason is that the more complex the relationship and its environment becomes, the more uncertainty is generated over the future actions of the actors. As actors attempt to deal with uncertainty and the risk of mistrust, they may find it necessary either to exercise hegemonic power, if they have the capacity to do so (interaction power), or to elaborate institutions that will control occurrences of distrust. Institutions will have as their function to generate “system trust” .They build on an existing level of trust, which is a necessary pre-condition for their existence. The reputation mechanism is one dimension of the story. Institutions will act as social networks implementing informal or formal sanctions to address mistrust. These could take the form of norms of exclusion in closed groups, of monitoring or of credible commitments that can be also a mechanism generating trust (trust-building tool).

There are different ways credible commitments may be established. First, there is a possibility of a rule which would cut off options. In our context that could take the form of a prohibition of inefficient restrictions of interstate trade (which comes to the same as a prohibition of measures having a protectionist intent) or the form of a broader prohibition of any obstacle to intra-EU trade.

Second, it is possible to arrange to suffer losses from a failure to act cooperatively (hostage taking). For example, the presumption of equivalence or mutual recognition shifts the burden of proof from the traders to the Member States in order to justify proportional restrictions of trade. This definitively increases the risk incurred by the regulation of the host State to be found illegal and thus sanctioned by the negative integration rules of the Treaty. Member States adopting regulations that are varying significantly from the regulations of the other Member States and thus fail to act cooperatively will suffer a higher likelihood of losing the case than States that are closer to the mean and which have taken proportional measures.

Third, an additional option would be to bring a third party to oversee and even enforce the commitments an actor made to others. In our context that would require the intervention of a centralized EU institution, which will monitor the process and will enforce sanctions that would mitigate the risks of distrust, or a decentralized network

that will ensure compliance through reciprocal monitoring and exclusion in case of non-compliance.

What is important here is to note that the definition of the concept of integration as an increased level of system trust is agnostic as to (i) the formal or informal character of the institutions generating trust (which could be either hard law, or soft law or conventions); (ii) their public or private nature, (iii) the fact that institutions are centralized or decentralized, (iv) or even to the choice of personal over “institutional-based”/“system trust”. We should recognize that there is a variety of trust-building tools which are very context-specific and do not necessarily form part of a *continuum*.

Turning to the example of the Internal Market, it seems that the existence of a high level of trust is a prerequisite for the application of the equivalence principle as regulators operate in a game of incomplete information. Kalypso Nicolaidis observes that long term contracts

“are obviously more sustainable when all parties are confident that the others abide by the letter and spirit of the contract. [...] (S)uch confidence is based on the initial familiarisation and continued involvement with the foreign system, including through: obligations of transparency of regulatory systems, decision making process, and change in such system through the continued exchange of information between regulators; mutual monitoring that allows for the continued assessment of technical competence, capabilities, and efficiency as well as the foreign industries overall state of art in its capability to comply with the importing country’s requirements; and finally, since there will always remain some information asymmetry, there needs to be trust that the foreign authorities will continue to have adequate regard for public health, safety and environmental concern”¹⁵⁴.

Host State regulators often lack information on the standards and practices of the home State regulators, but are asked to trust the standards and practices of the home State, according to the principle of equivalence. Extracting information on the regulatory regime of the home State constitutes an effective trust-building tool. Transparency, sustained exchange and monitoring will increase the level of trust between the home and the host State. The more important these costs of information

¹⁵⁴ Kalypso Nicolaidis, “Mutual Recognition of Regulatory Regimes : Some Lessons and Prospects”, (Jean Monnet Working Paper, 1997), available at <http://centers.law.nyu.edu/jeanmonnet/papers/97/97-07.html>, at § 56.

are, the more attractive the harmonisation of the standards would be, in particular as courts are ill-suited to perform this trust-building exercise at a lower cost. This explains why technically complex regimes, such as financial services, transports and communications were harmonized before other areas in services trade. This is not to argue that the adoption of harmonised rules is a costless enterprise. However, an essential step of any negotiation process is the initially selective but gradually increasing exchange of information between the parties. This will avoid the costly quest for information on a case-by-case basis that is characteristic of the implementation of the principle of equivalence by courts. The process of negotiation will reduce uncertainty and therefore increase trust between actors.

Action at the Union level usually aims to facilitate the process of economic integration by providing a negotiated common set of rules/standards. It usually intervenes, after it has been made clear in the implementation of the equivalence principle, that there are differences between the values protected by the regulatory regimes of the home and the host States. Action at the Union level may also intervene if the specific sector is subject to technically complex and detailed regulation that the courts are unable to cope with, in case they are required to apply the proportionality principle and therefore to compare the regulation of the host State with that of the home State. A regulatory regime may also be intrinsically complex if, for the accomplishment of its goals, it requires continuous supervision. The monitoring of technically detailed or intrinsically complex regulations involves important costs with respect to the acquisition of information and the implementation of the decision. The courts acquire this information on a case-by-case basis, without the benefit of prior knowledge or experience of the specific economic sector. Harmonisation leads to a more manageable governance regime, as the focus will shift from courts to national regulators (be it the legislative power, a cabinet department or an independent regulatory authority) that will have the means to perform more effectively such a monitoring function. Monitoring by national regulators, under the supervision of the European Commission, could provide important economies of scale with regards to the acquisition of specialised knowledge (as this will not be done now on a case-by-case basis). Regulators have also an important prior experience of the economic sector. National regulatory regimes often include an independent authority which has the task to regulate the specific sector. These national regulatory authorities have contributed to the

emergence of sector-specific harmonization standards. The involvement of independent administrative authorities operates as a credible commitment tool that the member states will not adopt protectionist strategies. For example the participation of independent regulatory national administrative authorities in the negotiation and enforcement of unified standards, as is the case with the Lamfalussy process in financial services or with the European regulators network in telecoms, ensures that other concerns than the very specific ones that are listed will be considered¹⁵⁵. The harmonisation process requires nonetheless an immense effort of negotiation and cautious drafting of an agreement between the various actors. The decision to proceed to harmonisation or to rely on the operation of the equivalence principle will be function of the comparison of these administrative costs, at least if we perceive harmonisation as entirely motivated by utility.

Trust may however be an important concern, even after the adoption of a harmonized standard. As the Court noted in *Hedley Lomas*, “(m)ember states must rely on trust in each other to carry out inspections on their respective territories”¹⁵⁶. It is therefore important to impose on the parties additional obligations in order to render operational the harmonized standard. By imposing transparency (simplification) and an obligation of administrative cooperation between the regulatory authorities of the Member States the Services Directive aimed precisely to address this concern.

One could identify three categories of trust relationships, on which the process of integration may operate. First, integration involves trust between national regulatory (norm-creation) actors, which would include national legislators, regulators, the judiciary, self-regulatory bodies, and actors at the EU level of governance, EU institutions. Second, it will involve trust between different national regulatory bodies across Member States that interact directly in the negotiation process or indirectly through the resolution of conflicts from the extraterritorial application of their regulatory standards. Third, there should be trust between individual (non normative) actors and the EU institutions (“trust in government”). The increased levels of trust between the different actors apply to all three relations (“total trust”). Total trust should be taken into account in order to examine the success of integration, not higher levels of trust in each relation. But how can we measure trust?

¹⁵⁵ See, the analysis by I. Lianos & D. Gerard, in this volume.

¹⁵⁶ Case C-5/94 *The Queen v Ministry of Agriculture, Fisheries and Food, ex parte: Hedley Lomas (Ireland) Ltd* [1996] ECR I-2553, para 19.

Measurement issues are certainly the most challenging aspect of this conception of integration. More research needs to be accomplished but there have already been some proposals for indicators measuring trust in international relations¹⁵⁷. First it is possible to identify policies that grant other states discretion over outcomes previously controlled by the first. For example, a majority voting system qualifies as an important discretion-granting policy. Second, the existence of mechanisms to oversee the exercise of discretion might be also a useful indicator. “Methods of oversight that permit actors more leeway to make decisions are consistent with trusting relationships”¹⁵⁸. For example, institutional-based trust may be promoted by the principle of mutual recognition as it increases the discretion of the home state to adopt regulatory standards that will differentiate from those of the host state without affecting the chances of its exports in the host state. The “discriminatory market access test” or a national treatment rule in the law of the Internal Market also recognizes more discretion to the home state than the “obstacles test”, as only regulations that impose costs to foreign goods that have not been incurred by domestic goods are subject to judicial control under the second step of the assessment. Finally, issues of measurement raise also important difficulties within the traditional views of economic integration. A variety of indicators are often employed, such as, from the more simple ones, the extent of free trade of goods, services, free movement of capital and labour, the existence of supra-national institutions and of monetary and fiscal coordination, to the more complex ones, such as the synchronization of business cycles, convergence of inflation rates and income, the degree of interpenetration of activities¹⁵⁹. A common feature of all these methodologies is that they are all based on the theory and typology of economic integration of Balassa, with the correspondent emphasis on economic efficiency as measured by the removal of trade barriers¹⁶⁰. These indicators assume the decoupling of the economic dimension from the political and social and are certainly inadequate if one adopts a holistic approach.

¹⁵⁷ On the measurement of trust see, A. M. Hoffman, “A Conceptualization of Trust in International Relations”, *European Journal of International Relations*, 8(3) (2002), 375-401, pp 385-393.

¹⁵⁸ *Ibid.*, p. 388.

¹⁵⁹ For a discussion see, Ph. De Lombaerde, ‘Indicators of Economic Integration’, *Statistika*, 4 (2008), 340-345; Ph. De Lombaerde, *Assessment and Measurement of Regional Integration* (London: Routledge, 2008).

¹⁶⁰ B. Balassa, *The Theory of Economic Integration* (Homewood: Richard Irwin, 1961).

In contrast, if one adopts a “cybernetic” approach, which would envision integration as having the aim to reach a “security community”¹⁶¹, either of the amalgamated or of the pluralistic type¹⁶², the focus would be on communication channels in order to create interdependence between peoples.¹⁶³ This approach may accommodate pluralistic concerns, but its emphasis on the “use of the same or equivalent patterns of living, and feeling among individuals, who are members of the various political units that make up the security community”¹⁶⁴ indicates that the principal focus is patterns of communication between people rather than between institutions (formal or informal). Hence, the measurement indicators suggested by this approach do not take into account that the process of establishing institutional-based trust is of particular importance if one is to distinguish between the concept of integration and that of globalization, the latter also referring to the development of shared patterns of living.

¹⁶¹ K. Deutsch, *Political Community and North Atlantic Area* (Princeton University Press, 1957), p. 5, defining integration as a process leading to the condition in which a group of people has “attained within a territory a sense of community and of institutions and practice strong enough to assure for a long time, dependable expectations of peaceful change among its population”.

¹⁶² *Ibid.*, p. 6. An “amalgamated” security community leads to the development of supreme institutions and the legal merger of, more than one, independent political units. A “pluralistic” security community emphasizes cooperation of independent political units, rather than amalgamation.

¹⁶³ K. W. Deutsch, *Political Community at the International Level* (Utah: Global Pub. Company, 2006, first published 1954).

¹⁶⁴ K.W. Deutsch, ‘Security Communities, International Politics and Foreign Policy’, in J.N. Rosenau (eds.), *A Reader in Research and Theory* (New York: the Free Press, 1961), pp. 98-99.