

## 6. Getting closer at different speeds: strategic interaction in widening European integration

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### INTRODUCTION

The purpose of the present study is to identify reasons for the current tendency of states to engage in political integration. The propensity to forgo national sovereignty in exchange for free-trade agreements and membership in regional IGOs contradicts Waltz's (1979, p. 105) statement that such developments are often talked about but seldom realized. On the contrary, the opposite holds true for the last decade of this century. Although regional co-operation frequently takes place, there has been hardly any progress in our understanding of such processes since the heyday of integration research in the 1950s and 1960s.

This theoretical stalemate is also manifest in studies about the enlargement ('widening') of regional integration. At present, no systematic explanation is available for the puzzling variation in the integration policies of otherwise comparable states: some want to integrate as quickly as possible while others are much more reluctant to sacrifice national sovereignty. However, the speed of nations is not an explicit topic in the classical approaches. In the perspective of neo-functionalism, it does not matter that governments pursue different interests (Haas, 1958, p. 524). Realist contributions (Moravcsik, 1991) are also of little help because they define state interests exogenously. Finally, studies focusing on political culture (Janssen, 1991) do not explain how the preferences of constituents should affect the positions of the negotiating governments.

Conceiving of integration as a principal-agent interaction between governments and their constituents, this chapter tries to shed some light on national strategies in the widening of regional integration. I develop micro-foundations of interstate co-operation for this purpose and define the preferences of parti-

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icipating governments endogenously. The chapter particularly shows that domestic institutions and the dependence of governments on voter support influence the negotiation strategies. Governments have to take into account the interests of their principal who only approves of a beneficial treaty. Ratification procedures accordingly determine how much latitude a negotiator has. Since unpopular governments try to preserve sovereignty to survive domestically, the outcome of such a process furthermore depends on electoral considerations. Both kinds of constraints shape the integration process in an ambiguous way. While they yield more favourable outcomes for some governments, they also enhance the likelihood of bargaining inefficiencies.

To explore the linkage between international and domestic politics, I present models of the prenegotiations, the interstate bargaining and the ratification of an integration treaty. The prenegotiations are visualized as a Stackelberg–Cournot game. This model shows that governments can be treated as unitary actors even if there is both domestic and international disagreement about the level of integration. Nevertheless, the negotiation positions depend upon the preferences of the constituents in all participating countries. In the formal bargaining, informational incentives are of the utmost salience. If the uncertainty about domestic constraints is asymmetric, some unconstrained governments obtain better solutions by imitating the behaviour of constrained governments. Due to this uncertainty, negotiations might even fail although all actors prefer the enlargement of the integration process. Additionally, governments may also fall into an integration trap because they cannot figure out what the constituents really want. In the ratification game, finally, some governments attempt to hide how much sovereignty they have sold. With incomplete information, the pivotal constituent can commit the mistake of rejecting a beneficial treaty.

The chapter is arranged as follows: Section 1 summarizes the literature and selects the relevant levels of decision-making; section 2 outlines the basic conflict of interest in regional integration. The formal models are presented in section 3. The empirical illustrations in section 4 refer to the talks between the European Free Trade Association (EFTA) and the European Community (EC) about the European Economic Area (EEA). Section 5 summarizes the results and suggests future avenues of research.

## 1 REGIONAL INTEGRATION AS A MULTILEVEL GAME

### 1.1 The Impact of Other Decision-making Levels

Although regional integration currently progresses on various continents, our understanding of such processes does not coincide with this new momentum. A sign of this theoretical stalemate is the tendency in many current studies to

borrow from the neofunctional (Haas, 1958, 1964) and the transactional traditions (Deutsch *et al.* 1957). While expressing varying degrees of scepticism towards their usefulness, some authors explicitly refer to the very broad categories of these theories (George, 1985, and Mutimer, 1989, for a neo-functional framework; Wallace, 1990, for a transactional set-up). As a result, these examinations reflect almost involuntarily the scientific discourse which prevailed in the 1950s and 1960s.

Regardless of the allusions to 'spillover effects' or other influential concepts, the classical approaches no longer seem apt to explain how political co-operation evolves at a regional base. This is to a large extent a result of the reluctance to accept intergovernmentalism (Scharpf, 1988) as the dominant decision-making mode. If supranational institutions, rather than governments, are the main actors, the divergence in the integration strategies of different states do not count. In the view of Haas (1958, p. 524), 'no government habitually seeks to hinder or advance integration'. To overcome the legacy of supranationalism, Moravcsik (1991, p. 688) recently proposed that 'the primary source of integration lies in the interests of the states themselves'. In other words, this kind of approach takes national preferences as exogenously given and resorts to a unitary-actor assumption. This is similar to examinations which focus on political culture as an explanatory concept. If the authors of such studies want to speak about integration policy they have to presume a direct link between voter attitudes and the negotiation style of governments (Janssen, 1991).

Owing to the necessity of a domestic vote on important integration issues this piece of research cannot solely rely on concepts such as the 'national' interest. In regional co-operation between two states at least four actors are crucial: two negotiators and two domestic principals, be it the cabinet, the parliament or the electorate. By disaggregating the preferences of states this chapter attempts to explore especially the impact of different decision-making levels on integration. Due to the importance of strategic considerations and the interactive nature of such an endeavour, I analyse regional integration from a rational-choice viewpoint. I assume that integration follows a rather strict temporal order. Such a process begins with the suggestion by one government to another to establish common political institutions. This proposal might lead to formal negotiations which are concluded by way of ratification. These approval procedures range from voting on the cabinet level to parliamentary decisions and referenda.

In sum, I assert integration to be a principal-agent situation at the domestic level. Yet, in contrast to less salient negotiations, governments do not act solely as agents of their constituents. This assumption is in accordance with an observation by Schelling (1960, p. 29). He described such negotiating agents as principals in their own right, with a preference order possibly deviating from that of its domestic constituents. As a result governments do not try to defend the 'national interest', but they are concerned about their own popularity and

other individual matters. By asking for a 'better' treaty they can compensate for crises in other arenas of government activity. Due to this connection with other conflicts, integration is a multilevel interaction with the negotiations being the central decision-making environment.

## 1.2 New Approaches Towards an Old Topic

The interaction between various levels of decision-making has gained considerable importance in the fields of international relations and comparative politics. Among all interfaces, the relationship between international and domestic politics still attracts most attention. For a long time the controversy between realism and its liberal counterparts dominated studies on this subject. Due to a preoccupation with hierarchical considerations the discussions remained centred on the alleged superiority of either international or domestic sources of foreign policy (Almond, 1989).<sup>1</sup>

Instead of proffering a futile rank order, it seems more fruitful to investigate the factors under which both kinds of circumstance play a role. By analysing the interactions between the two levels in this way, Putnam (1988) offered a first rigorous treatment of the issue. In a formal development of these ideas, Iida (1991) shows how a government may benefit from asymmetric information. This study follows a similar approach and highlights the role of informational incentives in different periods of an integration process. In contrast to Iida's application of the Rubinstein (1982) model, the bargaining is, however, about discrete options and does not involve discounting.

Along with another attempt to put forward a general model of two-level games (Dupont, 1992), several indirect applications of this notion exist. In the domain of arms-control negotiations such models involve bargaining among allies (Brams, 1990) or between a government and its electorate (Morrow, 1991). Bueno de Mesquita and Lalman (1992) study the impact of domestic opposition on the beliefs and actions prior to war. Relying on an explicit principal-agent framework, Richards *et al.* (1992) contemplate the conditions under which governments engage in diversionary foreign policy behaviour. In comparative politics, studies on legislative committees (for example, Baron and Ferejohn, 1989) and on government formation (such as Laver and Shepsle, 1990) are similar to the idea of a nested interaction.

While the majority of these authors rely exclusively on the tools of non-cooperative game theory, the most acclaimed approach for building up a unifying approach draws upon Aumann's (1974) concept of correlated strategies. According to Tschebelis's (1990) notion of 'nested games' the potential for cooperation can be enhanced by allowing players to communicate. Another general idea is that the payoffs of the players in a principal arena vary according to the situation prevailing in other contexts. In other words, the general payoff

attributed to an outcome could represent some combination of the payoffs in all relevant conflicts. However, it should be noted that this method hardly provides single equilibria. In technically sophisticated extensions (McGinnis and Williams, 1991), no clear threshold between conflict and co-operation exists. In a critique, Kreps (1989, p. 19) calls for the explicit inclusion of correlating devices and enforcement mechanisms. As every textbook describes integration as a process (for example, Groom and Heraclides, 1985, p. 174), it seems appropriate to rely on extensive form games

## 2 THE ENLARGEMENT OF AN INTEGRATION PROCESS AS A NESTED INTERACTION

In defining a national strategy towards regional integration, governments are confronted with a severe tradeoff. They must strike a balance between the loss of sovereignty and the prospects of welfare gains. At the same time, they are compelled to take other domestic conflicts into account. In a general manner, the following analysis illustrates in what respect popularity becomes important for the decision on the extent of integration. It furthermore shows how some leaders may use domestic resistance against a loss of sovereignty as a negotiation tool. I shall call this government the 'applicant'. In negotiations about the widening of an integration process, the applicant typically tries to preserve more sovereignty than the existing intergovernmental organization (IGO) would like to grant. Both sides perceive integration, however, to be better than the status quo. No bargaining would take place otherwise

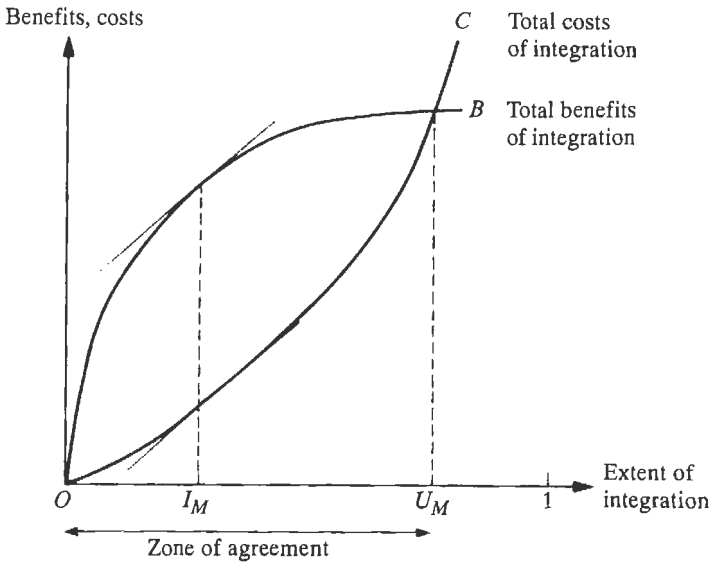
To begin with the perspective of the constituent in the applicant country, I assume that the parliament or the electorate has the final say about the likely negotiation outcome. As the final decision will be taken with respect to some kind of majority rule, a pivotal constituent such as the median voter plays the central role. By comparing the costs of losing national sovereignty with the benefits of integration, this actor delimits how much flexibility a government has. Figure 6.1 shows how the median voter takes position with regard to political integration. The horizontal axis depicts how far the formal links between two entities can go. For simplicity, the extent of integration is an interval  $[0,1]$ , with 0 representing full independence and 1 complete unification. The vertical axis measures the costs and benefits of political integration.

The curve *OC* displays the costs associated with different degrees of political integration. It seems reasonable to expect a rising slope. As a consequence, the more national sovereignty the applicant government decides to trade in, the more a voter has to give up. To mention but a few such losses, the individual sacrifice consists of giving up protectionist rents, rising information costs, a growing anonymity due to the enlargement of a decision-making system, and the

shrinking importance in political matters of the own state.  $OB$  is the curve which indicates the benefits obtained from integration. Such benefits include the growth in personal income and in influence on the politics of other states.

The ideal point of the median voter  $I_M$  is where the difference between total costs and total benefits reaches its maximum. This is of course the point where the marginal total costs and the marginal total benefits are equal. As the pivotal constituent would approve of all outcomes promising higher benefits than costs, the intersection between  $OC$  and  $OB$  bounds the zone of agreement. Possible integration treaties lie within the range  $OU_M$ . Figure 6.1 indirectly shows the impact of different ratification procedures. By letting a qualified majority decide, the zone of agreement contracts.

Figure 6.1 The median voter and political integration



The following equations summarize the utility that voters  $C_{11}$  and  $C_{21}$  can derive from an integration attempt:

$$U_{c11(x)}^* = b_{11} - (x_1 - c_{11})^2 - r_{11}x_1$$

$$U_{c21(x)}^* = b_{21} - (x_1 - c_{21})^2 - r_{21}x_2$$

The ideal points of the applicant government and the IGO are  $g_1$  and  $g_2$  respectively; their constituents prefer most  $c_{1i}$  and  $c_{2j}$  ( $i = 1, \dots, n; j = 1, \dots, m$ ). All

actors have quadratic loss functions. Constituents can receive a maximal benefit  $b_{1i}$ , and  $b_{2j}$ , from an integration treaty. They punish or reward a government upon evaluating how beneficial the outcome is. The scalars  $r_{1i}$  and  $r_{2j}$  represent the respective choices. They translate in the form  $r_{1i}x_1$  and  $r_{2j}x_2$  into rewards for the governments and voting costs for the constituents. Because of rising information costs I assume the voting costs to grow linearly with the level of integration. In other words, it becomes more and more difficult to receive adequate information about national integration policies the closer two political entities move towards unification and the less important the national level is.

The ratification constraint is the point where the utility of integration is zero for the pivotal constituent. Assuming negligible voting costs, this restriction is defined as follows for the principal of the first country:

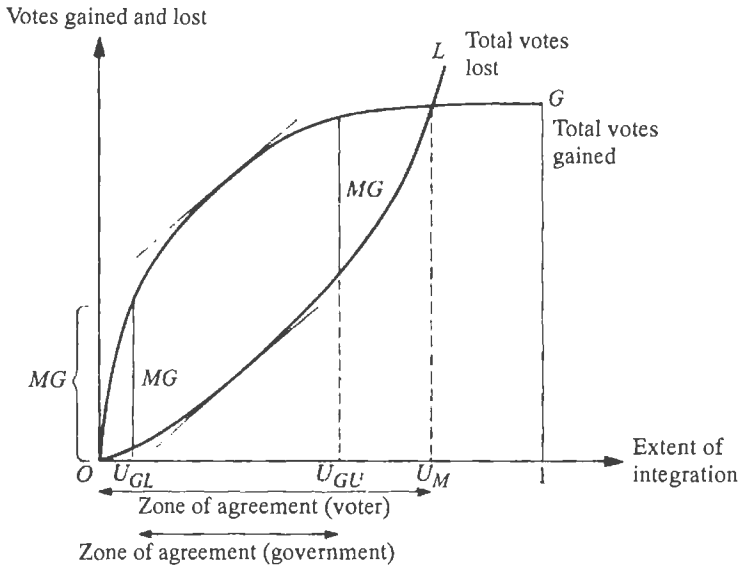
$$x_1 = c_{11} + \sqrt{b_{11}}$$

Within their respective ratification limits leaders are basically free to choose exactly how intensive the established links with another entity should be. Although ideology may matter up to a certain point, domestic competition can prevent partisan integration policies. The negotiation position depends, in particular, on the support it enjoys for its general performance. In a period of high unemployment, for instance, its popularity may be exceedingly low. This creates an incentive to link the integration issue to other policies in order to improve domestic reputation. In the extreme, integration is embedded into a nested conflict in which executives try to maximize the support they can gain across all relevant policy arenas. Figure 6.2 indicates how this connection may affect the set of possible agreements.

$OL$  displays the curve of votes an executive stands to lose when it opts for further integration. The curve  $OG$ , on the other hand, suggests how many votes it may gain from a specific policy. If an unpopular leader seeks additional votes in an attempt to stay in power, agreements are less likely to be reached. As the government in Figure 6.2 has, as a minimum, to seek a popularity gain  $MG$ , the zone of agreement becomes smaller.  $UG_L$  illustrates the lower and  $UG_U$  the upper level of the set of feasible agreements.

In formal terms, leaders can expect a maximum popularity reward  $\sum r_{1i}x_1$  and  $\sum r_{2j}x_2$  for a single integration treaty. If the treaty does not coincide with their ideologically preferred position, they suffer a quadratic loss  $-(x_1 - g_1)^2$ . This disutility is multiplied with a constant  $a_i$  which expresses to what extent the government depends upon its own popularity. The more sensitive a government is to changes in public support the more the deviation from the ideal point to the bargaining position matters. Accordingly,  $a_i$  is bigger than 1 for an unpopular government, and the range of this crucial parameter is between 0 and 1 for popular governments.

Figure 6.2 The position of an unpopular government with regard to integration



At the international level a strategic interaction unfolds because the two negotiation positions are not identical. The larger the distance between  $x_1$  and  $x_2$ , the more cumbersome it is to agree upon an integration treaty. As a consequence, the popularity functions include the popularity loss  $-(x_1 - x_2)^2$  and  $-(x_2 - x_1)^2$ . As governments have to respect the domestic politics of other countries to varying degrees, this disutility mirrors the power structure in the international system. The parameters  $w_1$  and  $w_2$  represent the weights which the two governments have to attribute to each other. As these exogenously given coefficients are relative measures of bargaining power, they add up to 1.

In sum, the popularity functions of the two governments accordingly look as follows:

$$U^*_{G1(x)} = \sum_{i=1}^n r_{1i}x_1 - a_1(x_1 - g_1)^2 - w_1(x_1 - x_2)^2$$

$$U^*_{G2(x)} = \sum_{j=1}^m r_{2j}x_2 - a_2(x_2 - g_2)^2 - w_2(x_2 - x_1)^2$$

Although the spatial analysis is helpful for developing the utility functions it is necessary to move beyond intuition. To obtain a more precise picture of the interaction between various decision-making levels I shall distinguish three different periods of integration negotiations: the prenegotiations, the formal bargaining and the ratification process.<sup>2</sup>

### 3 THREE PERIODS OF REGIONAL INTEGRATION

#### 3.1 Defining the Bargaining Position

Because both governments and their constituents define how much their countries shall be formally linked with another political entity, regional integration can be represented as a nested two-stage game. This first becomes obvious in the prenegotiation period which I shall describe as a Stackelberg–Cournot game.<sup>3</sup> To assume the strict sequentiality of a Stackelberg game may be objectionable. However, integration negotiations are so salient that domestic actors try to influence the government strategy before the interstate negotiations commence.

Domestically, the interaction is a Stackelberg game in which the constituents move first to establish their position. This leads them to incorporate the executives' optimal reaction into their decision of whether they want to support the integration policy. Thus, they are the Stackelberg leaders, whereas the second-moving governments are the Stackelberg followers. On the international level, the interaction represents a Cournot game in which the governments choose their negotiation positions simultaneously. By incorporating the interests of the other side, the two executives have to take one another into account.

Despite the pressure from both the domestic and the international level, the preferences can still be consistently aggregated into negotiation positions for each country. Proposition 1 describes this result for the applicant government.

*Proposition 1:* If the applicant government has to respect the interests of its constituents and to take into account the strategy of the regional IGO, its integration negotiation position represents the weighted average of the executives' bliss points in both entities.

The appendix includes the derivation of this result. The main result of the Stackelberg–Cournot prenegotiation game is that the lack of domestic consensus does not prevent governments from adopting a consistent policy. The model furthermore shows that governments still may be treated as unitary actors if they are exposed to pressure from other governments. The international linkage only forces them to come to terms with domestic as well as international considerations. The prenegotiation game also allows the definition of the negotiation

positions endogenously. This is in contrast to the state-centric integration literature. Substantially, the possibility of an unambiguous negotiation position adds to the recent criticism of the bureaucratic politics model (Bendor and Hammond, 1992). In an implicit way, the 'third' model presented in the 'Essence of Decision' (Allison, 1971) is a reaction against rational choice and the unitary-actor assumption.

In other words, position-taking in both countries influences government strategies with regard to an upcoming international negotiation. The dependence on government support is ambiguous. The rewards which the applicant receives influence the willingness to integrate of the IGO. Because their zones of agreement are generally smaller, unpopular leaders ( $a_1 > 1$ ) are less integration-minded than popular leaders. As the sensitivity parameters  $a_1$  and  $a_2$  grow, the size of the negotiation positions thus decreases. Finally, if a government is internationally omnipotent ( $w_1 = 0$  or  $w_2 = 0$ ), it has only to take into account its own domestic struggle.

This first model offers a general framework and highlights the mutual interdependence of negotiators. It furthermore shows that international unanimity ( $x_1^* = x_2^*$ ) about the extent of integration is rare. In opposition to functionalist reasoning, national strategies therefore influence the integration processes, and bargaining is a necessary part of this kind of interstate interaction.

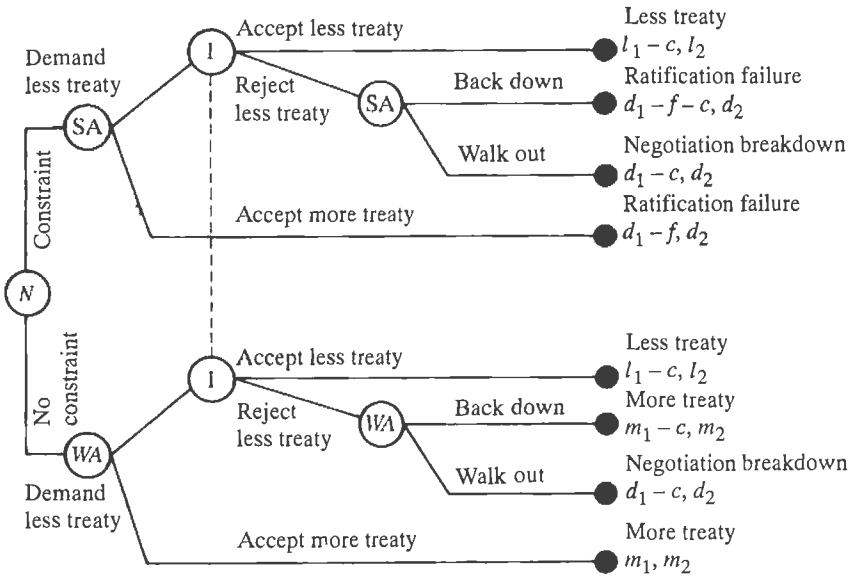
### 3.2 Exploiting and Enduring Domestic Constraints

The Negotiation Game models a situation where the two agents negotiate about two qualitatively different treaties. The first outcome (More Treaty) promises a higher level of integration than the less ambitious result (the Less Treaty). In the context of the enlargement of an IGO, the More Treaty could represent the 'entry conditions' of the IGO. The Less Treaty stands for a solution where the applicant would have to sacrifice less sovereignty. To move from the Less Treaty to the More Treaty involves the potential member in giving up a central symbol of its independence. The division into only two options reflects the fact that many political decisions are dichotomous, especially if electoral considerations are important. These domestic circumstances force politicians to choose between integration with or without an issue, such as a common currency.

In such a bargaining situation the IGO has to reckon with the power of the weak negotiator (Allan, 1984). If states are disaggregated into principals and agents, domestically constrained governments turn out to be the tough negotiators. To obtain more favourable outcomes, they can employ different kinds of threats (Schneider and Cederman, 1992). The Negotiation Game models the consequences of one of these manipulations. I assume that the applicant has private information about the preferences of its principal. To put it another way, the IGO does not know the ratification prospects of the other negotiator. The

informational advantage of the applicant refers to the monopoly this player has in influencing its own public opinion. As in every signalling game, the presence of incomplete information leads to the distinction between different senders of a message. In Figure 6.3, two types of 'applicant' governments are presented. The principal of the strong applicant (player SA) never approves of the More Treaty whereas the constituents of its weak counterpart (WA) always ratifies such an agreement. The applicant prefers the Less Treaty to the More Treaty ( $l_1 > m_1$ ) whereas the IGO opts for the opposite ( $m_2 > l_2$ ).

Figure 6.3 Integration negotiations with incomplete information (ratification threat)



The game starts with a move by nature. The applicant has to decide whether to succumb to the More Treaty or to demand the Less Treaty. If it opts for the preferred Less Treaty, the IGO can in return insist on the More Treaty or accept the Less Treaty. The demand for the More Treaty forces the applicant either to walk out of the negotiations or to back down. In the event of a walkout the status quo prevails. The two negotiators can count on the deadlock payoffs  $d_1$  and  $d_2$  for such an outcome. Furthermore, the applicant has to reckon with different

kinds of costs. First, it receives a penalty  $f$  if its principal refuses to support the More Treaty. Secondly, the commitment to the Less Treaty invokes signalling costs  $c$ . If a strong type subjects a More Treaty to ratification after demanding the Less Treaty, it obtains the payoff  $d_1 - f - c$ . For a weak type, the corresponding utility amounts to  $m_1 - c$ .

The Negotiation Game is based on the following assumptions:

$$\text{Assumption 1: } d_1 - f - c < d_1 - f < d_1 - c < m_1 - c < m_1 < l_1 - c$$

$$\text{Assumption 2: } d_2 < l_2 < m_2$$

Notice that all players prefer integration to a negotiation breakdown ( $d_1 < m_1$  and  $d_2 < l_2$ ). The analysis shows that integration negotiations under uncertainty are very different from bargaining under complete information. If the IGO knows the applicant's type, such negotiations are always efficient. Neither of the applicants walks out of the negotiations and the weak applicant never attempts to bluff. On the contrary, this player immediately accepts the More Treaty, anticipating that the IGO would reject the demand for a Less Treaty. The strong applicant, by contrast, obtains the Less Treaty. Proposition 2 summarizes this result:

*Proposition 2:* Under complete information, the Negotiation Game has two outcomes:

EQUILIBRIUM I: If the IGO is certain to encounter the weak applicant, the negotiations result in the More Treaty.

EQUILIBRIUM II: If the IGO is certain to encounter the strong applicant, the negotiations result in the Less Treaty.

Enlargement negotiations are, however, much more ambiguous as soon as the assumption of complete information is abandoned. If there is uncertainty about the applicant's constituent, the integration process may lead to suboptimal outcomes. Proposition 3 summarizes this case. A sketch of the proof for the two propositions can be found in the appendix.

*Proposition 3:* Under incomplete information, the Negotiation Game has two major outcomes:

EQUILIBRIUM 1: Up to a certain threshold belief  $p_0 = (m_2 - l_2)/(m_2 - d_2)$ , the strong applicant always demands the Less Treaty. As the IGO sometimes rejects this demand, both walkouts and Less Treaties are possible outcomes. The weak applicant randomizes the first move. If this player demands the Less Treaty, the IGO also adopts a mixed strategy. This leads to the Less Treaty or to the backing down outcome.

**EQUILIBRIUM 2:** Above the threshold belief  $p_0$  both the weak and the strong applicant always asks for the Less Treaty which is, subsequently, accepted by the IGO.

The outcome of integration negotiations under uncertainty depends on whether the IGO strongly believes that it will encounter a constrained applicant. The applicant's demands are always successful above this borderline belief. The suboptimal outcome of a negotiation failure only becomes possible below the crucial belief. The walkout from the negotiations happens when the IGO erroneously believes it faces a weak applicant. In this situation the weak applicant can successfully bluff, although some of these attempts might be called.

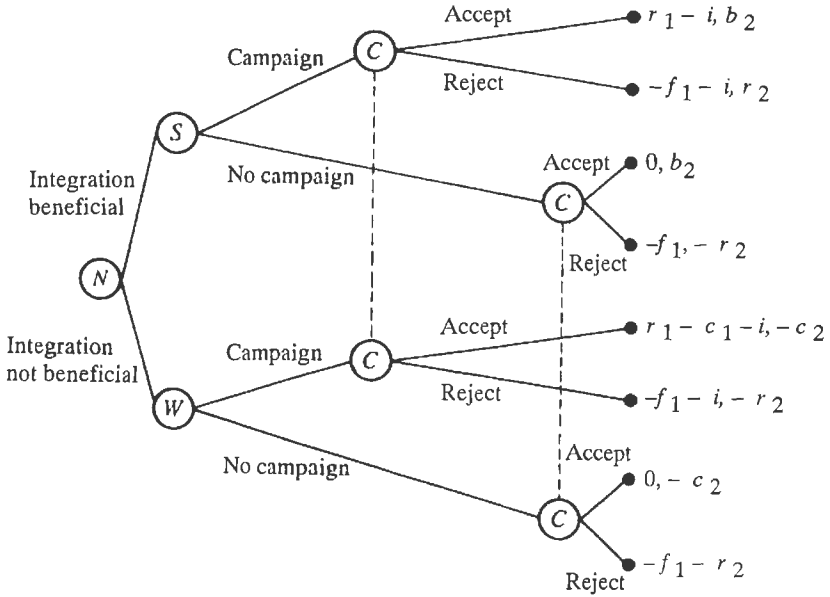
Although their reasons differ, both types have an incentive to negotiate. The strong applicant derives its motivation to ask for a concession from the penalty for the ratification failure. In the absence of carrot-and-stick measures by his principal, this type of negotiator would not mind subjecting the More Treaty to ratification and experiencing a defeat. By contrast, the likelihood that its weak counterpart immediately accepts the More Treaty only depends on the deadlock payoff  $d_2$ . If the IGO enhances this payoff, the More Treaty becomes more likely; or, to put it another way, the power of the IGO grows as long as the negotiations become less salient.

### 3.3 Circumventing Constraints During the Ratification

However important private information may be, bilateral uncertainty is a very common trait of integration negotiations. Negotiating agents do not necessarily know whether a principal may ratify the envisioned treaty. Due to the veto power of the constituents some governments accordingly fall into a decision-making trap in which both ratification failure and a negotiation breakdown are very likely outcomes. The higher the uncertainty about the principal the more reluctant the strategy of the government (Lax and Sebenius, 1991). Although a constrained government is strong at the international level, rigid ratification procedures may turn this advantage into a disadvantage in the domestic setting.

In contrast to the prenegotiations, the executives at least have the privilege of moving first in the ratification process. When approval is uncertain, they have an incentive to ensure a success. In this last model<sup>4</sup> (Figure 6.4), the government possesses private information about the outcome of integration negotiations. In accordance with the preceding situation, bargaining can either result in a More or a Less Treaty. A government is strong (player *S*) domestically if it brings home a Less Treaty. Its weak counterpart (player *W*), however, accepted a More Treaty at the international level. The constituent with the decisive vote (player *C*) would like to reject a More Treaty, but accepts a Less Treaty. It should be noted that this model is naturally only relevant for cases where ratification matters.

Figure 6.4 The Ratification Game



The game commences with a move by nature which determines the level of the treaty. Subsequently, the government has to decide whether it wants to convince the pivotal constituent that the treaty is beneficial. Regardless of the decision by the government, this crucial member of the electorate has the last word. If the information campaign succeeds and the treaty passes to ratification, the government obtains a popularity bonus  $r_1$ . A successful ratification without campaign, by contrast, does not have any effect on government popularity. Since governments cannot count on any change in their popularity, the payoff for an effortless success is zero. In the case of a ratification failure, governments are punished with a penalty  $f_1$ . To engage in an information campaign invokes a cost  $i$  additionally. A weak type has moreover to take into account that the decisive constituent will withdraw its long-term support when it realizes that the treaty was not advantageous. This second cost is denoted as  $c_1$ .

To mistakenly approve of the More Treaty imposes a cost  $c_2$  on the constituent. When accepting a beneficial treaty, the constituent can count on the benefit  $b_2$ . The voting costs are assumed to be  $r_2$ . The payoff orders are thus defined as follows:

*Assumption 3:*  $-f_1 - i < -f_1 < 0 < r_1 - c_1 - i < r_1 - i$

*Assumption 4:*  $-c_2 < -r_2 < b_2$

The inequality  $0 < r_1 - c_1 - i$  denotes that the weak type has an incentive to send a message. Yet this player tries to reach this outcome only if the constituent is uncertain about the outcome of the international negotiations. Under complete information there would again be no inefficiency in such a game. This situation is summarized in the following proposition:

*Proposition 4:* Under complete information, the Ratification Game has two outcomes:

EQUILIBRIUM I: If the government can present a beneficial treaty, it will engage in an information campaign and the constituent will accept the treaty.

EQUILIBRIUM II: If the government cannot present a beneficial treaty, it will refrain from an information campaign and the constituent will reject the treaty.

Since the constituent knows the identity of the governments under these circumstances the strong type would send a message and the Less Treaty would pass the ratification process. Weak types, however, abstain from any promotion, and the ratification fails. This kind of applicant can only mimic the behaviour of its strong counterpart in the presence of asymmetric information. The outcome largely depends on the beliefs of the pivotal constituent of facing a strong applicant after it had observed a campaign. This situation is described in the fifth proposition:

*Proposition 5:* Under incomplete information, the Ratification Game falls into two basic cases:

EQUILIBRIUM 1: Up to the threshold belief  $p^* = (c_2 - r_2)/(c_2 + b_2)$ , the strong government always starts a campaign. The pivotal voter randomizes its strategy in order to make the weak government indifferent. This unsuccessful negotiator in return equivocates between campaigning and refusing to start a campaign. The constituent rejects the treaty if no message was sent.

EQUILIBRIUM 2: The government always starts an information campaign and the voter always accepts it above the threshold belief  $p^*$ .

The model establishes that there is always an incentive to start a campaign for a strong applicant. It indicates that the uncertainty about the level of the treaty may induce suboptimal results. Hence, a government might be successful in pretending that it achieved a Less Treaty although it had to accept a More Treaty. On the other hand, pivotal constituents might mistakenly reject the strong

applicant's Less Treaty, suspecting that the information campaign was not sincere. Comparative statics reveal that the likelihood of such an outcome increases with growing rewards for the successful information campaign ( $r_1$ ), decreasing signalling costs  $i$  and a growing size of the penalty  $f_1$  for a ratification failure. The probability of a successful bluff increases when the weak government commits itself strongly to the information campaign. The opposite effect occurs if this type is about to lose considerable electoral support after the pivotal constituents find out that they voted in favour of the More Treaty instead of the Less Treaty. The occurrence of bluffs thus depends very much on whether governments can be held accountable for what they said during a ratification campaign. It is obvious that the size of such costs grows the more competitive a political system is.

Considering the crucial impact of such possible punishments, the dependence of negotiations on their domestic setting has thus been again the general feature of this last integration period. I demonstrate the empirical relevance of the different models by describing the negotiations between the European Free Trade Association (EFTA) and the European Community (EC) about the creation of an European Economic Area (EEA). Analytically, these talks represented a three-level game, consisting of the interactions between the EC and the EFTA, the intraorganizational coalition-building and the domestic negotiations in each state. Substantively, the goal of the EEA is to enlarge the scope of European integration and to extend the Internal Market Programme to the EFTA.

## 4 THE EEA NEGOTIATIONS AS A THREE-LEVEL GAME

### 1.4 Reactions to the Internal Market Programme

It was Austria which reacted most fiercely to the Internal Market Programme of the EC. A coalition of business forces particularly influenced the junior partner in the government, the conservative ÖVP, to request full membership of the EC (Luif, 1990, p. 184). After the dominant Socialist Party had followed suit the National Parliament voted in favour of such a step. The government applied for full EC membership on 17 July 1989. At this time such a move was out of the question for the other EFTA members.<sup>5</sup> They still hoped to be able to continue their pick-and-choose strategy and to strike separate deals with the EC. Bilaterally they were already closely tied to the Community. By 1989 the links of Switzerland alone amounted to around 150 separate accords.

This approach remained the main channel for integration despite some efforts to establish direct negotiations between the EFTA and the EC. At a joint summit in Luxembourg in 1984, the two organizations had solemnly declared their intention to create a 'dynamic European Economic Space'. Notwithstanding this

proclamation, the supranational talks took off only very reluctantly. Almost half a decade passed before the idea achieved a prominent place on the integration agenda. In this new situation, the label of the project soon changed from 'European Economic Space' to 'European Economic Area', primarily for linguistic reasons.

## 4.2 Defining Integration Strategies at the National Level

A move by a single player turned the issue of how 'to incorporate other nations into the Internal Market Programme' into a three-level game. By asking for direct negotiations between the EC and the EFTA on this account, Jacques Delors (1989), the President of the EC Commission, reactivated the idea of an EEA in January 1989. By calling for a more structured partnership, he thereby temporarily succeeded in protecting the deepening of EC integration from the admission of neutral countries such as Austria. Simultaneously, Delors drove all other EFTA governments into a corner. They were now forced to co-ordinate their policies and to speak with one voice.

After Delors had unilaterally defined the bargaining rules, the governments of the EFTA member states had to circumscribe the extent to which their countries were prepared to integrate. Press leaks soon revealed which governments would enter the upcoming talks as hard-liners. A quantitative indicator for the negotiation positions is the number of exceptions (derogations) which the EFTA members tried to obtain from the set of relevant Community rules, the so-called *acquis communautaire*.<sup>6</sup> According to a British source (Select Committee, 1990), the EFTA countries aspired to various permanent exemptions: Switzerland (4), Iceland (3), Austria (2), Sweden (2), Finland (2) and Norway (2). For example, the governments tried to limit foreign ownership of land and to uphold high standards for health and environmental protection. Nevertheless, the Commission categorically refused any permanent exceptions to the *acquis* in May 1990. Notwithstanding this blow, the hard-liners gave in only so far as they were urged to. At a meeting in spring 1991, the EC refused to accept the following number of temporary derogations: Switzerland (21), Iceland (9), Norway (6), Austria (5), Finland (4) and Sweden (2).<sup>7</sup>

These figures confirm that Switzerland and Iceland were indeed the countries which tried the hardest to preserve their sovereignty. Switzerland tried to compensate for losses in this realm by insisting on a role in the shaping of Community decisions around the EEA. Sweden, Finland and Austria, on the other hand, were much less reluctant to accept EC rules. As these states were the first to opt for EC membership the formation of the EEA institutions did not much matter.

It is still puzzling that there was a greater convergence of interests between the governments of Sweden and Austria than between the administrations of

neighbouring countries like Switzerland and Austria. As the evaluation of the EC and the EEA does not deviate very much in public opinion across the EFTA member states, cultural factors account only marginally for this divergence. As suggested in the models, the prospect of possible gains along with electoral and institutional constraints appear to be dominant in the negotiation positions. A nation desperately in need of the blessings of deregulation would be more keen to reach a liberalizing integration agreement than a country with a strong economy. In other words, a crisis-ridden country is more likely to accept a considerable loss of sovereignty. Among the political factors, popularity and ratification constraints are of the utmost importance. Table 6.1 summarizes the ratification requirements and the state of the economy during the negotiations (1989–91).

*Table 6.1 Determinants of the negotiation positions in the EEA talks: GNP growth, inflation, and unemployment between 1989 and 1991, and ratification procedures in the EFTA member states (minus Liechtenstein)*

	GNP Growth <sup>a</sup>	Inflation <sup>a</sup>	Unemployment <sup>a</sup>	Ratification procedures <sup>b</sup>
Austria	3.8 (2.8)	2.8 (3.2)	3.3 (3.4)	Parliament/QM
Finland	0.2 (-5.2)	5.4 (4.1)	4.9 (7.7)	Parliament/QM
Iceland	-0.3 (0.3)	13.8 (8.2)	1.5 (1.6)	Parliament/SM
Norway	2.1 (4.1)	4.1 (1.5)	5.1 (5.3)	Parliament/QM
Sweden	0.4 (-1.2)	8.1 (7.0)	1.9 (2.7)	Parliament/SM
Switzerland	1.8 (-0.2)	5.3 (6.2)	0.8 (1.2)	Referendum/SM <sup>c</sup>

*Notes*

<sup>a</sup>OECD Economic Outlook December 1991. The numbers in parentheses refer to 1991 only.

<sup>b</sup>SM = Simple Majority required, QM = Qualified Majority.

<sup>c</sup>Simple majority of both the voters and the states.

On the economic side, no EFTA country performed exceptionally well in the period under scrutiny. Yet the countries hit most ferociously by the recession of the early 1990s, Sweden and Finland, also pursued a moderate course during the negotiations. Furthermore, they were the first countries to apply for EC membership after Austria, which had experienced economic difficulties in the mid-1980s.

On the institutional side, only Switzerland and Liechtenstein<sup>8</sup> were required to hold referendums about the EEA treaty. Swiss direct democracy provides territorial minorities with a veto power because the ratification requires a majority of both the voters and the cantons (states). As the smaller cantons are less export-orientated and urbanized than the densely populated centres the rat-

ification procedures benefit the protectionist forces. In Norway, the EEA had to find a qualified majority, but only as far as the *Storting* (national parliament) is concerned, where 75 per cent of the members of parliament must approve a treaty.

Norway provided the clearest example of the importance of popularity constraints and the connection of integration with domestic issues. According to a journalistic account, the Norwegian negotiation position eventually stiffened after the ruling Labour party experienced a major setback in local elections: 'Its new loss of popularity will further complicate Norway's problems (notably the concessions asked of it on fish)', commented *The Economist* (14 September 1991).

As the government and the major opposition parties in Austria and Finland were always in favour of the EEA agreement, the ratification constraint of two-thirds majorities in the national parliaments never represented major obstacles. Similar to the Swedish case, the Icelandic approval procedure requires only a simple majority. However, protectionist interests tend to be overrepresented in the parliament. Fifty-five per cent of the seats are given to regions in which fishing is the main economic activity, although these regions make up only 38 per cent of the population.

Because the EEA requires the ratification of all participating states and the European Parliament, domestic concerns also influenced the strategies of the EC member states. Hard-liners could profit from the unanimity rule that was a prerequisite for the final decision about the EEA. This enabled in particular the Southern members to ask for concessions with regard to fishing rights and the EFTA contributions to the structural funds. The importance of the veto threat even from a minor state became overt through the Greek insistence on obtaining a sharp increase in the license fees for trucks passing through Austria. This demand ran counter to attempts to protect the Alpine environment from excessive lorry transportation. On the eve of the final decision about the EEA, the EC could block the hampering claim by a majoritarian decision in a separate transit treaty with Austria and Switzerland. However, such a manoeuvre ceased to be an option when the EC was to make a decision on the whole EEA treaty the next day. By threatening to veto the EEA, Greece managed to get very close to its initial request.

### 4.3 Intraorganizational Threats and Counterthreats

Throughout the negotiations, the governments of the EFTA member states remained the central actors. Nevertheless, as they were forced to speak with one voice, they also had to reckon with intraorganizational dynamics as a second relevant level of decision-making. In this respect the EFTA had to reconcile the interests between obstinate and conciliatory governments. Owing to the unanimity requirement, the power was on the side of those who favoured keeping as much sovereignty as possible, even to the detriment of other EFTA

states. By hinting at their domestic hurdles they also enhanced the risk of a negotiation breakdown. This intraorganizational exploitation of domestically less-constrained governments was, however, far from complete. Integrationist governments possessed a forceful counterstrategy as they could threaten to strike a separate deal with the EC. Accordingly, Austria, Sweden and Finland undermined the firm positions of other EFTA members by pursuing their EC membership applications in parallel.

Leaking information about the nationalistic integration course of Switzerland was among the attempts to isolate this laggard. Scandinavian officials employed this tool at the beginning of the negotiations and even considered moving ahead without the Swiss. This manoeuvre revealed the tension between partial and full integration which is a common feature of IGOs (Schneider and Cederman, 1992).

#### **4.4 Different Bargaining Leverage and Discount Rates**

There is still no full explanation for the decision by the EC to intensify direct negotiations with the EFTA. Delors justified his initiative of January 1989 as a wish to negotiate in a more efficient way. He might have counted on the possibility that the negotiating power of the EFTA would decrease through internal fighting. These factors were probably strong enough to compensate for the loss of bargaining power compared to a situation where the EC would have to negotiate with each individual country.

Originally, the President of the EC Commission promised the EFTA countries 'a new, more structured partnership with common decision-making and administrative institutions' (Delors, 1989). One year later he officially retreated from this offer. In Delors's view, the 'osmosis' between the two organizations 'must stop short of joint decision making, which would imply Community membership' (Delors, 1990, p. 9). In the end, the EFTA was indeed forced to leave practically all decision-making power to the EC. This became even more overt after an unforeseen objection by the EC's European Court of Justice which ruled compulsory a revision of the treaty. Accordingly, the EFTA had to acquiesce to the demand that all disputes should be subject to adjudication by the EC and not solved by a joint legal body.

At the level of the individual countries, the EC partially respected the wishes of the EFTA governments and granted a number of special transition periods: Switzerland (25), Iceland (20), Norway (19), Austria (14), Sweden (13), Finland (11). Switzerland obtained some temporary derogations in highly sensitive areas, such as foreign immigration and the recognition of diplomas. The Nordic countries in part achieved an extension on the limitations of the free flow of capital. Additionally, Iceland and Norway were able to obtain permanent permission to keep out foreign investment from their fishing industries. The EC furthermore allowed Switzerland to continue with its weight limit of 28 tons on lorries passing through the country.

Despite this partial success, the treaty failed to live up to the initial expectations of the more nationalistic members of the EFTA. Instead of being treated like 'equals', they largely had to accept the conditions set forth by the much more powerful EC. The EEA thus stands in great contrast to the free-trade agreements which the EFTA countries and the EC concluded in the early 1970s. It should be obvious that the divergence in bargaining power principally accounts for this imbalance in the early 1990s. While the EC gained strength during this period of bilateralism, the EFTA remained the organization of the rich European outsiders.

#### 4.5 Trying to Avoid Referendums

Switzerland was the only larger EFTA country which had real problems in ratifying the agreement. As a consequence, its government postponed a clear commitment to the integration process, hoping for a major shift in public opinion. As it turned out, this change did not happen. On 6 December 1992, a narrow majority of the voters and a clear majority of the cantons rejected the agreement, driving Switzerland into international isolation and a domestic crisis. Even the voters of Liechtenstein accepted the agreement a week later. The popular vote in Switzerland necessitated renegotiations among the remaining EEA participants. The passive stance of the Swiss government also indicated that the penalty for ratification failure is small in a consociational democracy. Nobody was forced to retire after the political establishment had experienced this major defeat.

In the other EFTA member states, governments had fewer problems in securing a success. The Austrian parliament rejected an initiative by the Green Party to subject EEA membership to a referendum. In Iceland, the question of holding a referendum was, for a certain period, more salient as the major opposition parties (Progressive Party, People's Alliance and Women's Alliance) declared themselves in favour of a ballot. The two major Norwegian parties, the Labour Party and the Conservative Party, rejected similar demands by some part of the opposition (Party of Progress, Socialist Left Party and Christian Democrats). However, none of these governments faced major problems in the ratification process.

The ratification phase completes the circle of a process which started and ended in the domestic setting. On the national level, governments were compelled to incorporate the opinions of their decisive constituent. At the intraorganizational level, the conciliatory EFTA governments could, nevertheless, undermine the veto power of the less integration-minded governments by a counterthreat to apply for EC membership. Finally, an imbalance in bargaining leverage and in possible benefits stemming from a treaty forced the EFTA to accept a very unequal treaty.

## 5 CONCLUSION

Relying on a formal framework, this study has analysed the different speeds of nations in the enlargement of an integration process. It has examined the interaction between different decision-making levels in the creation and enlargement of a regional IGO. Three formal models show how domestic factors influence integration strategies. This perspective is opposed to traditional approaches which focus on the overall integration process and mainly invoke system-level or functional explanations. By offering micro-foundations of interstate co-operation, this chapter also contrasts with state-centric theories and cultural explanations.

More specifically, this chapter highlighted the importance of the relationship between domestic constituents (principals) and their governments (agents). If a government lacks popular support, it tries to compensate during the integration negotiations. This inhibits its zone of agreement internationally. The principal may execute considerable influence on the government through carrot-and-stick measures. However, integration processes can be inefficient in two respects. First, negotiations can fail although all participating governments wish to strengthen the ties with another government. Secondly, the pivotal constituent can erroneously reject a beneficial treaty. Such suboptimal outcomes may arise under the condition that one actor possesses private information.

I described the EEA negotiations as a paradigmatic integration case in which governments have to balance interdependence and national sovereignty. As the evidence for strategic interaction in this setting is, up to now, only anecdotal, subsequent empirical applications will deal with the interface between domestic and international politics in a more rigorous way. This first step has, on the other hand, already pointed out that it is high time to move the research on political integration beyond the agenda set up in the 1950s and 1960s.

## APPENDIX

### A.1 Prenegotiation game

This first part of the appendix contains the solution for the Stackelberg–Cournot game of section 3.1. In this respect, I have to establish that the prenegotiation positions are influenced by the preferences of the constituents in both countries. Proposition 1 states that the positions  $x_1^*$  and  $x_2^*$  represent the weighted average of the executive bliss points. The popularity functions of the governments are as follows:

$$U^*_{G1(x)} = \sum_{i=1}^n r_{1i}x_1 - a_1(x_1 - g_1)^2 - w_1(x_1 - x_2)^2$$

$$U^*_{G2(x)} = \sum_{j=1}^m r_{2j}x_2 - a_2(x_2 - g_2)^2 - w_2(x_2 - x_1)^2$$

As the leaders move domestically second, their equilibrium choices ( $x_1^*$  and  $x_2^*$ ) can be easily derived from these functions:

$$x_1^* = (g_1 + w_1x_2)/(a_1 + w_1) + \sum r_{1i}/2(a_1 + w_1)$$

$$x_2^* = (g_2 + w_2x_1)/(a_2 + w_2) + \sum r_{2j}/2(a_2 + w_2)$$

The constituents influence the negotiation position through their reward-and-punishment system. They can influence the leader by their choice of the scalar  $r$  which is included as a linear voting cost in their utility functions.

$$U^*_{C11(x)} = b_{11} - (x_1 - c_{11})^2 - r_{11}x_1$$

$$U^*_{C21(x)} = b_{21} - (x_2 - c_{21})^2 - r_{21}x_2$$

The principals can anticipate how the executives change the positions  $x_1$  and  $x_2$  with respect to the size of  $r_{1i}$ . These conjectural variations amount to  $\phi_1 = \frac{1}{2}(a_1 + w_1)$  and  $\phi_2 = \frac{1}{2}(a_2 + w_2)$  respectively. The domestic constituents incorporate them in their calculations. The first-order condition for the utility function of the  $i$ th constituent in the first country is as follows:

$$0 = -2(x_1 - c_{1i})\phi_1 - r_{1i}\phi_1 - x_1 + g_1.$$

Summing up the decisions with respect to  $r_{1i}$ , the government of the first country can count on the following reward for its integration policy:

$$\sum r_{1i} = 2[-nx_1 + \sum c_{1i} - (a_1 + w_1)nx + (a_1 + w_1)ng_1].$$

The government incorporates these rewards into its negotiation position  $x_1^*$  for the integration talks:

$$x_1^* = [g_1\{1 + n(a_1 + w_1)\} + \sum c_{1i} + w_1x_2]/[a_1 + w_1 + n(1 + a_1 + w_1)].$$

By analogy,  $x_2^*$  can be found which is expressed entirely in terms of  $w_1$  instead of  $w_2$

$$x_2^* = w^*[g_2\{1 + m(1 + a_2 - w_1)\} + \sum c_{2j} + x_1 - w_1x_1].$$

In this last equation,  $w^*$  stands for the following weighting factor:

$$w^* = 1/[1 + a_2 - w_1 + m(2 + a_2 - w_1)].$$

Substituting  $x_2^*$  and some manipulation leads to the negotiation position  $x_1^*$  of the first country:

$$x_1^* = [g_1\{1 + n(a_1 + w_1)\} + \sum c_{1i} + w_1w^*(g_2\{1 + a_2 - w_1\} + \sum r_{2j})]/[a_1 + w_1 + n(1 + a_1 + w_1) - w_1w^*(1 - w_1)].$$

As stated in the proposition, the weighted executive bliss points thus completely represent the negotiation positions. Or to put it differently, governments can be treated as unitary actors even when confronted with both domestic and international competition. If a government is omnipotent, it need not care about the international aspect. Hence, its negotiation position can be expressed in a simplifying equation:

$$x_1^* = [g_1\{1 + n(a_1 + w_1)\} + \sum c_{1i}]/[a_1 + w_1 + n(1 + a_1 + w_1) + n].$$

## A.2 Negotiation Game with Ratification Threat

Here I sketch the proofs for Propositions 2 and 3. Complete proofs for an almost equivalent game can be found in Schneider and Cederman (1992). I shall refer to the strong applicant as player 1, to its weak counterpart as player 1' and the IGO as player 2. The two subgame perfect equilibria (SPE) described in Proposition 2 can be derived through backward induction. If the IGO is certain to encounter the weak applicant (Equilibrium I),  $U_2(\text{Demand } M) = m_2 > U_2(\text{Accept } L) = l_2$ . Anticipating this, player 1' chooses the More Treaty:  $U_1(\text{Accept } M) = m_1 > U_1(\text{Demand } L) = m_1 - c$ . In Equilibrium II,  $U_2(\text{Accept } L) = l_2 > U_2(\text{Demand } M) = d_2$ . The strong applicant profits from this opportunity by calculating  $U_1(\text{Accept } M) = m_1 < U_1(\text{Demand } L) = l_1 - c$ .

The sequential equilibria of Proposition 3 can be described by the behaviour strategies  $s$ ,  $t$ ,  $q$  and the organization's posterior belief  $p'$ . The parameter  $s$  stands for the probability of player 1 choosing Demand  $L$ . Since  $U_1(\text{Exit}) = d_1 - c > U_1(\text{Accept } M) = d_1 - f$ ,  $r = 1$  by assumption. The likelihood for player 1' to formulate a demand is  $t$ . The IGO asks for the More Treaty with probability  $q$ .

These definitions can be used for the derivation of the equilibria 1, 1a and 2. It should be noted that the likelihood of equilibrium 1a is very small.

**EQUILIBRIUM 1:** If player 1' randomizes its moves,  $U_1(\text{Demand } L) = q(m_1 - c) + (1 - q)(l_1 - c) = U_1(\text{Accept } M) = m_1$ , leading to  $q = (m_1 + c - l_1)/(m_1 - l_1)$ . As 2 always mixes its strategy,  $U_2(\text{Demand } M) = p'd_2 + (1 - p')m_2 = U_2(\text{Accept } L) = l_2$ . This last equation can be used to establish the threshold belief  $p' = p_0 = (m_2 - l_2)/(m_2 - d_2)$ . Using Bayes rule ( $p' = p/(p + (1 - p)t)$ ) we can finally derive that  $t = (p/(1 - p))(l_2 - d_2)/(m_2 - l_2)$ . This first equilibrium is partly pooling.

**EQUILIBRIUM 1a:** Given  $s = 1$  and assuming  $t = 1$ , the IGO cannot distinguish the applicants. As a consequence, player 2 cannot update its beliefs ( $p' = p$ ). If 2 still mixes its response, the equation  $U_2(\text{Demand } M) = p'd_2 + (1 - p')m_2 = U_2(\text{Accept } L) = l_2$  still holds, leading to  $p' = p_0 = p$ . This knife-edge equilibrium is pooling.

**EQUILIBRIUM 2:** A second pooling equilibrium can be obtained if  $t = 1$  and  $q = 0$ . This means that player 2 always gives in to a Demand L.  $U_2(\text{Accept } L) > U_2(\text{Demand } M)$  implies that  $p_0 < p = p' < 1$ .

### A.3 Ratification Game

The strong applicant is player 1, its weak counterpart player 1' and the pivotal constituent is player 2. Equilibria can be described by the behaviour strategies  $s$ ,  $t$ ,  $q'$  and  $q''$  and the posterior beliefs  $p'$  and  $p''$ . Player 1 engages with probability  $s$  into an information campaign, player 1' with probability  $t$ . After an information campaign, player 2 accepts the treaty with probability  $q'$ . In the absence of a message, the likelihood for the equivalent step is  $q''$ . Player 2 attributes the belief  $p'$  to facing player 1 after receiving a message, and  $p''$  is the belief if no message was sent. These notations appear in proposition 4 which describes the complete information case.

*Proposition 4:* Under complete information, the Ratification Game has two Subgame Perfect Equilibria (SPE):

**EQUILIBRIUM I:** If the government can present a beneficial treaty, it will engage in an information campaign and the constituent will accept the treaty ( $s = 1, q' = 1, q'' = 1, p' = 1, p'' = 1$ ).

**EQUILIBRIUM II:** If the government cannot present a beneficial treaty, it will refrain from an information campaign and the constituent will reject the treaty ( $t = 0, q' = 0, q'' = 0, p' = 0, p'' = 0$ ).

**PROOF:** As in Proposition 2, the concept of backward induction is used to derive the SPEs. In equilibrium I, player 2 is certain to encounter a strong government. Hence, its posterior beliefs  $p'$  and  $p''$  are 1. To accept is thus a dominant strategy,

with  $U_2(\text{accept/Campaign}) = b_2 > U_2(\text{reject/Campaign}) = -r_2$  and  $U_2(\text{accept/No Campaign}) = b_2 > U_2(\text{accept/No Campaign}) = -r_2$ . Player 1 anticipates these choices. Because  $U_1(\text{Campaign}) = b_1 > U_1(\text{No Campaign}) = 0$  by definition, this player starts an information campaign.

In equilibrium II, by contrast, player 2 is certain to encounter a weak government. The posterior beliefs are accordingly both 0. By assumption, rejection of the treaty must then always be a dominating strategy, regardless of the preceding action by the government:  $U_2(\text{reject/Campaign}) = -r_2 > U_2(\text{accept/Campaign}) = -c_2$  and  $U_2(\text{reject/No Campaign}) = -r_2 > U_2(\text{accept/No Campaign}) = -c_2$ . To minimize the losses, player 1 in return does not start an information campaign:  $U_1(\text{No Campaign}) = -f_1 > U_1(\text{Campaign}) = -f_1 - i$ . QED

Assuming incomplete information, it is useful to establish first the relationship between  $s$  and  $t$ . In accordance with assumption 3, the likelihood of 1 choosing  $s$  is at least as big as the probability  $t$ . Given the preference order, the strong government is more likely to commit itself to an information campaign than its weak counterpart. I continue by testing whether the remaining possible combinations of  $s$  and  $t$  are part of  $D - 1$  equilibria (Banks and Sobel, 1987). The reference to an equilibrium refinement is necessary because the structure of the game allows for out-of-equilibrium beliefs.

### Case 1: $s = t = 0$

As the upper information set is not reached in this case, I cannot use Bayes' rule to derive  $p'$ . There are beliefs such as  $p' = 0$  which support this case as a sequential equilibrium. The  $D - 1$  criterion however allows this out-of-equilibrium belief to be discarded and, in consequence, this candidate equilibrium. According to the  $D - 1$  refinement, I have to check whether the strong applicant is more likely to defect from this equilibrium path. The weak government would thus only weakly prefer to engage in a campaign:  $U_1(\text{No campaign}) = (1 - q'')(-f_1) < U_1(\text{Campaign}) = q'(r_1 - c_1 - i) + (1 - q')(-f_1 - i)$ . Its strong counterpart, by contrast, would strongly prefer to do so:  $U_1(\text{No campaign}) = (1 - q'')(-f_1) < U_1(\text{Campaign}) = q'(r_1 - i) + (1 - q')(f_1 - i)$ . This also implies that  $1 - p' = 0$  and  $p' = 1$ . As a consequence of this belief, player 2 would strongly prefer to accept after receiving a message. If  $q' = 1$  accordingly, player 1 starts a campaign with probability  $s = 1$  contradicting the initial assumption  $s = 0$ .

### Case 2: $0 < s < 1, t < 1$

Case 2a ( $0 < s < 1, t = 0$ ) can be discarded by considering that  $p' = 1$  in consequence. This would again lead to  $q' = 1$  and  $s = 1$ . Case 2b ( $0 < s < 1, 0 < t < 1$ ), by contrast, assumes that both types of governments mix their strategies. This case can be excluded because such behaviour would lead to different

reactions towards the two governments by player 2. More precisely,  $U_1$  (Campaign) =  $q'(r_1 - c_1 - i) + (1 - q')(f_1 - i)$  and  $U_1$  (No Campaign) =  $(1 - q'')f_1$  leads to  $q' = (i - q''f_1)/(r_1 - c_1 - f_1)$  while  $U_1$  (Campaign) =  $q'(r_1 - i) + (1 - q')(f_1 - i)$  and  $U_1$  (No Campaign) =  $(1 - q'')f_1$  invokes  $q' = (i - q''f_1)/(r_1 - f_1)$ . This is not possible at the same information set.

### Case 3: $s = 1, t < 1$

I first analyse the possibility that 1' employs a mixed strategy (Case 3a). This behaviour is a consequence of 2 randomizing between accepting and rejecting. Because  $U_1$  (Campaign) =  $q'(r_1 - c_1 - i) + (1 - q')(-f_1) = U_1$  (No Campaign) =  $-f_1$  by consequence, I can derive that  $q' = i/(r_1 - c_1 + f_1)$ . By using Bayes' rule, I can furthermore calculate  $t$ . The equation  $U_2$  (accept) =  $p'b_2 + (1 - p')(-c_2) = U_2$  (reject) =  $p'(-r_2) + (1 - p')(-r_2)$  first circumscribes  $p' = [c_2 - r_2]/[c_2 + b_2] = p^*$ . As  $p'$  is also equal to  $p/(p - (1 - p)t)$ , I establish  $t = [p/(1 - p)] [(r_2 + b_2)/(r_2 - c_2)]$ . Given the strategies and the supporting belief,  $p''$  has to be zero in return, meaning that the second player always rejects the treaty if it could not observe an information campaign. This completes the description of the first equilibrium which is semi-pooling.

It remains to be shown whether the contingency  $s = 1$  and  $t = 0$  is a Perfect Bayesian equilibrium. This would be a separating equilibrium, with the priors  $p'$  and  $p''$  amounting to 1 and 0 respectively. However, as 2 can never be certain about the identity of the government, such a separation is only possible under complete information. The weak type has therefore an incentive to bluff.

### Case 4: $s = t = 1$

If both types of government engage in a campaign with probability 1, there is no possibility that player 2 can distinguish different types. Because no updating according to Bayes' rules takes place, the posterior and the prior after receiving a message are identical ( $p' = p$ ). Player 2 always accepts the offer if  $p' = p > p^*$ . The second information set is never reached. The belief  $p''$  is thus not defined. In contrast to case 1, there is, however, no incentive to switch to the strategy of No Campaign. This second equilibrium is pooling.

Another pooling equilibrium can be reached under the knife-edge condition that  $p = p^*$ , fixing  $0 < q' < 1$ . In this case, it is still a (weakly) dominating strategy for 1' to start a campaign. Having exhausted all possible cases, I have thus derived that only three contingencies are  $D - 1$  equilibria. This result is summarized in the following proposition:

*Proposition 5:* Under incomplete information, the Ratification Game falls into three cases:

**EQUILIBRIUM 1:** The first equilibrium is semi-pooling and defined by the following strategies and beliefs  $s = 1, t = [p/(1-p)][(r_2 + b_2)/(r_2 - c_2)]$ ;  $q' = i/(r_1 - c_1 + f_1), q'' = 0; p' = p < (c_2 - r_2)/(c_2 + b_2) = p^* \quad p'' = 0$ .

**EQUILIBRIUM 2:** If  $p > (c_2 - r_2)/(c_2 + b_2)$ , we obtain a pooling equilibrium which is described by the following parameters:  $s = 1, t = 1, q' = 1, p' = p > (c_2 - r_2)/(c_2 + b_2) = p^*$ .

Under the knife-edge condition  $p' = p = (c_2 - r_2)/(c_2 + b_2) = p^*$ , another pooling equilibrium exists which I call **EQUILIBRIUM 2A:**  $s = 1, t = 1, q' = i/(r_1 - c_1 + f_1), p' = p = (c_2 - r_2)/(c_2 + b_2) = p^*$ .

Comparative statistics show which parameters affect the likelihood of specific outcomes. It should be noted that this last analytical step only refers to Equilibrium 1.  $Pr(r)$  represents the probability that the pivotal constituent mistakenly rejects the Less Treaty, and  $Pr(a')$  stands for the likelihood that the mimicking behaviour by 1' is successful:

$$Pr(r) = ps(1 - q') = p(1 - [i/(r_1 - c_1 + f_1)])$$

$$Pr(a') = (1 - p)tq' = (1 - p)[p/(1 - p)][(r_2 + b_2)/(r_2 - c_2)][i/(r_1 - c_1 + f_1)]$$

$$= p[(r_2 + b_2)/(r_2 - c_2)][i/(r_1 - c_1 + f_1)].$$

The results in Table A6.1 are derived by partially differentiating the outcome probabilities with respect to different parameters. The table accordingly displays how key variables affect the likelihood of outcomes in Equilibrium 1. A plus sign indicates that the effect is positive and a minus sign that it is negative. A zero stands for the absence of an effect.

*Table A6.1 The effect of key parameters on the likelihood of outcomes of the Ratification Game*

Outcome	$r_1$	$i$	$f_1$	$c_1$	$b_2$	$r_2$	$c_2$
$Pr(r)$	+	-	+	-	0	0	0
$Pr(a')$	-	+	-	-	+	-	-

**NOTES**

1. While either relying on the Waltzian 'second image' or on the 'second image reversed' (Gourevitch, 1978), the antagonists thereby only repeated an old debate. In the nineteenth century, the German historians von Ranke and Dilthey disagreed about the primacy of either international or domestic politics.
2. This categorization is close to the four dimensions of Randolph (1966), who differentiates between prenegotiation, negotiation, agreement and implementation phases.

3. This game is an extension of Achen (1988) who analysed the interaction between government leaders and influencers as a Stackelberg game. The extension refers to the international dimension.
4. This game resembles, of course, the setter models which study the relationship between an agenda-setter and the voters. The concept has been introduced by Romer and Rosenthal (1978, 1979). Recent contributions study the effects of asymmetric information on the outcome of referendums (Banks, 1990; Lupia 1992).
5. The present analysis has had to rely on informal accounts because the official negotiation positions have not yet become public. I exclude Liechtenstein from the analysis because it only became a full EFTA member in 1991.
6. The *acquis communautaire* embodies Community rules in the four relevant areas (free circulation of goods, persons, capital and services) laid down by the EC Treaties, by Council and Community legislation and by case law.
7. This list is adapted from an unpublished document obtained during interviews at the EFTA, Geneva, May 1991.
8. A popular initiative forced Liechtenstein to introduce a new article into its constitution, aiming specifically at the ratification of the EEA agreement and stipulating an optional referendum for all international treaties.
9. In contrast to the game described in Schneider and Cederman (1992), no reference to an equilibrium refinement such as universal divinity is necessary. A further difference is that signalling is always costly in the present model. For a technical introduction to other signalling games in political science, see Banks (1992). Based on the pioneering work by Spence (1973), the theoretical foundations for this special class of limited-information models are largely due to Kreps and his collaborators (Kreps and Wilson, 1982, and especially, Cho and Kreps, 1987).

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