Designing International Institutions

Hierarchy Amidst Anarchy: Transaction Costs and Institutional Choice, by Katja Weber (Albany, NY: State University of New York Press, 2000). 195 pp., cloth, (ISBN: 0-7914-4719-7), paper (ISBN: 0-7914-4720-0), $20.95.

In Hierarchy Amidst Anarchy, Katja Weber offers a creative synthesis of realist and institutionalist approaches to international relations to explain when countries choose to make binding security commitments. Weber is appreciative of the contributions of both perspectives. She argues that realism in its balance-of-threat variant (Walt 1987) does a good job of explaining which states forge alliances, but that a transaction-cost approach is needed to explain the design of the security institutions that they devise. This question of institutional design is her primary focus, and to assess the impact of transaction costs upon institutional design she compares the security arrangements that emerged from the Napoleonic Wars to those that arose in the wake of the Second World War. In contrast to realism, she makes a compelling case that when they face severe risks, states are prepared to pool their sovereignty in order to balance against external threats.

Following Oliver Williamson (1975, 1985), Weber argues that institutions are designed in order to mitigate the costs that are imposed by the potential for opportunism, which might otherwise prevent beneficial transactions from taking place. According to Williamson, there is a trade-off between these costs of opportunism and governance costs--the cost of implementing an organizational solution to collective action problems. Governance costs increase and opportunism decreases as institutional arrangements are made more binding, and the trade-off between these costs determines the choice of institutional forms. For Weber, the trade-off facing the designers of international security organizations is between security (opportunism) and loss of sovereignty (governance). When states face high degrees of external threat and high risks due to the potential opportunism of their allies, she argues, they will pool their sovereignty, as in the German Bund and the Swiss Confederation in 1815. When either factor is absent, they will choose less binding forms of alliance, as in the alliances against Napoleon, the North Atlantic Treaty, and the failed case of the European Defense Community.

Weber's argument is strikingly similar to the one made by David Lake (1996, 1999), but the authors apparently came to their conclusions independently, and they analyze different selections of historical cases. Both draw heavily on Oliver Williamson to provide variables that are expected to influence transaction costs: uncertainty and asset specificity. Weber observes that her approach differs from Lake's in that she adds two more variables: the technology of communications, and cultural heterogeneity.

Weber has an impressive command of detail and a clear set of overarching themes, and she is a compelling writer, which makes her case studies readable and persuasive. For example, she shows vividly that efforts to build security arrangements among the great powers at the Congress of Vienna, among the German states, and among the Swiss cantons were paralyzed until Napoleon revived them by escaping from Elba in 1815. The results included two confederations and an enduring security regime for Europe. On the whole, she gets the history right, although one could argue interpretation here and there. During the Napoleonic Wars, for example, she focuses on a balance-of-threat interpretation to explain the shifting alliances of Prussia and Austria, but it is much more natural to describe their behavior as bandwagoning. When Napoleon's power was at its height, Prussia and Austria complied with his demands to provide troops for the invasion of Russia, "since both countries feared that Napoleon would crush them before moving into Russia" (33). After Napoleon's defeat in 1812, Prussia was the first to shift allegiance to Russia--but only when it was in danger of being overrun by Russian troops. Metternich's brilliant diplomacy in 1813 amounted to a ploy to buy time for a military buildup, as Weber emphasizes, but also to gauge the risks of joining a coalition against France. Austria was careful not to commit itself until the allies' troops finally outnumbered Napoleon's (38-39).

These objections are not central to Weber's theoretical argument. Two areas of more significant concern, however, involve the operational use of the key term, "transaction costs," and the evidence that is used to test the theory.

Although Weber discusses four variables that affect transaction costs, she decides that technology, culture and asset specificity are not essential to her explanation, while uncertainty alone explains all of the variation in her cases (114-15). "Uncertainty," however, is a term that she uses in an unconventional way. When Williamson discusses uncertainty, he means lack of information: certain transactions are more risky if we are not fully informed about our partner's preferences or capabilities, or if we cannot perfectly observe our partner's actions. From this point of view, uncertainty is greater if we have to put a larger confidence interval around our estimate of the true state of the world. When Weber discusses uncertainty, however, what she really means is risk. Consequently, she often says that uncertainty is high when what she means is that our estimate of the true state of the world is unfavorable. For example, she explains the US preference for relatively non-binding commitments to its allies after World War II by saying the US faced "less uncertainty" than they. What she means is not that the US had better military intelligence than its allies, but that the risk to the US of being abandoned by France was less significant than the risk to France of being abandoned by the United States, particularly when the US had a monopoly on nuclear weapons. This is an example of asymmetric risk, not asymmetric uncertainty. Similarly, Weber argues that the key variable that accounts for the formation of confederations in Germany and Switzerland and the choice of the loose Concert regime on the European level was that the Germans and Swiss faced a higher level of uncertainty than the Great Powers. To the extent that her argument is based upon the relevant number of actors, this is indeed an argument about uncertainty. However, Weber also emphasizes the long history of antagonisms among the German and Swiss states, which could only serve to decrease uncertainty (although it might well increase the estimate of risk).

Another conceptual issue arises when Weber argues that agreements to create binding security institutions failed because the contracting parties faced "asymmetric" transaction costs. Following Coase, the transaction cost is specific to the transaction, not the actor. These costs have to be paid by someone in order for cooperation to take place, so they reduce the value of a potential agreement to both parties, but they are essentially fungible (hence the rationale for calling them costs). For example, the cost of monitoring an agreement may be borne by only one party, but it will be capitalized into a bargain. Similarly, risks can be insured against, or bonds can be offered as collateral. In Thucydides' day, the preferred method of transferring risks was the exchange of hostages; today it involves linkages across issue areas. Furthermore, however the risks are distributed, excessive transaction costs will make an agreement unprofitable, so it will not be made. This is the sense in which high transaction costs lead to organizational solutions: market-based solutions are impossible or highly inefficient, so cooperation can only be achieved through costly organizational mechanisms. In terms of a transaction-cost explanation of organizational design, it does not really matter who bears the risk.

Since Weber builds a convincing case that asymmetry of risks was a key factor in states' decisions about security institutions, this suggests that something besides transaction costs must be at work. Indeed, it probably is not true that transaction costs were really low in any of the cases in Hierarchy Amidst Anarchy; rather, the puzzle is why countries chose less binding forms of alliance in spite of significant risk. This points to an important contrast between international security and industrial organization, from which the transaction-cost theory is drawn: firms can opt out of cooperation if opportunism imposes high costs, so firms that are determined to cooperate in spite of the risks may be compelled to purchase each other. States, on the other hand, cannot opt out of the international security game, so they may have no choice but to accept a bargain that leaves them insecure. France felt its insecurity acutely after World War II, and certainly would have preferred greater security guarantees from the United States, but was willing to take whatever it was offered under the circumstances. Consequently, the US was not compelled to offer a binding commitment (it did not have to "acquire" France in order to secure French cooperation). Furthermore, it is generally the weak states that face the most insecurity, and therefore have the greatest incentive to innovate security institutions. When the coin of the realm is military capabilities, the weak have little with which to buy security.

Finally, the empirical material in the book would be more appropriately termed an illustration of the theory rather than a test (112), because there are not enough cases and is not enough variation in outcomes to untangle the effects of the multitude of variables that Weber expects to be important. In addition, there is an important omitted variable in the analysis: in both of the cases in which confederations emerged there was a history of hundreds of years of confederation before the Napoleonic Wars, and Napoleon's own intervention in Swiss and German politics strengthened central institutions and reduced the number of actors that had to be coordinated. Consequently, we might have expected those states to form confederations even in the absence of a theory of transaction costs.

These objections notwithstanding, Weber makes an important contribution to understanding the design of international security institutions. She draws creatively on two bodies of literature that have rarely been combined, and juxtaposes important cases in a novel way. This book will be of particular interest to students of international security and international relations theory.

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