Chapter 1

Incomplete Sovereignty and International Relations

Introduction

Territorial sovereignty presents us with a paradox. On the one hand, it forms the key constitutive rule in international relations.[1] In strict terms it denotes that the people within recognized territorial borders are masters of their own fate. No higher juridical authority exists above that of the national government. And all states are equal in international law. Sovereignty is thus highly desired. As we have witnessed in the former Soviet Union and Yugoslavia, and many other parts of the world, nations vie for their own state, and people fight and die for that cause.

Yet on the other hand, the world is replete with instances where sovereignty appears fragile. Some observers claim that the territorial state is obsolete and in the process of being supplanted by other institutional forms.[2] Others see territorial sovereignty solely as a juridical fiction. Although states are equal from an international legal perspective, they fail to capture the continued relevance of power, domination, and hegemony.[3] Indeed, in the wake of American military action in Iraq and elsewhere, some argue that we are witnessing the resurrection of the study of empire and imperialism. Empire, thought to have become obsolete in the decades after World War II, has returned as an international reality.[4] But many cases of sovereign relations do not comfortably fit these categories.

Consider the following two cases. The first involved the evolution of sovereignty within Iraq itself. On June 28th, 2004, the United States transferred sovereignty to an interim government in Iraq, formally concluding a fifteen-month occupation that followed its military campaign to forcibly disarm the country and enact regime change.[5] Even though the Coalition Provisional Authority led by Paul Bremer formally disbanded, the continued presence of over 120,000 American troops in Iraq led many analysts

[1] See, for example, Ruggie 1986; Spruyt 1994; Zacher 2001.

[2] Herz (1976) argues this is the case for security reasons, whereas Ohmae (1995) attributes this to economic changes.

[3] See especially Krasner 1999.

[4] For representative examples, see Cox 2004; Johnson 2004. For skeptical analytical responses, see Nexon and Wright 2007; Motyl 2006.

[5] Chandrasekaran 2006; Diamond 2006.

to question whether this handover was practically significant.[6] Four years after the transfer the exact division of sovereignty between Iraq and the United States still remained ill defined and incomplete. The UN mandate authorizing the presence of the U.S.-led coalition mission in Iraq was extended through 2008. However, in 2007 the United States and Iraq agreed to negotiate a bilateral framework to govern critical future sovereign issues after 2008, including the role of U.S. forces, the legal status of military contractors in Iraq, and the future levels of U.S. economic and military assistance to the country. The politically thorny question of the likelihood of a permanent U.S. military basing presence in the country was also brought to the fore. Iraq had regained much of this sovereignty since the 2003 U.S. invasion, but many of these sovereign transfers happened gradually and remain open-ended.

Just one week before the 2004 formal transfer of sovereignty in Iraq, leaders of the (then) twenty-five members of the European Union (EU) agreed to adopt a common constitution that would consolidate previous agreements, clarify voting procedures, expand the role of the European parliament, and unify the foreign policy preferences and decision-making procedures of the member countries. Although leaders were relieved to have actually agreed upon a text for the accord, thereby avoiding the public embarrassment that followed the collapse of negotiations six months earlier, immediate concerns arose as to its future political viability. According to one observer, the accord was the product of "arm-twisting, obfuscation and opt-outs" that had papered over substantive disagreements over the future of the EU.[7] One year later, the rejection of the constitution by the French and Dutch publics in national referenda indicated that the European Commission had not been able to guarantee to these skeptical publics that its authority would be restrained and accountable. It took three more years to allay the resistance among the French and Dutch citizens—at least for a majority—as many of the same provisions were included in the 2007 Lisbon Treaty, but even this accord was rejected by Irish voters in a June 2008 referendum. These rejections show how Europeans remain concerned about the exact future contours of the European project and the scope and momentum of ongoing European integration.

Despite their obviously contrasting regional settings and political processes—the disengagement of Iraq from American control and the continued integration of the EU countries—both of these cases highlight a number of common features and dilemmas surrounding the institution of state sovereignty in contemporary international politics. First, in both cases,

[6] For example, see *International Herald Tribune*, June 30, 2004, p. 5.
[7] *The Economist*, June 26, 2004, 42.

the exact apportioning of sovereignty after these agreements, despite weeks of prior speculation and analysis, was unclear. Could Iraq truly claim to be a meaningfully sovereign country—despite the fact that it controlled the functions of twenty-six ministries—if American troops operating under their own command and control remained in the country for an indefinite period of time? Would the position of an EU foreign minister have any credibility or authority when individual member countries dissented from the external policy positions of the EU? In both cases, sovereignty had been reapportioned across political actors, but the exact nature and boundaries of this sovereign authority was difficult to specify.

A second common feature of these agreements was the uncertainty surrounding their exact downstream distributional consequences. How would these accords affect the future relative bargaining power of these states? Would the handover of sovereignty give the Iraqi government real authority or even veto power over the United States and its military decisions? How would the new voting procedures affect the ability of the European "big three" to shape the European Community's policy agenda? After the failed referenda, would the Commission try to "smuggle" in these constitutional changes through other established procedures and European agencies? Thus, not only were the particular contours of sovereign authority unclear, but the future consequences of these particular sovereign arrangements were also uncertain. Yet, even without being able to anticipate future power dynamics and distributional consequences, the various states involved in concluding these agreements had agreed, at least initially, to reapportion and transfer their sovereignty.

Finally, both of these agreements ignited renewed domestic political debates about the acceptability of altering the existing institutional scope of sovereignty. Would the Iraqi public be able to accept the continued presence of so many foreign troops now that they had regained their nominal sovereignty? Would U.S. policymakers call for the withdrawal of U.S. forces now that a major political disengagement had taken place? In the European case, the very ability of a member country to secure public acquiescence to greater integration was thrown into question. Thus, in both cases, new agreements over the scope of sovereign authority exacted a fresh set of domestic political costs and constraints.

These cases are but two examples of a much larger set of instances in which states negotiate about, bundle, or surrender their sovereign prerogatives. To be sure, territorial sovereignty remains a critically important institution in international relations. If it were merely organized hypocrisy, pace Stephen Krasner, how should we understand the desperate pursuit of that goal by so many nations?[8]

[8] Krasner 1999.

But sovereignty is rarely absolute. Rather, sovereignty consists of a bundle of rights and obligations that are dynamically exchanged and transferred between states.[9] For example, decolonization and territorial partition do not always mean that the newly independent states acquire full sovereignty. Instead, nationalist leaders might be content to obtain partial sovereignty if it accelerates the process of imperial withdrawal. In other instances, elites might grant some sovereign rights to another state or international organization because of perceived gains from the transaction.[10] Such forms of hybrid sovereign relations represent mixed forms of organizational governance that are neither purely "anarchical" nor "hierarchical."[11]

In agreeing to such hybrid sovereign relations, leaders are rarely sure about the long-term consequences of the agreements they sign. Few European statesmen foresaw the expansion of the EU and the depth of integration of the Community today. When Algerian nationalists and the French government agreed that France could maintain military bases and oil facilities after Algerian independence, they had no clear view of the durability of that agreement and the credibility of both parties to follow through. Who knows whether American-Iraqi agreements that authorize the presence of American troops in Iraq will stand the test of time?

What is noteworthy from our perspective is that states *frequently* contract with other international actors in both the economic and security spheres, despite the uncertainty and distributional pressures that the anarchic international system generates. As we shall see across the areas of international security and economy, states regularly and voluntarily divide and cede their sovereignty in both bilateral and multilateral settings.

Our book has two key aims. First, we wish to delineate how a particular sovereign governance structure emerges. Second, we will show how choices made at a given point in time have important downstream consequences that may not be readily apparent to the contracting parties at the time of the initial agreement.[12]

We argue that incomplete contracting theory can clarify how and why states choose to bundle and unbundle their sovereignty, what the dynamics will likely be of future renegotiation, why some agreements are more readily achieved than others, and why some of these incomplete contracts

[9] On sovereignty as a bundle of rights, see A. Cooley 2000–2001.

[10] On rulers and their possible interest in ceding sovereignty, see Krasner 1999.

[11] On the anarchy-hierarchy distinction and continuum of sovereign relations, see Lake 1996.

[12] As Kathleen Thelen notes (2004), institutional outcomes do not always follow from initial preferences. Indeed, as she shows from her discussion of labor relations in Germany, opponents and proponents of particular outcomes today occupy diametrically opposite positions from where they stood a century ago.

might unravel. Incomplete contracting theory can shed light on many diverse governance structures, and we will highlight the relevance of our theory by looking in depth at imperial and postcolonial relations, overseas military basing agreements, and regional integration.

The Importance of Incomplete Contracting in International Politics

Agreements such as the end of formal U.S. occupation of Iraq or the European Union's draft constitution are incomplete contracts. Although both agreements transfer significant elements of sovereignty among international actors, many clauses of these treaties and accords remain initially unspecified or are deferred for future negotiation.

Theories of incomplete contracting are particularly instructive for explaining the organizational boundaries of the international system. Kenneth Waltz's seminal work on international politics draws on the concept of market competition as an analogy for state competition,[13] but the international system more closely resembles an imperfect market than a perfect market. In international relations, anarchy generates a tremendous degree of uncertainty and informational asymmetries about the actions and intentions of political actors.[14] The lack of a central governing authority ensures that states must be wary of the long-term distributional consequences of their actions and be hesitant to commit to long-term agreements.[15] Moreover, states cannot take for granted that other international actors will honor agreements, especially when they lack well-established domestic institutions such as constitutions or electoral systems that help establish this credibility.[16] As David Lake notes, "opportunism is ubiquitous in international relations."[17] This imposes significant costs on the actions of political actors. Even when ceding authority to an international institution, states consciously design rules and procedures for international institutions so that they can adapt to changing circumstances.[18]

[13] Waltz 1979, 89–91.

[14] Koremenos (2001) notes how contextual uncertainty and confounding variables, which make it difficult for actors to assess contractual outcomes, hamper the ability of states to conclude long-term agreements.

[15] Grieco 1990.

[16] Lipson 2003; Cowhey 1993. On the importance of democratic legislatures for establishing credibility, see Martin 2000. Ikenberry (2001) describes how even powerful states can benefit from strategically restraining themselves through international institutions.

[17] Lake 1999, 52–53.

[18] See Koremenos, Lipson, and Snidal 2001.

In such an environment, incomplete contracts offer two important advantages for states. First, incomplete contracts delineate general principles and broad goals to which states can aspire. Given that actors cannot foresee, anticipate, or describe every possible contingency that may arise, general framing agreements are more likely to be initially accepted than a complete contract, and states will be willing to defer the negotiation of more intricate details to a later stage. Second, contractual renegotiation acts as an important institutional check on the future behavior of actors. As has been argued elsewhere in reference to international regimes, renegotiation increases the iteration among actors and ensures that problems of information and verification that pertain to the initial contract can be identified and resolved and/or redefined.[19] Incomplete contracts also offer states added flexibility to correct for distributional asymmetries that may arise as the result of the initial agreement.[20]

In short, incomplete contracts between states are framework agreements that do not fully apportion sovereignty. Instead, such agreements make the distribution and allocation of sovereign rights a matter of ongoing negotiation between the contracting parties or between those parties and a third party, such as a supranational organization.

Hypocritical Agreements?

Existing theories of international relations are not particularly concerned with explaining the dynamics of such mixed forms of sovereignty and the political uncertainty generated by "incomplete" agreements. The prevailing view among international relations scholars is that such modified forms of sovereignty are largely insignificant and do not alter the fundamental capacities and preferences of states. Stephen Krasner perhaps best summarizes this consensus by arguing that the institution of sovereignty is given lip service by the international community but is consistently violated by powerful political actors.[21] From this perspective, the nominal sovereignty of Iraq is of little practical consequence, as the United States is still able to exert its power and impose its preferences on the country. Similarly, the EU Constitution is relatively insignificant given that it still allows countries to opt out or veto EU decisions, especially in the realm of security policy. For skeptics of international institutions, contractual arrangements are secondary to the national interest and capabilities of the powerful actors entering these arrangements.[22]

[19] On regimes and iteration, see Keohane 1984.

[20] We share many of the assumptions that underlie the work of Koremenos 2001, 293–94.

[21] Krasner 1999.

[22] Such is the standard skepticism expressed by neorealist theories of international relations and international institutions. See Mearsheimer 1994–95.

But while sovereignty, at times, may seem like "organized hypocrisy," its mere violation, erosion, or compromise does not necessarily diminish its causal significance. By thinking in the strict binary terms of "full sovereignty" or "violations of sovereignty"—or "autonomy" and "hierarchy"—scholars have neglected the many mixed forms of sovereignty, split property rights, and hybrid governance arrangements that have historically proliferated through the international system. While we agree with the aim of prevailing attempts to explain the dynamics of non-sovereign forms of governance such as supranationalism and empire with organizational theory, especially transaction costs theory and relational contracting, we regard the strict anarchy/hierarchy distinction as unable to capture many of the nuanced forms of sovereignty that are critical for understanding many forms of international organization and governance.[23]

From a practical perspective, understanding the various ways in which sovereignty can be bundled and unbundled underscores how states can potentially develop creative and new non-conflictual institutional solutions to problems that surround their sovereignty such as territorial partition.[24] Often the sovereignty-related underlying sources of conflicts among states—contested assets, territory, borders, and functions—can all be split, shared, and reapportioned in a mutually beneficial manner. States can agree to lease or use an asset or piece of territory for a specified duration or during a transitional period before exclusive sovereignty arrangements are finalized. Delegation of a certain state function to a third-party organization can bind both parties to a common set of principles and procedures. The malleability of sovereignty and partial sovereign arrangements may thus help foster stability and orderly arrangements in international politics. Forms of hybrid sovereignty may provide additional institutional solutions for competing states to avert the high costs of conflict.

Recasting Our Understanding of "Integration" and "Disintegration"

By focusing on the varied modes of contracting employed by states across a broad range of issue areas, we recast our understanding of the twin processes of "integration" and "disintegration" in international relations. Traditionally, scholars have examined integration as the aggregated

[23] Some of the most important works on sovereignty and relational contracting include Lake 1999; Weber 2000; Frieden 1994.

[24] Our emphasis on different governance forms as solutions to intractable conflicts and/or territorial disputes thus differs from scholars who view territoriality and indivisibility in more socially constructed or psychological terms. On social legitimacy and indivisibility, see Goddard 2006; on ideational barriers to territorial disengagement, see Lustick 1993.

transfer of sovereign assets or functions to another actor or organization, while disintegration is viewed as the process by which territories and functions are disengaged from a larger polity. However, our framework suggests that both integration and disintegration in their incompleteness involve the reconfiguration and re-bundling of assets and/or functions from one party to another. We show that all processes of sovereign transfer—including imperialism, supranationalism, decolonization, and overseas military basing agreements—involve the reapportioning of sovereign, rights, functions, and territories from one actor to another.[25] For example, the loss of a state's exclusive sovereignty over an area of economic governance to a regional organization also implies that regional organization's gain of the governance of that same function. Similarly, the collapse of an empire or multinational state implies a transfer in sovereignty from a territorially greater polity to a newly independent state. Thus, both integration and disintegration involve sovereign gains, losses, and reconfigurations of assets and functions for the involved contracting parties. Accordingly, we believe that these different forms of sovereign transfers and their institutional dynamics can and should be studied within a common analytical framework despite their varying issue areas. From our perspective, the direction of these sovereign transfers matters less theoretically than the mode and contractual arrangements that govern their transfer and whether these arrangements are exclusive and complete or hybrid and incomplete.

The Argument in Brief: Incomplete Contracting and the Organizational Dynamics of Sovereignty

The Logic of Incomplete Contracting

The type of contracting employed by political actors during integration and disintegration has observable effects on various aspects of state sovereignty and institutional arrangements. Critical to our account is the distinction between complete contracts and incomplete contracts. Complete contracts describe and specify the full array of responsibilities and obligations of the contracting parties, as well as anticipate every possible future contingency that may arise throughout the course of the exchange agreement.[26] By contrast, incomplete contracts arise from the imperfections and transaction costs generated by the contracting environment that

[25] In this sense, this collaborative project is a continuation of our recent individual work on the common institutional dynamics of empire, decolonization and other hierarchical forms of territorial organization (Spruyt 2005; A. Cooley 2005a).

[26] For an overview and discussion, see Hart and Bengt 1987.

prevent actors from specifying complete contracts. Incomplete contracts arise for both "procedural" and "strategic" reasons.

Procedural incompleteness arises when contracting actors are unable to do the following: (1) anticipate the full array of contingencies that may arise in the future; (2) negotiate optimal agreements given the asymmetries of information that characterize the contracting environment; and/or (3) negotiate an agreement that is verifiable or enforceable by the parties themselves or an outside third party, such as a court system or central regime. As a result of these different transaction costs—"uncertainty," "negotiating costs," and "enforcement costs"—states, even if they prefer a complete contract, may not be able to anticipate all the possible transaction costs, exogenous events, and future bargaining positions that might arise throughout the course of an extended exchange.[27]

As a result, contracts will often specify the initial terms of the exchange (as in the complete contract), but will also neglect several contingencies. Consequently, the contract itself will have to make provisions for the process of renegotiation, revision, and adjustment that will likely be needed but cannot be accurately predetermined or specified *ex ante* by both parties—that is, the contract will be "incomplete."[28] Thus, the incomplete contract will provide the starting point but not necessarily the long-term specifics for the exchange relationship. In some extreme cases, such initial contracts that specify common goals and objectives as opposed to plans of action have been described as "framing agreements."[29]

Contracts can also be left incomplete for strategic reasons—*strategic incompleteness*. When actors transact over specific assets, the incompleteness of a contract may arise not only from transaction costs and exogenous shocks but also from the strategic advantage gained by one of the parties from renegotiating the agreement at a later date. When assets are specific and transactions are frequent, the owners of these assets will have increased bargaining leverage or will be in a position to "hold up" the agreement and exchange.[30] As a result, strategic incompleteness

[27] See Hart 1995, especially 23–28.

[28] For an overview of the various debates that have been spawned by the incomplete contracts approach, see Schmitz 2001.

[29] Milgrom and Roberts 1992, 131, as discussed in Doleys 2000, 535–36.

[30] This is the classic hold-up problem described in O. Williamson 1985. We discuss the theory at length in the next chapter. Transaction-specific assets are assets that cannot be easily be redeployed to some alternative use. Thus buyer and seller are locked into the transaction to a significant degree (O. Williamson 1985, 52–56). Williamson suggests that asset specificity arises out of site specificity, physical asset specificity, and human asset specificity. We will focus particularly on the site-specific nature of assets, as natural resource ventures and overseas basing, in chapters 3 and 4. Indeed, we will discuss transaction-specific assets almost exclusively in the sense of site specificity.

may be desirable for a party that feels it can extract a greater payoff or rent after renegotiations rather than as part of the agreement *ex ante*. Much as Barbara Koremenos, Charles Lipson, and Duncan Snidal argue about the rational design of institutions in general, states consciously design and incorporate incompleteness in their contracts in order to best pursue their interests.[31]

Analytic Categories of Incomplete Contracting Theory: Allocating Rights, Bargaining Power, Momentum for Integration, and Credibility of Commitment

Over the course of this book, we explore how both procedural and strategic incomplete contracts involve several distinct facets of state sovereignty: the distribution and governance of rights among parties; the relative bargaining power of the contracting members over time; the momentum for sovereign transfer (i.e., the evolution of the incomplete contract); and credibility of commitment. Particularly when transaction-specific assets are at stake, the possibility of hold-up arises. Moreover, since bargaining power shifts to one power as time progresses, the disadvantaged party will require assurances from the other actor. In the following chapter we develop a causal model that incorporates these categories. Here we wish to highlight how these categories serve to differentiate complete from incomplete contracts.

First, incomplete contracts involve the division of property rights over sovereign issues and assets. Intermediary forms of hybrid governance can emerge as stable organizational solutions to contracting problems. Specifically, incomplete contracts allow sovereignty to be unbundled into various rights and then split or shared among contracting parties. Of these property rights, the most important distinction is that between "control rights" and "use rights."[32] Control rights allow a party to make decisions about how to use an asset, such as the right to lease, transfer ownership, or even destroy the asset. Use rights designate the right to incur the costs and reap the benefits from the use of an asset, usually for a finite period of time. By splitting the control rights and use rights of an important sovereign asset—such as a strategic installation or site-specific economic asset—incomplete contracts allow states to divide sovereign assets and territory in nonexclusive ways. Alternatively, states can also share sovereignty over an asset or function by creating joint production agreements,

[31] See Koremenos, Lipson, and Snidal 2001.

[32] On various property rights, see Eggertsson 1990, chapters 2 and 4. For a discussion and application to sovereignty, see A. Cooley 2000–2001.

thereby jointly supplying the particular sovereign good.[33] Rather than exclusively apportioning sovereignty to either state, incomplete contracts allow states to both split and share sovereignty over especially sensitive or important assets and functions.

Second, incomplete contracting affects the relative bargaining power of the contracting parties over time. As David Baldwin notes, power in international relations is a relative concept that must be specified in terms of scope and domain.[34] The interactions and relative positions of contracting states change over time, and initial decisions made about contracting modes can have important downstream consequences. Specifically, the apportioning of property rights over a particular asset or territory at a given time *t* determines the threat point of subsequent renegotiations and bargaining games at $t + 1$.[35]

Complete contracts involve one-time concerns regarding bargaining power. Bargaining asymmetries are clear and static. With incomplete contracts, by contrast, bargaining leverage may change over time and in unforeseen directions. In certain cases of incomplete contracting, such as contracting over natural resource use, the host country tends to gain more leverage as the foreign country (the investor) sinks more transaction-specific assets into such exploitation.[36]

Consequently, renegotiation is a critical juncture at which point relative bargaining power over sovereign issues can shift dramatically and in a way that does not correspond to contracting partners' relative power capabilities.[37] States that hold the residual rights of control over an asset will be empowered to appropriate any surplus rent or revenue stream at renegotiation, even if the other party remains more powerful absolutely.[38] For example, Algerian ownership rights over the Saharan oil reserves gave the Algerian government increasing leverage over the French government and companies that were allowed to exploit such oil after Algerian independence in 1962. Thus, incomplete contracts alter the relative bargaining positions and change the distribution of benefits to contracting parties over time. Most important, the holder of residual rights of control will be able to determine the future allocation of sovereign rights that were not covered in the initial agreement.

[33] These are also known as "horizontal agreements" in the institutional literature.

[34] Baldwin 1989.

[35] See Schmitz 2001; Hart and Moore 1990.

[36] Vernon 1971; Moran 1974.

[37] Arguably, if the exact consequences of renegotiation could be foreseen *ex ante*, then the contract would cease to be incomplete as the renegotiation outcome could be folded into the initial agreement. See Tirole 1999.

[38] This is the main insight of the property rights literature, as developed by Oliver Hart. See Hart 1995; Hart and Moore 1990.

Third, we argue that the particular sovereignty arrangement can affect the momentum for sovereign transfers. Complete contracts do not automatically have consequences for renegotiation and the forward momentum of further (dis)integration. Actors know the terms of the agreement, which is meant to be final and complete. Incomplete contracts, however, are based on the premise that future negotiations will be forthcoming and that the complementarity of assets and incentives for future iterative relations might change.

All other things being equal, actors will prefer to change incomplete contracts to complete ones to reduce the uncertainty that goes with renegotiations. However, an increase in the level of incompleteness of a contract expands the available continuation equilibria, thereby increasing the available ways in which an institutional arrangement can be maintained and, if necessary, amended.[39] Since iteration itself may have positive distributional consequences, rational states may also use strategic incompleteness to continue to capture surpluses during multiple renegotiations.

Whether or not a hybrid sovereignty arrangement unravels will depend on the potential efficiencies and increasing returns from joint production.[40] Further, how such renegotiations proceed will also depend on the availability of alternative contracting parties. Greater gains might be achieved by either party by violating the terms of the incomplete contract and seeking terms with other states. For example, U.S. displacement of the Netherlands as the primary investor in Indonesia greatly increased momentum toward the dismemberment of the incomplete contract between the Dutch and Indonesian governments regarding Dutch fixed assets.

All forms of contracting inevitably raise questions regarding the ability of actors to commit. But complete contracts address the issue in a different manner than do incomplete agreements. Complete contracts that involve transaction specificity increase the possibility of hold-up. Thus, partners to a complete contract will seek noncontingent solutions to the problem. Vertical integration will be the most preferred solution, thereby diminishing the issue of credibility of the contracting parties over time.

In contrast, incomplete contracts split ownership by allocating and dividing control rights and use rights. Given the incentives for actors to renegotiate or expropriate fixed assets, the credibility of the contracting parties will remain a continuous issue, but will fall especially on the shoulders of the party with the residual rights of control. What guarantees does one have that the distribution of rights will remain acceptable to both parties as time passes?

[39] Bernheim and Whinston 1998, 917.

[40] On complementary assets and increasing returns, see Hart 1995, 47–51; Joskow 1985.

TABLE 1.1
Summary Table of Characteristics of Complete and Incomplete Contracts

Sovereignty-Related Issues		*Complete Contracts*	*Incomplete Contracts*
Governance of Assets		Absolute and exclusive sovereign rights	Mixed governance arrangements
	Effect of Specific Assets	Hold-up potential leads to vertical integration or hierarchy	Split property rights (separation of use rights from control rights)
Bargaining Leverage		Static: transparent at initial agreement	Changes over time in favor of residual rights holder
	Possibility of Residual Surplus/Rent	None	Available for capture at time of renegotiation
Momentum for Transfer (Integration or Disintegration)		Limited; specifies complete scope of integration or disintegration	Significant; incompleteness increases continuation pathways
	Effect on Renegotiation	No impact; scope of agreement perfectly described *ex ante*	Strategic use of renegotiation by holder of residual rights
	Effect of Complementary Assets/Functions	No impact; scope of agreement perfectly described *ex ante*	Increased likelihood of further transfers
Credibility of Commitment		Credibility issues are dealt with by specification in initial contract (self-enforcing; mutual hostage taking; vertical integration)	Credibility issues exist *ex ante* particularly for the actor who wishes to obtain residual rights of control

The Domestic Costs of Contracting for Sovereignty

All of these issues can of course impose domestic political costs for elites. Issues involving state sovereignty are often among the most contentious for state leaders, and bargaining over sovereignty can inflame nationalism and increase demands for intractability over certain sensitive issues. If cast in terms of complete contracts, the options will seem dichotomous and zero-sum. One party will gain full control over the assets at stake, which the other state will have to forego.

Incomplete contracting can mitigate such domestic political pressures in a number of ways. By splitting the property rights of certain sovereign territories, assets, or functions, bargaining states can find acceptable mixed governance arrangements short of exclusive sovereignty than can satisfy the immediate short-term needs of both parties. By specifying a time period and incorporating a renegotiation clause within an agreement about sovereignty, elites can reassure constituents that initial agreements are only temporary and will eventually revert to their desired payoff. For example, the Ukrainian government was able to absorb the domestic political costs and public criticisms of leasing the Crimean harbor facilities to Russia by specifying that the agreement be limited to a period of twenty years, after which it would be subject to renegotiation.[41] Finally, the temporary duration of incomplete contracts can allow key domestic actors to modify their preferences. Assets or functions previously considered indispensable or integral to their operations might become less so at the contract's renegotiation. In short, if actors can credibly commit to such incomplete contracts, this raises the possibility that the hold-up problem can be mitigated or solved, short of assigning exclusive sovereignty to one particular actor.

Scope of This Study

We argue that the principal advantage of our incomplete contracting approach over other institutional accounts of sovereignty lies in our ability to study many different types of political organizations, polities, and processes under a common theoretical framework. While scholars typically study many of these processes as distinct topics—for example, studies of supranational EU integration will rarely invoke the literature on imperialism, territorial disintegration, or overseas basing—we seek to show that their common organizational dynamics can be explained within a single theoretical framework. Nevertheless, there are some im-

[41] See A. Cooley 2000–2001.

portant limits to our study. Most notably, our incomplete contracting framework assumes that states, to some degree, can make voluntary choices about the nature and shape of their organizational boundaries.[42] One might object that states do not always voluntarily choose institutional arrangements, even if they are framed in terms of treaties or contractual obligations. However, even formal empire often required the support of local elites.[43] Moreover, one of the aims of our study is to show how, over time, coercion-based interactions can actually give way to the contractual-based dynamics described by our model. We explore this dynamic further in our empirical investigations of decolonization agreements and the evolution of U.S. military basing agreements. Furthermore, as empire has become highly contested, the contractual dynamics by which states seek to solve issues of asset allocation and reallocation of sovereign rights have become more important.[44]

Finally, since sovereignty has become an ever more entrenched principle of the international system, leaders will be reluctant to engage in complete contracts that fully allocate such rights to one of the parties. Put differently, even if joint production gains might be achieved by allocating authority to one of the contracting parties, each individual government will be reluctant to surrender control over "hot button" items as sovereign control over natural resources, or to yield use rights for some foreign-run military base.[45] An incomplete contracting perspective is thus highly relevant to understanding interstate conduct today.

Chapter 2 lays out our approach in greater detail and compares our incomplete contracting approach with other organizational theories, most notably transaction costs approaches. We specify our theoretical model in greater detail and show how incomplete contracts affect the configuration of ownership rights over specific assets. The particular configuration of rights in turn affects the bargaining leverage of actors, as well as the momentum of integration and disintegration. We further discuss our methodological approach and the rationale behind our case selection. Finally, we offer a set of general hypotheses and propositions that frame the following case chapters. Each of the ensuing empirical chapters further specifies these hypotheses with regard to the cases at hand.

[42] We thus follow many of the methodological assumptions of Lake (1999) and Koremenos, Lipson, and Snidal (2001).

[43] Doyle 1986, 135; Nexon and Wright 2007.

[44] See Spruyt 2005.

[45] As will become clear from our discussion in the empirical chapters, natural resources and basing issues tend to generate intense preferences in former subject territories and developing countries. On natural resource debates with regard to foreign ownership and exploitation, see, for example, Krasner 1978; Moran 1974.

Chapters 3–5 apply the incomplete contracting approach to three distinct settings in international relations. In choosing our cases, we have selected topics that encompass both sovereign integration and disintegration, and issues that span the fields of both international security and international political economy as traditionally defined. Thus, like other recent works, we seek to show how organizational logics are common to sovereign transfers involving security and economy.[46] Each of the case chapters examines the theoretical propositions developed in chapters 1 and 2, but also engages with the broader literatures on integration and sovereignty inherent in that particular topic or field.

Chapter 3 examines how hybrid sovereignty arrangements emerged following the decolonization of modern empires. We explore how leasing agreements, joint production arrangements, and other hybrid forms of sovereign governance designated over peripheral military installations and economic assets facilitated the disengagement of core powers in the British, Dutch, French, and Soviet empires. We show how explicitly splitting the control and use rights of key peripheral assets within the framework of incomplete contracts allowed new national elites to overcome domestic opposition and permit foreign agencies and multinational companies to use national assets in exchange for achieving independence. The chapter first clarifies how initial preferences, shifts in the balance of power, and the ability to commit influenced the choice for particular hybrid sovereignty arrangements. We subsequently chart how these agreements were renegotiated and explore how these host countries used the bargaining power afforded by their residual rights of control to secure more beneficial terms. Decolonization thus usually involved bilateral negotiation and the distribution of fixed assets. Bargaining leverage over time was likely to shift to the host country (the newly independent state). Momentum favored further specification of ownership rights in favor of the host country and full sovereignty. Consequently, credibility of the host country *ex ante* became a key issue for the successful conclusion of such incomplete contracts upon independence. Far from being peripheral arrangements, we show how the successful conclusion of such intermediate solutions was critically important to facilitating decolonization and sometimes averting or concluding violent conflict between former imperial metropoles and emerging independent states. Across these cases we observe considerable variation. The incomplete contracts between the Netherlands and Indonesia unraveled in short order, without being replaced. The French agreements with Algeria and Tunisia did not last either, but France continues to maintain a network of hybrid sovereignty arrangements with

[46] Lake 1999; Koremenos, Lipson, and Snidal 2001.

its overseas bases, which are not that different in nature from the types of agreements it concluded during the decolonization period. In the former Soviet space, Russia's incomplete contracts with the "Near Abroad" continue to show a remarkable resilience. And, finally, the British, cautious about the bargaining leverage that flows to host countries holding residual rights, have retrenched to bases that they can hold outright without sovereign concessions.

Chapter 4 focuses on the various incomplete contracts that determined the sovereignty of U.S. overseas forward basing and security installations during the cold war. Military basing agreements provide a particularly powerful arena to test our claims, given that security considerations and relative power distributions should be paramount, yet we find that basing agreements were characterized by similar organizational logics as other sovereign transfers governed by incomplete contracts. We describe how the United States organized a network of overseas sites and outline the hold-up problem faced by U.S. planners when securing agreements to govern their important or specific installations. We explore how host countries strategically used their residual rights of control to periodically renegotiate these agreements to extract greater material and political concessions from the United States and restrict the scope of U.S. basing activities and use rights. We present more detailed accounts of the evolution of the agreements governing the use of the Subic Bay and Clark bases in the Philippines and the military installations on the Azores (Portugal). In both cases, we chart how incomplete contracts over these specific assets shifted bargaining strength away from the United States and toward the host countries despite these countries' nominal power differentials and alliances with the United States. Finally, we explore how the U.S. Department of Defense's recent global force restructuring plan is a partial response to the political problems created by the incomplete contracts governing the use of overseas military assets. By decreasing its forward presence in countries where its presence has become politically contentious and emphasizing flexibility and mobility in force posture, the Pentagon hopes to avoid cases of political hold-up and excessive quid pro quo demands by countries hosting overseas military assets. This chapter thus deals with bilateral negotiations in which states choose to bundle fixed assets.

Chapter 5 explores whether an incomplete contracting approach can shed light on the formation and deepening of regional economic integration, even if we relax our assumption of transaction specificity of assets, which we employed in chapters 3 and 4. It examines the institutional consequences of the incomplete contracting that governed European integration from the outset and compares this to the nature of contracting that governed the North American Free Trade Agreement (NAFTA). The chapter focuses specifically on the formation of the European Coal and

Steel Community (ECSC) in 1951 and the European Economic Community (EEC) in 1957. The institutional choices made during that formative phase influenced the subsequent evolution of the European Union. We highlight how the European Commission and the European Court of Justice used their bargaining power and the control rights that were delegated to them to extend their jurisdiction over complementary issue areas and functions. We then contrast the incomplete contracting that has characterized European integration with the relatively complete contracts that typified NAFTA. Furthermore, we show how variations in the type of contracting correlated with differences in initial preferences, relative distribution of power, and ability to credibly commit. The variation in initial contracting subsequently affected the bargaining power of the international institutions that were created in these two cases of regional integration, as well as the momentum toward further integration. Finally, we argue that despite widespread discussion of the impending onset of economic regionalism, other regional organizations are unlikely to achieve the level of integration in the EU, especially as they continue to adopt a complete contracting approach to their negotiations.

In chapter 6, we recapitulate our central theoretical arguments and offer suggestions for further research. In addition to assessing the organizational boundaries of integration and contraction in the international system, we argue that the incomplete contracting/property rights model potentially offers new theoretical insights on many additional issues such as why federal arrangements may encourage stability in some multinational states more so than in others, how hybrid forms of governance over fixed assets has impacted Arab-Israeli peace negotiations, and what the logic of incomplete contracting suggests for international transitional administration in post-conflict territories such as Kosovo.