

Reconciling Institutions: Nested, Horizontal, Overlapping, and Independent Institutions

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This memo is divided into three parts. The first concerns the origins of the concept of nesting and the literature on nested systems and nested regimes/institutions. Per the focus of the conference, the second section considers the political process of bargaining strategies within the context of existing institutions,¹ be they sectoral or regional. In the third section, I go beyond the static analysis of bargaining within a preset institutional context, and focus on the politics of institutional *change* as a key strategy. Because new or significantly modified institutions may create institutional overlap, I consider the question of institutional reconciliation by looking at what I have termed nested, horizontal, and independent institutions in the context of institutional design.

I. CONCEPTUAL ORIGINS: NESTED SYSTEMS AND NESTED REGIMES

Nesting as a concept has been used in the fields of statistical modeling, computer science, and of course in biology (nesting of birds!). I have not been able to track down when the term first came into use in these other fields. In political science and allied fields, the first reference to nesting with which I am familiar at this point goes back to the work of Michael Barkun in his book *Law Without Sanctions* (1968), although there may be earlier uses. When I wrote my own dissertation in 1981, I was not aware of his use of this term (pre-Google days), and only discovered it later when someone mentioned to Robert Keohane that Michael Barkun had written about nesting.

Before I elaborate on Barkun's use of nesting, it is worth noting that in my own work and work that has subsequently followed, there are two commonly used approaches to nesting: the first is "nested systems" (and the related notion of nested games; see Shubik, 1984; Heckathorn, 1984; Tsebelis, 1990);² the second is "nested regimes/institutions." The concept of nested systems focuses on the interrelationship among systems at different levels. The second usage, and the most common one, focuses on how international regimes and institutions might be reconciled in some type of "hierarchical" ordering and examines how these institutions are influenced by one another. In addition, I have introduced the notion of what I initially called "parallel" institutions, which I have subsequently referred to as "horizontal institutions" that reflect a division of labor among institutions rather than a hierarchical ordering.

1. I also discuss briefly the possibility of non-institutional bargaining, but given the focus of this memo, focus on bargaining within an institutional context.

2. Tsebelis uses the term "nested games" extensively, including in the title of his book. He appears to be unaware of the earlier uses of this term, particularly by Heckathorn (1984) who discusses "The Theory of Nested Games" in his article.

A. Nested Systems

In his work *Law Without Sanctions* (1968), Barkun focused on “nested systems” but does not focus on the idea of nested institutions. In discussing different types of units at different levels, he notes that “We are dealing here with ‘nested’ groups, large units that encompass small units, like so many Chinese boxes.... The systems are indeed nested...” (p. 17). He goes on to discuss the notion of nesting again when he notes, “We can speak of an inter-American subsystem, within which nest sub-subsystems, defined in terms of dyads or triads of Latin American states.” And “Second, all of the models perceive a nested quality in international relations: the state system, within international subsystems, within the global system” (p. 31).

In my own work (1981), I drew on Simon’s work on decomposable systems (1962) to discuss the same idea as Barkun. Without being aware of his work, I discussed the concept of what I termed “nesting constraints”—that is, the fact that subsystems are couched within larger systems. As I argued “the behavior of units in subsystems will be affected by the structure of the system within which the subsystem is nested” (p. 62-63). Barkun was interested in looking at how what he termed “stateless primitive societies” might be seen as similar to the international system. In his own analysis, he did not develop what the implications of nested systems might be for institutional design or political behavior in his pioneering work on this concept.

B. Nested Regimes and Institutions

The second usage, which I have alluded to, concerns the idea of nested regimes and institutions. The only mention of institutions in Barkun’s work comes in passing, when he notes that:

Some of these subsystems we have no difficulty in identifying, because they have some rudimentary institutional expression: the Common Market or the Organization of American States. Others, such as the U.S.-Canadian system, we take much more for granted” (p. 29).³

Beyond this brief passing remark, Barkun did not discuss any type of regime nesting or institutional nesting in his work nor look at the implications of nested systems.

My own analysis of what I termed “nested regimes” began in 1981 with analysis of the relationship of the textile regime to the broader GATT trading system. In my dissertation, and subsequently in other publications,⁴ I focused on how broader regimes will influence the design of new institutions that are narrower in scope. From a causal perspective, drawing on Simon (1962), I argued that “lower-level” systems such as trade or within it textiles, are influenced by the objectives that actors have in higher-level systems. In particular, I focused on how the structure of the overall security system would influence the trading system, and the trading system would in turn influence behavior in the “textile system.” This impact of security on lower-level systems would include possible constraints on aggressive behavior by Western

3. This notion of a U.S.-Canadian system and Barkun’s discussion provides an interesting anticipation of Keohane and Nye’s Power and Interdependence analysis of this relationship.

4. Aggarwal (1981), (1983), and (1985).

countries vis-à-vis developing countries in view of their broader objective of security for which the allegiance of developing countries was critical. I also argued that “countries would endeavor to bring subsystem behavior into line with objectives of the higher-level system.”⁵

With respect to nested *regimes* and textile trade, I then suggested that because the GATT regime was broader than the textile regime, in creating and modifying the textiles regimes of the Long Term Arrangement on Cotton Textiles (LTA) and the Multifiber Arrangement (MFA), states would avoid undermining the norms of the GATT. Thus, they should attempt to bring as many norms from the GATT into the LTA and MFA as possible, thus affecting what I termed the “nature” of the regime as well.

In my empirical work, I specifically showed how nested systems affected U.S. behavior vis-à-vis other states, focusing initially on how the bipolar security system influenced the U.S. to be more concessionary towards Japan because of nested system constraints.⁶ With respect to nested regimes, I focused on how the GATT norms (particularly as identified systematically in the work of Finlayson and Zacher 1981), were incorporated into the textile regime to the extent possible, while others were modified to meet the objectives of states in the issue-area. In doing so, in my view, nested regime constraints were at work as the U.S. sought to preserve its commitment to the broader regime of the GATT while still creating a sector-specific regime to regulate the actions of states in the textile and apparel trade.

Subsequently, as I discuss below, I have elaborated on the question of institutional reconciliation by focusing on four terms: 1) nesting (which I have already discussed); 2) horizontal institutions (which refer to a division of labor); 3) overlapping institutions (institutions that create possible conflict because of their similar mandates—at least in part; and 4) independent institutions (which refer to institutions with totally separate mandates, generally in different issue areas.⁷ Other scholars have also discussed the nesting of regimes and institutions. For example, Robert Keohane has looked at how nested regimes might influence the process of issue linkages. As he argues, such nesting could reduce transaction costs involved in making side-payments because nested institutions provide ready-made clusters of issues that facilitate this process.⁸

Elinor Ostrom has discussed the idea of “nested rules” extensively. She does not appear to be aware of earlier work on nested regimes, but instead relies on the work of Douglas Heckathorn (1984) on nested games. She argues, “All rules are nested in another set of rules that define how the first set of rules can be changed.”⁹ Then, she examines how nested rules influence the provision of common pool resources, particularly in their area of the management of natural resources. A number of scholars who have focused on environmental management draw on this

5. Aggarwal (1985), p. 27.

6. 1985, pp. 46-47. The most systematic treatment of the link between security systems and trade is Gowa (1995), which looks at the relationship between alliances and trade.

7. See Aggarwal and Koo (2005) on types of institutional connections. Young (1996 and 1999) also considers the issue of institutional connections. In 1998 I used the term “parallel” institutions to denote a division of labor but subsequently changed to using the term “horizontal” to avoid confusion.

8. Keohane (1984), p. 91.

9. Ostrom (1990), p. 51.

work to examine nested institutions, although Ostrom does not use this specific term in her 1990 work.¹⁰

In his innovative work on regime types and interconnections, Oran Young has focused on what he terms “embedded regimes”, “nested regimes”, “clustered regimes”, and “overlapping regimes”. The first is used to refer to regimes that draw on the broadest level of international society, while nested regimes are used in a similar way to my own work—namely issue specific regimes that draw on a broader regime.¹¹ Finally, he uses the term “clustered regimes” to refer to what appears to be tactical connections among issues and “overlapping regimes” to those that may impact one another.

C. Institutional Connections in Issue Areas and a Regional Context

In addition to thinking about institutional linkages, it is important to keep in mind that these types of institutional connections can take place as a method of coping with overlapping institutions from both an issue-area and a regional perspective.¹²

Nested institutions in an issue-area are nicely illustrated by the relationship between the international regime for textile and apparel trade that I have already discussed. In the 1950s, continental European protectionist measures in textile and apparel trade were inconsistent with the GATT’s objectives and eroded American efforts to bolster an open multilateral trading system. At the same time, in the early 1960s, President John F. Kennedy faced strong protectionist lobbying efforts from the cotton textile and apparel industries. In view of Kennedy’s desire to promote a new round of tariff reductions, the U.S. Government found itself in a quandary. To cope with these competing pressures, the U.S. nested the sector-specific international regime of the LTA under GATT auspices.

For an example of the nesting of regional institutions, we can turn to the development of the Asia-Pacific Economic Cooperation grouping (APEC) in 1989 and its relationship to the GATT. APEC’s founding members were extremely worried about undermining the GATT, and sought to reconcile these two institutions by focusing on the notion of “open regionalism.” APEC members saw this as a better alternative to using Article 24 of the GATT, which permits the formation of free trade areas and customs unions, to justify this accord.

An alternative mode of reconciling institutions would be to simply create “horizontal” institutions that deal with separate but related activities, as exemplified by the GATT and the Bretton Woods monetary system. By promoting fixed exchange rates through the IMF and

10. Apesteguía (1998), McCabe and Feiock (2003), Messer and Townsley (2003), Folker et al.(1998), King (1997), Choe (2004), Barrett, Brandon, Gibson, and Gjertsen (1999), Olson and Folke (2002), Sick (2002).

11. Although Young (1996) and (1999) does not mention my earlier work, he now seems aware of this earlier research on nested regimes (personal communication).

12. See Aggarwal (1983 and 1985) for a discussion of nested systems and institutions in the context of sectoral arrangements. Aggarwal (1994) analyzes nested institutions in the context of the North American and Asia-Pacific regions. Aggarwal and Morrison (1998) analyze the evolution of APEC while Aggarwal and Fogarty (2004) focus on EU interregional and hybrid strategies.

liberalization of trade through the GATT (following the ITO's failure), policymakers hoped that this horizontal institutional division of labor would lead to freer trade.

Finally, on a regional basis, one can see the development of the European Economic Coal and Steel Community and the Western European Union as horizontal organizations. The first was oriented toward strengthening European cooperation in economic matters (with, of course, important security implications), while the WEU sought to develop a coordinated European defense effort.

II. THE POLITICS OF INTERNATIONAL BARGAINING WITHIN AN INSTITUTIONAL CONTEXT

To understand the politics of bargaining and how different types of institutional linkages might affect this process, we can consider the idea of what I have termed an institutional bargaining game. This approach focuses on the logic of bargaining game choices with attention to several questions:

- What are the factors that set a bargaining game in motion?
- What factors influence the bargaining game payoff structure?
- What is the institutional context? Are there one or more existing institutions, be they in an issue area or regional context?
- If *no* institutions exist, will actors simply bargain in a non-institutional context?
- If one or more institutions already exist, how will the bargaining process be affected?

In addition to the “static” bargaining process, be it in an institutional or noninstitutional context, one can consider a more dynamic approach focusing on efforts to alter the bargaining context, with a specific focus on institutional change efforts, which I take up in Section III.

A. Theoretical Framework: The “Static” Bargaining Game

To address these questions, I have developed the notion of an institutional bargaining game in various works that are available to the participants on the conference website. Here, I provide a significantly abridged discussion of key issues and instead focus on empirical examples with which I am familiar in order to address the impact of institutional connections on the political process in the various elements of the bargaining game I have developed. Figure 1 depicts the elements of the initial “static” bargaining game.

1) Initial Impetus

To set the game in motion, we can focus on some type of an initial impetus that significantly alters the preexisting bargaining context. Examples include the oil shock of 1973, the breakdown of the Bretton Woods system in 1971, and the end of the Cold War following the collapse of the Soviet Union. An impetus to change can also come from both endogenous and

exogenous changes that are less dramatic such as actions by currency speculators or electoral victories that shift actors' individual situations.

2) Goods and Externalities

Initial shocks may either create a positive or negative externality on actors who are not immediate participants in the precipitating event. Alternatively, economic or political changes may stimulate or impede the provision of some type of "good", namely public goods, common pool resources (CPRs), inclusive club goods, or private goods.¹³ The nature of the particular good involved will influence the type of game that is involved. Types of goods will also influence the potential advantages of an institution in promoting a cooperative outcome.¹⁴ The type of goods involved in a negotiation, however, only gives us a first cut into understanding the type of problems that actors face and their incentives: knowledge of the types of goods involved in the bargaining does not allow us to adequately determine specific payoffs of games because the position of national actors or the institutional setting may alter the bargaining problem. We now turn to these two elements.

3) Individual Bargaining Situations

States are likely to have varying interests in the issue or regional area within which bargaining takes place. While the factors that might affect actors' interests (and hence their payoffs) are nearly endless, the most significant influence on national responses can be narrowed down to (1) an actor's international position, as defined by its issue-specific and overall capabilities; (2) its domestic coalitional stability; and (3) elite beliefs and ideologies. The first of these elements will influence a state's objectives as well as its ability to secure its desired outcomes. The second element, a state's domestic coalitional stability, focuses on the incumbency expectations of government decisionmakers, which taps into decisionmakers' discount rates. Finally, elite beliefs and ideologies about the causal connections among issues and the need to handle problems on a multilateral basis will also influence the payoffs and actors' responses.¹⁵

4) The Institutional Context

As states attempt to secure their preferred outcomes, they will interact strategically, *possibly* in the context of one or more institutions. Institutions should influence how actors interact, and may provide either focal point solutions for coordination games or may help states to overcome collective action problems.¹⁶ Institutions are also likely to have important distributive consequences, and may influence actors' bargaining behavior by tying the hands of both other international and domestic actors.¹⁷ More significantly, some analysts argue that international

13. On common pool resources in particular, see Ostrom (1990). For an earlier insightful discussion of types of goods see Snidal (1979). The best summary of the literature on goods is by Cornes and Sandler (1996).

14. For a formalization of the link between goods, games, and institutions, see Aggarwal and Dupont (1999).

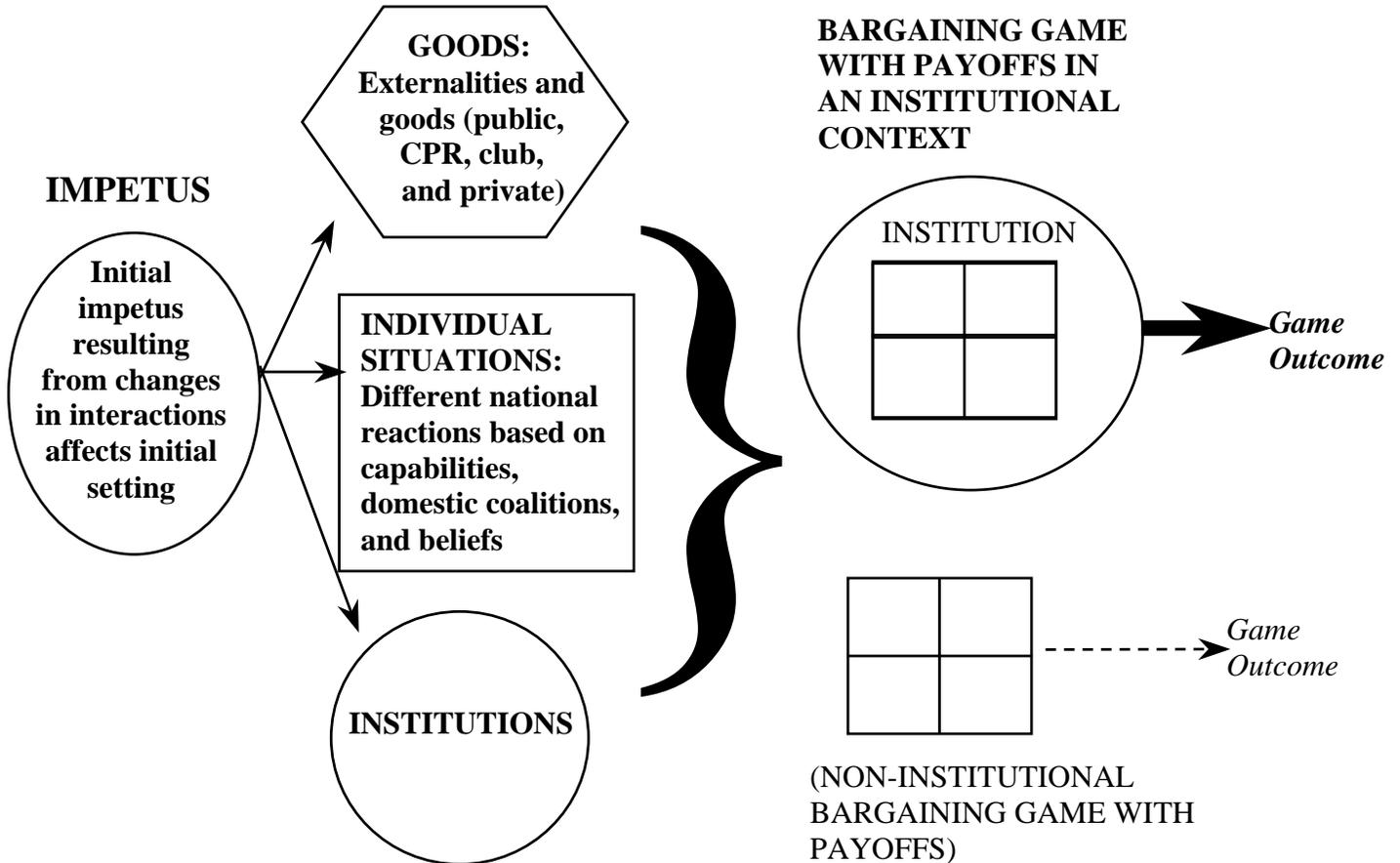
15. Aggarwal (1996) formalizes these arguments for debt rescheduling. Here my discussion is informal.

16. See Stein (1983), Snidal (1985a), Axelrod and Keohane (1985), and Martin (1992), among others.

17. See Aggarwal (1985) and below on the use of institutions to control other actors. For additional discussions, see Krasner (1991) and Knight (1992).

institutions may lead to fundamental changes in actors' basic interests and possibly facilitate greater cooperation.¹⁸

Figure 1: The “Static” Institutional Bargaining Game



Source: Aggarwal (1998a), p. 7, Figure 1.3A.

5) Constructing Institutional Bargaining Games

Combining the factors of initial impetus, goods, individual bargaining situations, and the context of existing institutions is not a simple task. Various theories, including neorealist institutionalism, neoliberal institutionalism, and constructivist approaches all address this issue in various ways, and the task of creating bargaining games is much simplified in specific empirical contexts. Without going into details on the predictions of these analytical approaches for the type of bargaining games we are likely to see,¹⁹ I instead turn to empirical examples of the

18. See, for example, Haas (1980) and the constructivist school more generally.

19. See Aggarwal (1998) for details.

influence of institutional nesting and other forms of connections on the political bargaining process.

B. Empirical Examples of the Influence of Multiple Institutions in a Static Setting

How might the presence of multiple institutional connections influence institutional bargaining games? We can consider four examples here.

1) The European Monetary System

Steve Weber's analysis of the European Monetary System's crisis and the question of what forum to use are particularly illuminating to understand the impact of nested institutions on political bargaining, particularly in the context of relatively minor institutional change.²⁰ He specifically focuses on the 1992-1993 crisis when both the British pound and the Italian lire left the EMS in the aftermath of German union following the end of the Cold War. Weber argues (in contrast to the majority of other scholars' accounts of this crisis) that the deep nesting of the EMS within the EC, exemplified by the nested substantive linkage to Maastricht, prevented the EMS from undergoing total collapse. Of particular interest for our purposes is the question of what forum would be used. As Weber notes:

The EU is made up of many potential decision-making fora where there is almost continual contact between states at many different levels. Looking at how issues get tracked into decision making channels would be one way to start differentiating nested regimes from institutional environments. *How important are strategic games played out by state actors who try to channel crisis management decision making into that forum where their autonomous, parochial preferences are likely to be best served?*²¹ [emphasis added]

He shows how options to end the EMS through a free float of EC currencies, or a bilateral French-German fast track EMU, were rejected in favor of continued exchange rate coordination through the EMS. In particular he argues that because of concerns about undermining Maastricht, France and Germany cooperated closely to prevent the collapse of the EMS. In his chapter, he systematically traces the interests of different actors and shows how the EU's nested institutions constrained their action. As Weber succinctly puts it:

France and Germany could have gone ahead and dropped the broader scope of European integration to save their bilateral ties. They still could do so. The range of discussions over forging a "hard-core"—more precisely, over what that would mean—show that this kind of option is not outside the scope of cognitive possibilities. But if my argument here is correct, it is outside the scope of

20. Weber (1998).

21. P. 81.

political possibilities set by the logic of nested institutions.²²

Ironically, the end result of the crisis from Weber's viewpoint was not a weakening of the EU, but rather its strengthening as member states successfully overcame the exchange rate crisis.

2) Coping with the Aftermath of the Yugoslavian Crises

Beverly Crawford deals with the response of European states to the end of the Cold War and subsequent civil war in Yugoslavia. She shows how the weakness of the meta-regime underlying existing European security institutions prevented them from coping with the break-up of Yugoslavia and the war in Bosnia. At first, EC members sought to use their own existing institutions without involving broader global institutions. But as debate continued over which institutions to use, Germany pursued a policy of unilateral recognition of Croatia and Slovenia, which undermined joint European coordination efforts.

In this case, then, as the institutional bargaining game approach allows, actors can choose not to work within existing institutions. Crawford notes, however, that this action had several negative spillovers that created an impetus for a more concerted effort to use the existing institutions. The problems included greater awareness of the dangers of unilateral action, greater involvement by broader institutions and the U.S., and eventual recognition of Bosnia as an independent state that led to a widening of the war. Crawford goes on to show how the effort to work out some type of nested relationship among the existing institutions failed, leading to an institutional division of labor that could not cope adequately with the crisis. But as she notes, this was more in the nature of a tactical horizontal connection among issues, rather than a true substantively agreed-upon arrangement that would endure in coping with the crisis. As she puts, because of the "lack of a cognitive consensus on a common definition of the European security problem and on agreeing on an appropriate institutional hierarchy, an empty institutional 'nest' will be constructed." The chapter thus highlights the difficulty in modifying relationships among existing institutions when the broader institutions themselves are poorly institutionalized.

3) EU Relations with the African, Caribbean and Pacific (ACP) countries

John Ravenhill has analyzed the bargaining over Europe's relationship with the ACP group of countries in a chapter entitled "Back to the Nest."²³ Ravenhill systematically shows how the transformation of the GATT into the WTO with a stronger dispute settlement mechanism dramatically influenced the domestic and international political process of EU relations with the ACP countries. In particular, the precipitating factor that he identifies is the ruling against the EU on the banana case in the mid-1990s.²⁴ Under the Lomé agreement, the EU had given preferential access to its market for ACP countries. The case arose as a result of actions taken by the U.S. and Central American countries against this preferential access (club goods for ACP).

22. P. 82.

23. Ravenhill (2004).

24. See the discussion by Alter and Meunier (2006).

When the GATT first ruled against the EU in this case, the EU secured a temporary GATT waiver to continue this preferential treatment.

Yet the nested institutional context of the Lomé agreement with the broader trading regime posed an interesting dynamic that led to a key “initial impetus” that would lead to transformation of the Lomé accord. With the transformation of the GATT into the WTO in 1995, the EU now found itself having to seek a WTO waiver. As Ravenhill notes, this development “was seized upon by those elements in the EU that wished to see a new basis established for relations with less developed countries.”²⁵ The bargaining that subsequently took place created a new agenda for the EU’s relations with the ACP countries. As a consequence, the EU embarked on a new approach to its relations with the ACP countries with a new institutional relationship, an issue I consider in Section III on institutional change efforts.

4) Textile and Apparel Trade

In the post-World War II period in textile and apparel trade, we have seen both an interesting pattern of politics within the GATT, within the LTA and MFA nested within the GATT, and now politics in the post-MFA era within only the WTO. Here, I do not focus on efforts to change the regimes but mainly on the political process within these different institutional contexts.²⁶

The preexisting institutional arrangement of the GATT clearly influenced the nature of politics in both the importing and exporting countries. To take just a few examples, the GATT constrained the use of import quotas and thus encouraged the U.S. to pursue export restraints by Japan and others in the form of voluntary export restraints to avoid violating the GATT in the face of the “initial impetus” of rising textile and apparel imports. When the U.S. industry lobbied for greater U.S. governmental involvement in the terms of the agreement, the U.S. became concerned about pressure for a unilateral accord that would violate the GATT and undermine broader nested system concerns that the U.S. had in the overall security system. The result was yet another VER, albeit with greater U.S. government involvement in the negotiations.

Following the creation of the Long Term Arrangement on Cotton Textiles in 1962, the politics of trade restraints grew more complex in this environment of multiple institutions. In 1965, the U.S. linked the renewal of the LTA to more liberal access to its market by lowering tariffs through the GATT Kennedy Round negotiations. And LDCs that had benefited under the LTA by securing large quotas also found LTA renewal to be in their interest. To increase pressure for renewal of the LTA, the U.S. also pursued both bilateral trade negotiations and hinted at threats of unilateral action, leading to a complex multifaceted institutional bargaining strategy. As to domestic interest groups, the existence of the LTA as a textile-specific regime provided a focal point and led U.S. groups to increase pressure on the U.S. government to expand the scope of the regime to encompass wool and man-made products. The end result was the creation of the MFA in 1974, an agreement that lasted until 2005.

25. Ravenhill (2004), p. 129.

26. See Aggarwal (1985) for a detailed discussion of regime change efforts.

During the MFA period, to note just a few examples, the nested connection between the GATT and MFA clearly affected political strategies. For example, as the EEC faced greater competition in the 1970s, it sought to differentiate among parties to the MFA who were members of the GATT and those who were not, to allow it to be more restrictive toward non-GATT members despite the rules of the MFA. Another example concerns the link between the MFA and broader negotiations. For example, a U.S. position paper noted that the American regime proposal “minimizes the likelihood of the meeting deteriorating into strong north/south dialogue that could spill over to other fora.”²⁷ Finally, a clear connection between the MFA and the GATT came with the agreement to phase out the MFA over a 10-year period starting in 1995 as an enticement to conclude the Uruguay Round negotiations that led to the creation of the WTO.

Currently, in the absence of a textile and apparel-specific regime, we have seen a use (and misuse) of WTO rules and procedures as the U.S. and EU respond to domestic political pressures to restrict imports from China.²⁸

III. THE POLITICS OF GAME CHANGE, INSTITUTIONAL CHANGES, AND INSTITUTIONAL RECONCILIATION

Faced with the payoffs that result from their initial strategic interaction, actors may simply accept the outcome of their bargaining. But the game may not simply “end” at this point: indeed, actors are likely to make efforts to alter the bargaining game in which they find themselves to improve their payoffs in a new game structure.²⁹ It is to this latter possibility that we now turn. The political process of institutional change is often more interesting than simply focusing on the implications of institutional connections for a static bargaining game.

When will actors make efforts to promote game change? Logically, they consider their existing payoffs in the current bargaining game and compare these with their projected payoffs from instituting some form of game change. To make this calculation, states evaluate their ability to secure more favorable outcomes by assessing their own power resources in light of their own individual situation and that of their opponent(s). Figure 2 identifies the choices that actors might make in the initial bargaining game in an effort to improve their payoffs.

As Figure 2 illustrates, based on the model that I have discussed, actors have three options when facing unfavorable payoffs.

- First, actors can attempt to directly manipulate the types of goods involved in negotiations, say, by forming an alliance that excludes other actors.

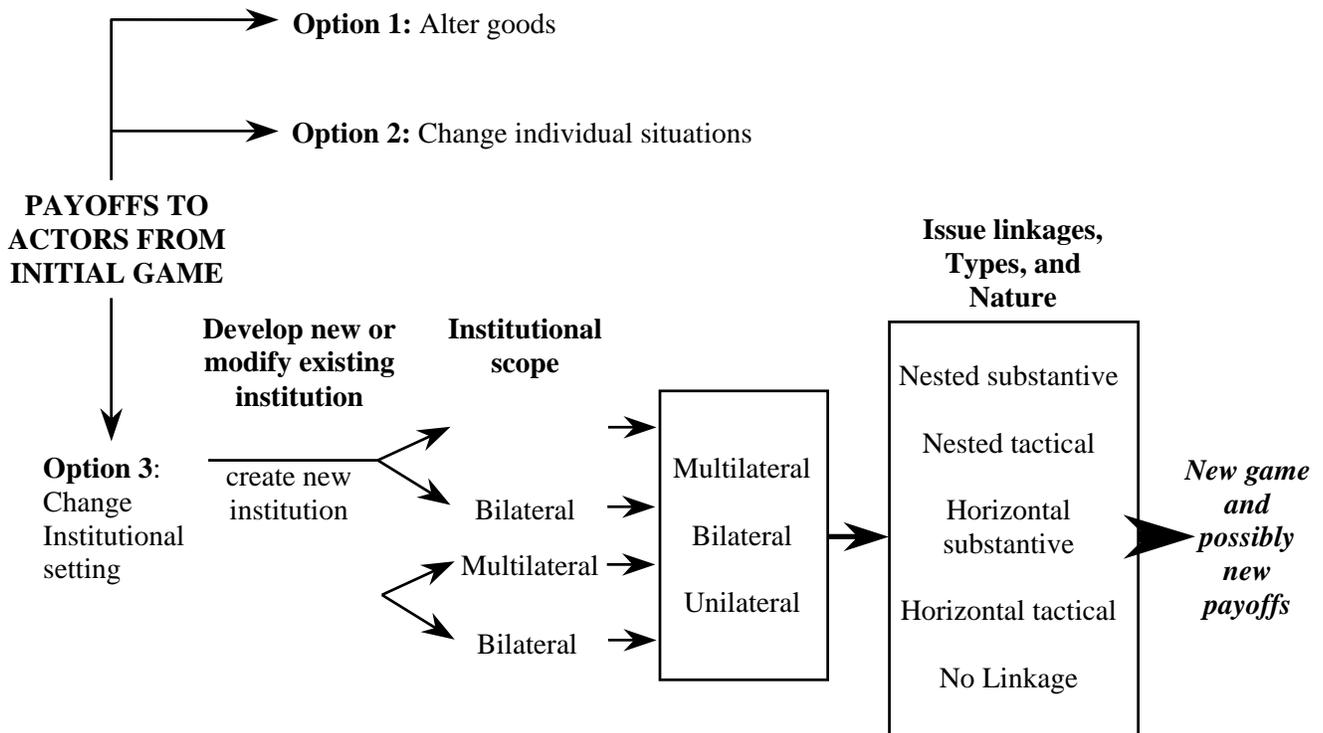
27. Quoted in Aggarwal (1985), p. 168.

28. Lawton and McGuire (2005).

29. See Aggarwal (1996) for a discussion of game change efforts in debt rescheduling. For applications to other issue areas, see Aggarwal and Allan (1993). While from a game theoretic standpoint the choices that actors make in subsequent bargaining rounds are simply choice points in an elaborate extensive form bargaining game, the notion of “game change” efforts provides a useful metaphor. This idea allows us to distinguish between the repeated play of the game within existing constraints, and efforts to improve one’s payoffs by modifying the constraints themselves.

- Second, actors can pursue strategies to alter either their own or their opponent(s)' individual situations. These could include such efforts as overthrowing governments, building up one's own capabilities in specific issue areas, or attempting to change the views of decisionmakers in other countries.
- Third—and the primary focus of this memo—actors can change the *institutional context* within which they operate.

Figure 2: Institutional Game Change Efforts



Source: Aggarwal (1998a), p. 14, Figure 1.3B.

Actors seeking to make game changes by using *institutional* strategies to alter games and influence bargaining outcomes must make several additional decisions. Specifically, they must (1) decide if they would be better off by creating a new institution or modifying the existing one(s); (2) choose the characteristics of the institution that they want; (3) select the bargaining route they want to follow to achieve their ends; and (4) decide whether to engage in issue linkages, and if so, the type and nature of these connections as they seek to reconcile possible institutional overlap. In each case, we also briefly consider some theoretical arguments about these choices.

A. Institutional Change Efforts

1) Creating New or Modifying Existing Institution(s)

Excluding the creation of an institution *de novo* in a non-institutional context and non-institutional bargaining, actors can either use or modify existing institutions or develop new ones and reconcile them with existing arrangements.

Based on simple inertia alone, we would expect that actors' first instinct will be to utilize or modify an existing institution to their advantage, rather than to pursue development of a new institution. Both neorealists and neoliberal institutionalists agree with this perspective.³⁰ New institutions are expensive to create. Thus, if actors can achieve their objectives by simply modifying an existing institution, this will likely be the preferred course. In the Tokyo Round, for example, major powers modified the Most Favored Nation norm of the GATT in order to prevent developing countries from free riding—that is, they decided to allow the benefits of trade liberalization only to those countries that signed onto specific codes (subsidies, government procurement, etc.).³¹

Yet, if the institution has repeatedly failed to “deliver the goods”—even with modifications—then institutional innovation will be the logical option. In other words, when faced with unsatisfactory payoffs, states may seek to create a new institution, be it on a sectoral or regional basis.³² For example, when several states in the Asia-Pacific became worried about the prospects for a successful conclusion to the Uruguay Round of trade negotiations, but at the same time did not wish to undermine the GATT, they decided to pursue the formation of Asia-Pacific Economic Cooperation (APEC) within a GATT umbrella.

One of the key issues in choosing whether to alter existing institutions or create new ones relates to the goods that are involved in the negotiations. If an existing institution is providing valued goods, it might be possible for actors to link the provision of goods in one arena with the provision of goods in another arena. Thus, given the organizational and informational benefits of an existing institution, actors may be reluctant to “free ride” in another area for fear of undermining the existing institution. With respect to new institutional creation and reconciliation, particularly in a nested context where goals in the new institution are subordinate to higher-level concerns in a broader institution, a similar incentive for actors to work together to provide public goods or CPRs may exist. That is, actors may be willing to risk cooperation in light of possible defection because of their concerns for meeting their superordinate goals.

30. On this issue, see Keohane (1984) and Haggard, Levy, Moravcsik, and Nicolaidis (1993), p. 181.

31. See Krasner (1979) and Grieco (1990) on this issue.

32. See the discussion below on linkage types and sectoral and regional institutions.

2) Characteristics of Institutions: Institutional Scope, Strength, Nature

If a state decides to pursue the formation of a new institution, it must decide on its institutional scope: bilateral (such as the Canada-U.S Free Trade Agreement) or multilateral (for example, APEC). It must also decide on the institution's specific characteristics such as the strength and nature of the arrangements. But if a state decides that a new institution is undesirable, it could still work to modify it, possibly by changing its institutional scope (as with the expansion of the Canada-U.S. Free Trade Agreement to include Mexico).

Institutional characteristics will be affected by several factors.³³ With specific respect to our interest in examining the issue of multilateralism vs. bilateralism, we would expect different predictions from neoliberals vs. neorealists. Neoliberals would expect that multilateralism would be the preferred avenue to reduce transaction costs and provide the widest dissemination of information. By contrast, from a neorealist perspective, unless an actor is exceptionally strong, it might prefer bilateral over multilateral arrangements to maximize its leverage.³⁴

Second, the choice of a multilateral versus a bilateral institution will be affected by the type of institutions that already exist. Thus, for example, I have argued that the norm of multilateralism in the GATT strongly constrained the formation of the Short and Long-Term Cotton Textile Agreements in 1961-2. This outcome can be explained as the result of actor concerns about institutional nesting, and fears that bilateral and unilateral actions would undermine this GATT norm *independent* of the benefits of reducing transaction costs through a multilateral arrangement.³⁵ By contrast, without strong substantive linkages among issues, the decision between a multilateral or bilateral institution will be more influenced by transaction and control considerations.

Third, the question of the choice between a multilateral or bilateral approach to institutional formation can be considered from a more cognitive perspective. In a volume edited by John Ruggie,³⁶ a number of scholars argue that this choice derives from the preferences of states who fundamentally believe in the value of organizing the world system on a multilateral basis. Thus, they are not concerned with the number of states involved in an activity, but rather with examining state commitments to norms of collective action. In doing so, these analysts go beyond the neoliberal institutionalist view of multilateralism as simply a means for reducing transaction costs.

3) Bargaining Route

As indicated in Figure 2, states may choose to bargain multilaterally, bilaterally, or take unilateral actions to achieve their ends.³⁷ Turning first to the bargaining route within an existing institution, although multilateral negotiations in a multilateral institution are common, states can also pursue bilateral and unilateral strategies despite the existence of a multilateral institution.

33. For a discussion of the factors that influence the strength and nature of regimes, see Aggarwal (1985).

34. For a discussion of these ideas, see among others Diebold (1952), Keohane (1984), and Gilpin (1987).

35. Aggarwal (1995).

36. See Ruggie (1992).

37. On the use of unilateral, bilateral, and multilateral approaches, see Diebold (1952), p. 36.

For example, even though the U.S. was involved in the Uruguay Round trade negotiations, it continued to discuss specific issues with Japan on a bilateral basis and took unilateral actions with respect to other states using specific GATT provisions.

What about the use of different bargaining routes for the creation of a new institution? In the case of multilateral arrangements, multilateral strategies can include coalition building efforts. States can also use bilateral and unilateral strategies by “imposing” agreements on other states through either bipolar cooperation or hegemonic imposition. By contrast, if the institution in question is a bilateral one, it is less theoretically obvious how states might pursue a multilateral bargaining route. An example of this could be when actors engage in multilateral negotiations and then decide on an appropriate bilateral regime for a subset of the states involved.

On what basis do actors decide to adopt one particular bargaining route over another? The classic argument in this regard is a neorealist institutionalist one with the view that hegemonic states will be tempted to develop regimes. Other work in this genre has shown that like-minded states may be able to cooperate on a bilateral or multilateral basis to secure regimes and need not always fall victim to collective action dilemmas.³⁸

B. Linkages and Institutional Reconciliation

1. Linkages

The final decision node in Figure 2 concerns an actor’s decision to link either issues or institutions in negotiations (or to keep them independent). In addition to choosing whether or not to engage in linkage formation, they must also make two other choices: the type of linkage (nested or horizontal) and the nature of the linkage (tactical or substantive).³⁹ We have already reviewed different types of institutional linkages. With respect to the nature of linkages, if two or more issues are seen to be unrelated but become tied together in negotiations, this can be considered a power-based connection or tactical link. By contrast, if the issues exhibit some intellectual coherence, then the linkage can be labeled substantive. In the first case in this chart, we have a case of substantive linkage, which will likely result in the creation of a stable issue-area and most likely a stable institutional arrangement.

The second type of manipulated linkage, “failed substantive linkage”, is more complicated. Here, even though experts agree that two issues are interconnected (e.g. access to markets for trade and the ability to service debt), policymakers in the target country do not recognize the issues as substantively linked. Instead, they perceive the issues as only tactically related.⁴⁰ Without changes, even though the target actor treats the issues as connected, this will prove to be only a temporary solution to the externalities problem, unless for example, experts in both

38. See Snidal (1985b).

39. For a discussion of tactical and substantive linkages, see Oye (1979), Stein (1980), and E. Haas (1980), among others. Building on Haas’s contributions in particular, I elaborate on the nature of linkages in Aggarwal (1996) from which a portion of the following discussion is drawn. For a discussion of these issues in more detail, see Aggarwal (1998a).

40. Haas (1980) refers to what I term “failed substantive” and “failed tactical” linkages as “fragmented” linkages, but does not distinguish between the two different types identified here.

countries sway decisionmakers' opinions. Thus, over time, with changed causal understanding, we may see a move to institutions based on substantive linkages.

The third type of link, tactical linkage, may foster even greater conflict. This method of connecting issues is a pure power play. If it is used as a positive inducement, it can diminish conflict. But if used as a stick, tactical linkages will create sharp conflict in negotiations and will most likely lead to unstable agreements or institutions.⁴¹

Finally, in the last case, misperceived tactical linkages, policymakers in the target country see the issues as substantively linked—even though they are only linked tactically. Although the target decisionmakers' own experts will attempt to dissuade their policymakers from accepting the linkage, target decisionmakers may agree to some type of joint agreement and consider the issues in question as a package. Clever manipulation by the linker could produce considerably more favorable outcomes than might otherwise be the case. But because it is based on a misunderstanding, this is an unstable situation and will lead to unstable institutional formation.

FIGURE 3: THE DYNAMICS OF ISSUE-LINKAGE

LINKAGE TYPE	“OBJECTIVE” REALITY	TARGET DECISION MAKERS’ PERCEPTIONS	BASIS FOR ISSUE CONNECTIONS	OUTCOME
Substantive link	Connected	Connected	Knowledge	(1) Stable issue-area
Failed substantive link (perceived as tactical)	Connected	Unconnected	Power	(2) Temporary solution to externalities
Tactical link	Unconnected	Unconnected	Power	(3) Unstable issue-area
Failed tactical link (perceived as substantive)	Unconnected	Connected	Misunderstanding	(4) “Contingent” (to unstable issue-area with knowledge change)

Source: Aggarwal (1998a), p. 17, Table 1.1.

41. See E. Haas (1980) for a discussion of this type of outcome.

2) Reconciling Institutions

We can now look at the possible outcomes resulting from efforts to either modify or create and reconcile institutions on the one hand, and the types and nature of linkages on the other.⁴⁰ In each of the two rows of Figure 4, the top and bottom entries (separated by dotted lines) reflect a convergence and divergence of perceptions on linkages, respectively.

Modifying Existing Institution(s). We can begin our discussion by focusing on the first major row -- a decision to modify existing institution(s). There are two possible types of linkages that we must consider, in addition to the possibility of no linkages.

The first example (1) reflects a case of nested substantive linkages. The relationships among issues in the IMF under the Bretton Woods system were clearly ordered. Fixed exchange rates were the crucial concern. Within that context, gold provided the basis for backing the dollar. The dollar played several key roles including the numeraire, the intervention currency, and the like and there was widespread agreement on this structuring. By contrast, in the second case, the EMU convergence targets for debt, government spending, interest rates, and inflation, have proved controversial. The Germans and some others see this as a natural economic connection between the higher-level objective of monetary union and the subordinate goals necessary to achieve smooth progress toward fixed exchange rates in the Union. But some Southern European members of the EU have exhibited considerable skepticism about this claim (2), viewing the connection as a tactical effort by the Germans and other Northern Europeans to control their economic policies.

The next case (3) provides an example of a tactical linkage. Almost all states recognized that the decisionmaking structure with the dominance of the Security Council over the General Assembly in the United Nations was a tactical consideration based on the power of the major players in the system. The fourth case of nested linkages (4) contains an example of aid to Lomé convention members for commodity price stabilization. From the perspective of the poorer members of this agreement, this is a substantive connection to stabilize markets. But from the perspective of many EC members, this was simply a tactical exchange tied to political and economic interests in maintaining the Lomé agreements.

Moving across the chart to the case of horizontal linkages, the relationship between the IMF and World Bank provides a good example of horizontal substantive connections with respect to financial assistance. In the Bretton Woods system, the IMF was to engage in short-term lending to help countries facing balance of payments difficulties to adjust. Meanwhile, the World Bank would provide longer-term loans to help improve the functioning of countries' economies. The second case, the connection between services and manufactures in the GATT Uruguay Round, provides an example of differing views involving negotiations within an existing institution. Whereas the U.S. saw this connection as a substantive one, many developing countries argued that this was merely a tactical ploy, and that services had no place in GATT negotiations. In the end, the negotiation proceeded on two separate tracks, but there was an implicit connection between the two.

40. For ease of presentation, I have left out the type of institution and the bargaining strategy that actors might pursue to accomplish their ends.

Moving to tactical horizontal linkages, the notion of weighted voting is clearly seen as a power-based decision. In the IMF, countries are allocated voting shares based on economic criteria. While the indicators of economic wealth have come under increasing challenge, there is little question that this linkage is tactical in nature. Finally, in this set, calls for special and differential treatment for the developing countries have been seen as a tactical concession to facilitate trade liberalization by the developing countries. Thus, developed countries have repeatedly made special provisions in negotiating rounds—dating back to the Kennedy Round and now in the Uruguay Round—that allows for delays in the implementation of WTO provisions. By contrast, this effort has been viewed by many developing countries as a substantive logical connection deriving from their relatively uncompetitive position.

In this row, the last example reflects a case of no linkage. The old GATT dispute settlement body provides a forum for the resolution of issues without linkages to other concerns. In an ideal setting, these institutional mechanisms are to deal with the specific issue brought up for resolution by member states, without connections to other issues.

Reconciling New and Old Institutions. We next turn to the second half of Figure 4. I have already discussed the WTO and APEC connection as one that explicitly argued for a new arrangement in the Asia-Pacific that would be consistent with actors' higher-level concerns about continuing trade liberalization through the GATT. The bottom of this first cell presents a case of what some view as substantive nesting being perceived by others as tactical. The nesting of the MFA within the GATT was seen by developing countries to be a tactical ploy to restrict their imports, and the claims of GATT consistency were argued to be a sham.

Moving to the next column, we have a case of tactical linkages. In this example, the connection between APEC and the East Asian Economic Caucus (EAEC), all parties recognize that this linkage exists because of pressure by Malaysia to create a separate grouping that would exclude North America and Oceania. Although some lip service is paid to the notion that this grouping is substantively connected, no one really thinks this is a credible view and nearly all see this as a tactical connection.

Finally, as an example of a tactical link being perceived as substantive, we can consider the case of the Global Environmental Fund and its connection to the World Bank following the Rio environmental summit. From the developing countries' point of view, the promise of aid was a natural logical connection to broader financial aid organizations such as the World Bank. But developed countries have a more jaundiced view of this linkage, and generally see it as a tactical payoff to get developing countries to reduce harmful emissions.

The third column in this row addresses the use of horizontal substantive linkages. When the IMF was created in 1944, it was initially seen to be conflict with the Bank for International Settlements.. But within a few years, the relationship between the two stabilized in a division of labor that actors have accepted as logical. Turning first to an agreed substantive linkage in the first cell, consider the cooperation between UNCTAD and GATT on trade enhancement. In this case, GATT's interest in trade liberalization was compatible with UNCTAD's focus on promoting exports, at least in the minds of developed countries. These two institutions have

been partially reconciled through the formation of a Trade Development Center,⁴² although developing countries remain more skeptical about this connection and perceive it more as a tactical linkage.

The fourth column examines the case of horizontal tactical linkages among institutions. The decision to create UNCTAD and its relationship to the GATT in the various trade rounds has been seen by all countries as a tactical development resulting from developing countries' pressure to create a forum for their interests. While negotiations continue in the GATT, UNCTAD often serves as a forum in which developing countries can get advice on how to improve their bargaining skills and obtain information about the issues involved. The fourth case concerns an example of a horizontal tactical link that is perceived as substantive. As Benjamin Cohen has argued, when the U.S. proposed the Financial Support Fund as a tactical linkage to encourage development of the International Energy Agency, the French saw this as a substantive link connected to helping countries facing balance of payments difficulties.⁴³

Finally, the last column in the table presents an example where no effort is made to reconcile institutions. Put differently, this is an example of a case of the persistence of independent institutions with no effort to make them compatible. An example would be the World Health Organization and the International Telecommunication Union, which traditionally have dealt with quite disparate issues.

42. Another example, mentioned earlier in this chapter, is the horizontal substantive link between the IMF and World Bank.

43. Cohen (1998).

FIGURE 4: LINKAGE BARGAINING AND INSTITUTIONAL ADAPTATION

		Linkage Type				
		Nested Linkage		Horizontal Linkage		No Linkage
		Substantive	Tactical	Substantive	Tactical	
Use or Modify Existing Institution or Institutions	1. Stable hierarchical link between issues within existing institution or between institutions <i>Role of dollar, gold, and exchanges rates in IMF</i>	3. Contingent, hierarchical link between issues within existing institution(s) (to independent or conflict with power change) <i>Security Council vs. General Assembly role in the UN</i>	1. Stable, intra- or cross institutional link between related issues <i>IMF and World Bank</i>	2. Contingent, intra- or cross institutional link between issues (to independent with power change) <i>Voting power and economic standing criteria in IMF</i>	Institutionally-based negotiations on single issue <i>GATT dispute settlement body</i>	
	2. Temporary hierarchy between issues within existing institution(s) (target perceives link as tactical link) <i>Southern Europe view of EMU convergence criteria</i>	4. Unstable, hierarchical link between issues within existing institution(s) (if target perceives link as substantive link) <i>Commodity fund aid within Lomé convention</i>	2. Temporary, intra- or cross institutional solution to externalities (target perceives link as tactical link) <i>Services & manufactures in Uruguay Round (LDC view)</i>	4. Unstable, intra- or cross institutional link between issues (target perceives link as substantive link) <i>Special and differential treatment for developing countries in the GATT (LDC view)</i>		
Create and Reconcile New Institution with Old Institution or Institutions?	1. Stable, hierarchically compatible institutions for related issues <i>WTO-APEC</i>	3. Contingent, hierarchically compatible institutions for issues (to independent or conflict with power change) <i>APEC-EAEC connection</i>	1. Stable, compatible inter-institutional link for related issues <i>IMF and BIS connection</i>	3. Contingent, inter-institutional compatibility for issues (to independent with power change) <i>GATT vs. UNCTAD role in global trade negotiations</i>	Independent institutions (no concern for compatibility) <i>World Health Organization and ITU</i>	
	2. Temporary, hierarchically compatible institutions for issues (if target perceives link as tactical link) <i>MFA within the GATT (LDC view)</i>	4. Unstable, hierarchically compatible institutions for issues (if target perceives link as substantive link) <i>Global Environmental Fund and World Bank (LDC view)</i>	2. Temporary, inter-institutional compatibility between issues (target perceives link as tactical link) <i>GATT-UNCTAD Trade Development Center (LDC view)</i>	4. Unstable, inter-institutional compatibility for issues (target perceives link as substantive link) <i>Financial Support Fund and the International Energy Agency (French view)</i>		

C. Empirical Examples of the Influence of Multiple Institutions in a Dynamic Setting

We can consider some empirical examples of how institutional connections influence bargaining efforts to promote institutional changes.

1) Beyond Lomé?

We can return to John Ravenhill's analysis of the EU's relationship with the ACP countries as an example of efforts to change the nature of the institutional bargaining game. As noted in Section II, the EU used the opportunity of the ruling against it in the banana case to alter its institutional relationship with the ACP countries. How was this done? In this case, the EU pursued an integrated strategy to change individual situations in the form of beliefs and coalitional interests as well as the institutional context itself.

With respect to interests, in this case the Commission decided to remove responsibility for trade with the ACP from the Development Directorate to the Trade Directorate, leading to what Ravenhill characterizes as "a clear signal of the Commission's intentions that trade with the ACP should be subordinate to the overall principles of EU external trade relations."⁴⁴ And with respect to an effort to possibly change beliefs about the appropriate relationship between the EU and the ACP countries, the Commission issued a "Green Paper" that called for the creation of regional economic partnership agreements (REPAs). Arguments in the paper included the benefits of linking the EU with specific newly created regional groupings around the world that would foster greater subgroup integration and increase the attractiveness of these new groupings as investment opportunities.

In short, the EU declared its clear intention to dramatically change the institutional context by creating new institutions with regional scope. Moreover, the approach called for relatively strong arrangements that would lock in trade policy reforms in the ACP countries. The bargaining route would be multilateral/bilateral with the EU on one side and the new REPA groups on the other. Finally, in terms of reconciling the new groupings with the WTO, each of the accords was to be made compatible with GATT Article 24 (which allows the creation of free trade agreements and customs unions).

Ravenhill remains skeptical of the ability of the former ACP members to come together in regional groupings and create new interregional accords, but this set of negotiations has not yet played out.

2) A New Nest? The European Economic Area

Cédric Dupont has nicely analyzed the politics process of creating a new umbrella accord that would incorporate the EU and EFTA.⁴⁵ Following the Single European Act (SEA) that set the EC members on the path to European Union, EFTA members began to worry

44. Ravenhill (2004), p. 131.

45 Dupont (1998).

about their position vis-à-vis the EC. Still, for the most part, they continued to emphasize the horizontal substantive linkage between the two existing organizations and pursued functional cooperation with the EC, particularly through the so-called Luxembourg process. After Central and Eastern European states called for closer economic relations with the EC, EFTA and the EC moved toward development of an overarching institution to manage the relationship between these two institutions. This effort resulted in the formation of the EEA with the EU nested partially (because some policy domains remained outside the EEA) and the EFTA fully nested within this broader arrangement, and the EEA in turn being nested firmly within the GATT. There was, however, disagreement on the nature of this nesting, with substantive reasons for the relationship based on integration principles. But a tactical logic for members of these organizations was also at work: the EC saw this relationship as a way of leveraging the EEA against U.S. demands in the GATT, while EFTA members saw the EEA in the context of possible accession to the EC. Because of the way the EEA was negotiated, some EFTA members began to worry about their ability to influence EC policy, and the EEA began to face difficulties.

Dupont shows why the EEA failed to fulfill its initial mandate. He argues that although there was a strong basis for a substantive nested linkage of the existing institutions inside the new one, the salience of the EC precluded such smooth nesting. EC countries resisted giving too many privileges to EFTA countries, forcing the development of an asymmetric institution that EFTA countries, under severe domestic pressure, had no reason to stick with. Without their support, the new institution could not provide the common pool resource of pan-regional stability, leaving the EC with not only growing demands from Central and Eastern Europe but with almost all EFTA countries knocking at their door.

In the end, the outcome was partial defection from EFTA as the majority of EFTA's member states sought complete EC membership -- thus leading to an outcome of a nested substantive connection of membership in the EC. In sum, despite considerable time and effort, the creation of a new nested substantive institution proved to be a failure but was marked by important domestic, national, and regional politics and strategies.

IV. CONCLUSION

Our marching order from the conference organizers is to consider how nested and overlapping institutions influence domestic and international bargaining. This memo has focused on these issues, with an initial analysis of the origin of the concepts of nesting systems and nested regimes and institutions. I then argued that it is useful to consider different two other concepts, including horizontal linkages (a division of labor among institutions) and independent institutions, both with respect to issue-areas and regions.

The second section of the memo considered what I have termed an institutional bargaining game to look at bargaining processes, both in an institutional and non-institutional context. As I suggested, following an initial impetus, a bargaining game defined by types of goods, individual situations, and the institutional context is set in

motion. Actors then bargain and achieve varying payoffs based on the structure of the game, resulting in a new institutional equilibrium. Empirically, I considered the work of several scholars in the areas of monetary relations, post-Yugoslavian conflict, EU relations with the ACP countries, and textile and apparel trade. The institutional context proved to be highly significant in affecting both domestic and international bargaining, and the presence of a multiplicity of institutions clearly affected the agenda setting process, actors' bargaining strategies, and actual outcomes.

Going beyond a relatively static analysis of how existing institutional linkages influence bargaining processes, I have argued that one strategy that actors could pursue is to directly alter the types of goods in an issue and/or the individual situations of their counterparts. Aside from these strategies, actors could also push for the modification of existing institutions or the creation of new ones in an effort to improve their bargaining situation. In pursuing such a strategy, they must then decide on the characteristics of the new or modified institution and the bargaining route to achieve their ends. If institutions are significantly modified or new ones are created, the problem of institutional reconciliation often comes to the fore. Actors are then likely to maneuver to engage in different types of linkages to influence the institutional context within which institutions will be reconciled with pre-existing ones. This political process of creating or modifying new institutions reflects both the efforts of domestic and international actors to achieve their desired outcomes. Two empirical cases, one that focuses on the dynamics of the evolving post-Lomé world, and another on the efforts to create an umbrella arrangement linking the EU and EFTA nicely illustrate many domestic, regional, and international bargaining processes.

As this theoretical and empirical analysis has shown, understanding how institutional linkages influence bargaining processes is indeed a fruitful area for research. We have much to thank our organizers in stimulating us to think about these issues.

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This paper provides information on institutional features and policy practices of investment guarantee programmes, reviews the institutional features of the public and private segments of the political risk insurance market and identifies issues of potential relevance for the investment policy community. Typically, international investment projects for which such insurance is sought are located in developing countries. In recent years, the value of investment guarantees has averaged about 3% of total FDI flows, but about 30% of FDI inflows to developing countries. Thus, investment guarantees a This chapter introduces the institutional environment matrix (IEM), a diagnostic and planning framework designed to analyze complex institutional environments and determine the institutional fit of...¹

¹ Aggarwal VK (2005) Reconciling institutions: nested, horizontal, overlapping, and independent institutions. Working paper. University of California at Berkeley, CaliforniaGoogle Scholar. Agrawal A (2008) The role of local institutions in adaptation to climate change, a paper prepared for the Social Dimensions of Climate Change. Social Development Department, Washington, DCGoogle Scholar. Agrawal A, McSweeney C, Perrin N (2008) Local institutions and climate change adaptation. In: Social development notes: the social dimensions of climate change, vol 113. ² Origin of institutions: to realize or maximize actors' value, survival of the fittest. ³ Institutional change: exogenous shocks push equilibrium to a new equilibrium. ⁴ Common questions: why do "bad"/"inefficient" institutions persist? 4. Sociological Institutionalism. ⁵ Individual must find a way of recognizing situation as well as of responding to situation. ⁶ A world of individual or organizations seeking to define and express their identity in socially appropriate ways. ⁷ Mutually constitutive character between institutions and individual action. 6. Sociological Institutions. ⁸ Problematic: why organizations take on. specific sets of institutional forms, procedures. Institutions strongly affect the economic development of countries and act in society at all levels by determining the frameworks in which economic exchange occurs.⁹ This essay aims to explain why institutions are important to economic development and to provide evidence for the arguments made. It argues that institutions support economic development through four broad channels: determining the costs of economic transactions, determining the degree of appropriability of return to investment, determining the level for oppression and expropriation, and determining the degree to which the environment is conducive to cooperation and increased social capital. Evidence is derived from the literature, from comparison of countries, and from examples at the micro I ¹⁰ Reconciling Institutions: Nested, Horizontal, Overlapping and Independent Institutions.¹¹ Presented at the Nested and Overlapping Institutions Conference, Woodrow Wilson School of Public and International Affairs, Princeton, NJ. Arter, David. 2002. ¹² On Assessing Strength and Weakness in Parliamentary Committee Systems: Some Preliminary Observations on the New Scottish Parliament.¹³