ABSTRACT We argue that European integration is provoked and sustained by the development of causal connections between three factors: transnational exchange, supranational organization, and European Community (EC) rule-making. We explain the transition, in any given policy sector, from national to intergovernmental to supranational governance, in two ways. First, cross-border transactions and communications generate a social demand for EC rules and regulation, which supranational organizations work to supply. We thus expect that Community competences will be unevenly constructed, both across policy sectors and over time, as a function of the intensity of these demands. Second, once EC rules are in place, a process of institutionalization ensues, and this process provokes further integration. Although we recognize the importance of intergovernmental bargaining in EC politics, our theory is not compatible with existing intergovernmental theorizing.

KEY WORDS Governance; institutionalization; integration; neo-functionalism; transnational society.

In this article, we propose a theory of European integration, focusing on the process through which supranational governance—the competence of the EC! to make binding rules in any given policy sector—has been constructed. We necessarily confront some of the most puzzling questions posed by the evolution of the Community. Why has integration proceeded more rapidly in some policy domains than it has in others? To what extent is the Community governed by ‘intergovernmental’ or ‘supranational’ modes of decision-making? What accounts for the relative dominance of the neo-liberal project, and for the relative failure of social democratic visions of Europe to gain influence? We do not claim to have definitively settled all controversy. But our theory yields responses to these questions, in the form of testable propositions, and intensive research has demonstrated the resilience of these propositions in a wide range of contexts.

The article also reports the results of a collaborative research project, recently completed, on European integration and its impact on policy-making. Brought together by a common concern for processes of history and institutionalization, and by a common dissatisfaction with ‘intergovernmental’ theories, the group set
out to develop a framework—a common vocabulary and heuristic—for understanding the dynamics of European integration. We then worked to transform this framework into a theory, by developing and testing causal arguments in a range of comparative case studies. Most important, we sought to explain the process through which supranational governance has emerged, widened, and deepened over time, in and across specific policy sectors.

The theory privileges the role of transnational exchange (e.g. trade, the development of Euro-groups, networks and associations, and so on) in pushing the EC's organizations to construct new policy and new arenas for policy-relevant behavior; once constituted, these arenas sustain integration in predictable ways, not least by provoking expansion in the level and the scope of transnational exchange. Some members of the group focused on the emergence and institutionalization of these arenas (Cameron 1996; Fligstein and McNichol 1996; Sandholtz 1996; Smith 1996; Stone Sweet and Caporaso 1996); others studied the consequences of institutionalization for policy-making (Pierson 1996; Pollack 1996); and still others examined the reciprocal impact of supranational governance and national politics (Stone Sweet and Caporaso 1996), and national public opinion (Dalton and Eichenberg 1996). The product, a book manuscript now in preparation, will offer a positive alternative to the intergovernmentalist framework.

The article proceeds as follows. In part I, we briefly contrast our theory with the main features of neo-functionalism and intergovernmentalism. In parts II and III, we elaborate the theory more fully, defining key concepts, discussing causal relationships between variables, and deriving hypotheses about how European integration proceeds. We also report substantive findings, where appropriate, given space limitations. In the concluding section, we clarify our differences with intergovernmentalist theories of integration.

I THEORETICAL CONTEXT

The primary theoretical divide in EC studies has been between intergovernmentalism and neo-functionalism. Endless nuance and distinction exist within each approach, but in the end most theorizing on integration endorses either the following statement or its opposite: the distribution of preferences and the conduct of bargaining among the governments of the member states broadly explain the nature, pace, and scope of integration, and neither supranational organizations nor transnational actors generate political processes or outcomes of seminal importance. In recent decades, intergovernmentalists have worked to refine their framework, and some have aggressively proclaimed its superiority (e.g. Moravcsik 1993, 1995). At the same time, neo-functionalism has gradually been abandoned. Its original adherents have moved away from integration studies, and critics of intergovernmentalism have not developed their own general theory, least of all by refining neo-functionalism (e.g. Marks et al. 1996; Pierson 1996; Sandholtz 1993, 1996; Sbragia 1993).

We set ourselves the task of developing and testing a theory of how supranational governance evolves over time. What we are seeking to explain, the nature and extent of supranational governance, varies along a number of dimensions. In some sectors,
the competence to govern is held exclusively by the Community; in others, national institutions are the primary sites of policy-making; and, in many domains, the transfer of power from the national to the supranational level has been only partial. Within the same policy sector, the answer to the question, 'who governs?,' has changed over time. And in those areas in which EC institutions have become sites of policy innovation and change, one finds variation in the relative capacity of the member state governments, acting in summits and in the Council of Ministers, to control that policy. In specifying the research problem in this way, we commit ourselves to theorizing integration as a dynamic process that yields divergent outcomes. We therefore problematize the notion, strongly implied by neo-functionalist theories, that integration is the process by which the EC gradually but comprehensively replaces the nation state in all its functions. And we reject the comparative statics of intergovernmentalists as a mode of analysis incapable of capturing crucial temporal elements of European integration.

Our theory, laid out in parts II and III below, privileges the expansion of transnational exchange, the capacities of supranational organizations to respond to the needs of those who exchange, and the role of supranational rules in shaping subsequent integration. We argue that supranational governance serves the interests of (1) those individuals, groups, and firms who transact across borders, and (2) those who are advantaged by European rules, and disadvantaged by national rules, in specific policy domains. The expansion of transnational exchange, and the associated push to substitute supranational for national rules, generates pressure on the EC's organizations to act. Generally, EC organizations, such as the Commission and the Court, respond to this pressure by working to extend the domain of supranational rules, in order to achieve collective (transnational) gains and to accomplish the purposes of the Treaties, broadly interpreted. A first hypothesis, then, is that the relative intensity of transnational activity, measured across time and policy sectors, broadly determines variation on the dependent variable (supranational governance).

We claim that transnational activity has been the catalyst of European integration; but transnational exchange cannot, in and of itself, determine the specific details, or the precise timing, of Community rule-making. Instead it provokes, or activates, the Community's decision-making bodies, including the Council of Ministers. Member state governments often possess (but not always) the means to facilitate or to obstruct rule-making, and they use these powers frequently. Nevertheless, we argue, among other things, that as transnational exchange rises in any specific domain (or cluster of related domains), so do the costs, for governments, of maintaining disparate national rules. As these costs rise, so do incentives for governments to adjust their policy positions in ways that favor the expansion of supranational governance. Once fixed in a given domain, European rules – such as relevant treaty provisions, secondary legislation, and the European Court of Justice's (ECJ's) case law – generate a self-sustaining dynamic that leads to the gradual deepening of integration in that sector and, not uncommonly, to spillovers into other sectors. Thus, we view intergovernmental bargaining and decision-making as embedded in processes that are provoked and sustained by the expansion of transnational society, the pro-integrative activities of supranational
organizations, and the growing density of supranational rules. And, we will argue, these processes gradually, but inevitably, reduce the capacity of the member states to control outcomes.

Our theory has important affinities with neo-functionalism. We acknowledge the insights of two of the founders of integration theory, Karl Deutsch and Ernst Haas. On crucial questions, we believe, they got it right. What we find complementary are Deutsch's emphasis on social exchange, communication and transactions, and Haas's attention to the relationship between global interdependence, political choice, and the development of supranational institutions.

Deutsch and his collaborators held that increasing density of social exchange among individuals over prolonged periods of time would lead to the development of new communities (shared identity) and, ultimately, to the creation of a super-state with centralized institutions (e.g. Deutsch 1953; Deutsch et al. 1957). We agree that social exchange across borders drives integration processes, generating social demands for supranational rules, and for higher levels of organizational capacity to respond to further demands. If this demand is not supplied, the development of higher levels of exchange will be stunted. We set aside Deutsch's concern with the formation of communities and identities, per se, and the issue of whether or not identity formation precedes state-building. Our dependent variable remains mode of governance, not the construction of a pan-European identity or of a super-state.

Haas (e.g. 1958, 1961) conceived of integration as the product of growing international interdependence and pluralist, interest-driven politics. Mitrany had theorized what would happen in a world increasingly beset by policy problems that transcended national borders: governmental functions would steadily migrate from national governments, who would act on the basis of 'politics,' to global technocrats, who would act on the basis of expertise. Haas recognized that the transfer of functions to supranational bodies would always be intensely contested, as some groups foresaw gains while others feared losses. He consequently saw the initial construction of supranational authority as the crucial political hurdle. Stripped down, Haas's neo-functionalist argument runs something like this. Some élite groups (leadership of political parties, industry associations, and labor federations) begin to recognize that problems of substantial interest cannot be solved at the national level. These groups push for the transfer of policy competence to a supranational body, finding each other and establishing cross-national coalitions along the way. If the problem is important enough and pro-integration élites are able to mount sufficient political leverage, governments establish supranational institutions.

Once supranational institutions are born, a new dynamic emerges. Haas pioneered in theorizing the logic of institutionalization at the supranational level (1961). He suggested a dynamic process. The creation of supranational authority leads to changes in social expectations and behavior, which feed back onto supranational policy-making, and so on. As supranational bodies begin to deliver the co-ordinative solutions that pro-integrationists hoped for, they become the locus of a new kind of politics. Groups increasingly seek influence over supranational policies, opening up new political channels, but also helping supranational organizations to acquire expertise, information, and legitimacy, thus bolstering
their authority. The dynamic is reinforced by the potential, inherent in integration processes, for functional ‘spillover’. Spillover is achieved when supranational authority is extended to new, but related, functional domains, as it becomes evident that initial policy objectives cannot be adequately attained without such an extension. Neo-functionalists – especially Philippe Schmitter (1969, 1970) – also attended to the role of bargaining among member governments. But they at least implicitly argued (and we argue explicitly) that, as integration proceeds, member state governments become less and less proactive, and more and more reactive to changes in the supranational environment to which they belong.

The three constituent elements of our theory are prefigured in neo-functionalism: the development of transnational society, the role of supranational organizations with meaningful autonomous capacity to pursue integrative agendas, and the focus on European rule-making to resolve international policy externalities. Further, we appreciate Haas’s insight that supranational policy-making (governance) generates a dynamic process of institutionalization. We do not, however, embrace all of Haas’s neo-functionalism. Haas defined integration as ‘the process whereby political actors ... are persuaded to shift their national loyalties, expectations, and political activities to a new and larger center’ (Haas 1961: 367). Again, we leave as an open question the extent to which the loyalties and identities of actors will shift from the national to the European level. There is substantial room for supranational governance without an ultimate shift in identification. And we will specify somewhat differently the causal mechanisms by which integration is provoked and sustained, tying both to the development of transnational society and to contemporary theories of institutions and institutionalization.

Intergovernmentalists (especially Moravcsik 1991, 1993; but see also Garrett 1992) conceptualize EC politics as a subset of international relations, namely, as an example of interstate co-operation sustained by an international regime. Successful regimes facilitate the ongoing co-ordination of policy among member states, by reducing the costs of information, policy innovation, and negotiation (e.g. Keohane 1984). In Andrew Moravcsik’s ‘liberal intergovernmentalism’ (1993, 1994), regime theory has been supplemented to take account of domestic politics. At times, Moravcsik conceives European politics as a two-level game (Evans et al. 1993). The crucial actors are national executives, who continuously mediate between domestic interests and the activities of the international regime. At other times, Moravcsik sequences, for analytical purposes, national preference formation (domestic politics) and intergovernmental bargaining (regime politics). National executives are constrained by, but also aggregate, domestic interests as national preferences; once fixed, the distribution of preferences among, and the ‘relative bargaining power’ of, member state governments determine outcomes.

European integration is a product of these outcomes. As Moravcsik puts it: ‘the EC has developed through a series of celebrated intergovernmental bargains, each of which set the agenda for an intervening period of consolidation’ (1993: 473). In order to consolidate these bargains efficiently, member state governments establish and delegate powers to the EC’s organizations, like the Commission and the ECJ. Although intergovernmentalists rarely focus empirical attention on the process of consolidation, they claim that the EC’s organizations broadly pursue goals
previously determined by the member state governments, or are called to order if they pursue divergent agendas (Garrett 1992; Moravcsik 1995).

National executives construct the EC's capacity to govern, Moravcsik argues, for two main reasons. First, for electoral reasons executives may find it in their interest to respond to international policy externalities by pooling their sovereignty at the supranational level. Such externalities are generated by international interdependence. Second, in order to enhance their own autonomy vis à vis domestic actors, national executives may shift competence to govern to an arena (such as the Council of Ministers) that operates with fewer constraints on executive authority than national arenas. Why executives do so in some policy domains, but not in others, appears to be indeterminate.

For Moravcsik, the following sequence encompasses virtually all that is important: rising interdependence > domestic politics and national preference formation > intergovernmental bargaining > delegation to supranational authorities > consolidation. Integration proceeds, but the sequence never varies in any meaningful way. In this imagery, transnational actors and society do not exist; instead, he notices domestic groups impacted by increasing interdependence. And supranational organizations do not impact integration processes in autonomous and decisive ways; instead, in accordance with their place in the sequence, they behave as rather faithful agents of intergovernmental bargains. By our reading, rising interdependence constitutes the only important causal factor that both provokes integration and is not decisively determined by intergovernmental bargaining. On this point, intergovernmentalism hardly displaces neo-functionalism, but rather relies on a causal argument developed by the neo-functionalists.

We will return to our differences with intergovernmentalists in the concluding section.

II A TRANSACTION-BASED THEORY OF INTEGRATION

As most students of EC policy-making have observed, simple characterizations of the Community, as either 'intergovernmental' or 'supranational', will not do. The brute fact is that integration has proceeded unevenly, and theories of integration have failed to explain this unevenness. Most recent research on EC politics has focused either on the grand bargains (the Single European Act or the Maastricht Treaty, for instance), or on how day-to-day policy is made in specific sectors. Neither emphasis has provided an adequate basis for theorizing the dynamic nature of integration over time and across policy domains. When we began our joint efforts we perceived the need for a unifying heuristic capable of capturing this dynamic.

From intergovernmental to supranational politics

We thus propose a continuum that stretches between two ideal–typical modes of governance: the intergovernmental (the left-hand pole), and the supranational (the right-hand pole).

One pole is constituted by intergovernmental politics. The central players in intergovernmental politics are the national executives of the member states, who
bargain with each other to produce common policies. Bargaining is shaped by the relative powers of the member states, but also by state preferences, which emerge from the pulling and hauling among domestic groups. These preferences are then given agency, as negotiating positions, by national executives in EC organizations such as the Council of Ministers. The EC level of governance operates as an international regime in the functional, transaction-costs mode: it is a 'passive structure' that enhances the efficiency of interstate bargaining (Keohane 1984; Moravcsik 1993).

The other pole is constituted by supranational politics. A 'supranational' mode of governance is one in which centralized governmental structures (those organizations constituted at the supranational level) possess jurisdiction over specific policy domains within the territory comprised by the member states. In exercising that jurisdiction, supranational organizations are capable of constraining the behavior of all actors, including the member states, within those domains. Many would argue that 'federal politics' would be the appropriate label (Lenaerts 1990; Sbragia 1992, 1993). We use the term 'supranational,' in part, to emphasize that the EC is an international organization, and that EC politics is a form of international politics. And we have avoided using the term 'federal' here in order to avoid an argument about the precise nature of the EC polity and how it compares with other federal polities. Movement from left to right along the continuum indicates that a shift away from intergovernmentalism, and toward supranationalism, has taken place.

In principle, the continuum is capable of situating – and therefore of characterizing – all international regime forms as sites (more or less) of intergovernmental or sites (more or less) of supranational politics. Unlike most regimes, which tend to organize interstate co-operation in one or a few closely related sectors, the EC possesses differing degrees of competence across a diverse range of policy areas. In principle, one could use the continuum to characterize the development of the EC as a whole, in terms of the composite picture of all policy areas. One could also use the continuum to chart the comparative development or lack of development of different policy sectors. Thus, policy sector A may be located at point 2, shading toward intergovernmental politics, while policy sector B may be located at point 4, exhibiting strong features of supranationalism. Used in this way, the continuum...
asserts that there are potentially many ECs. As discussed in the next section, we hope that by disaggregating EC governing processes by policy domain, we will be able to learn more about the nature of European integration than we can by working to characterize, in a blanket fashion, the EC as an 'intergovernmental' or 'supranational' regime.

**Dimensions of institutionalization**

The continuum measures the movement from intergovernmental to supranational governance in three interrelated dimensions:

- **EC rules**: the legal, and less formal, constraints on behavior produced by interactions among political actors operating at the European level;
- **EC organizations**: those governmental structures, operating at the European level, that produce, execute, and interpret EC rules; and
- **transnational society**: those non-governmental actors who engage in intra-EC exchanges—social, economic, political—and thereby influence, directly or indirectly, policy-making processes and outcomes at the European level.

For any given policy area or process, movement from left to right along the continuum therefore measures the growing presence and intensity of each of these factors.

We understand these dimensions to be crucial indicators of levels of integration in the EC. By ‘integration,’ we mean the process by which the horizontal and vertical linkages between social, economic, and political actors emerge and evolve. Vertical linkages are the stable relationships, or patterned interactions, between actors organized at the EC level and actors organized at or below the member state level. Horizontal linkages are the stable relationships, or patterned interaction, between actors organized in one member state with actors organized in another. We understand these linkages to be ‘institutionalized’ to the extent that they are constructed and sustained by EC rules.

The three dimensions are analytically distinct, although we expect them to covary, as integration proceeds, in predictable ways. As we move from left to right along the continuum the influence of EC (or supranational) organizations on policy-making processes and outcomes increases. Supranational EC organizations include the Commission, the Court of Justice, the Parliament, and even at times the Council of Ministers. At the left-hand pole, the regime’s organizations exhibit little if any meaningful autonomy from the most powerful member states. By autonomy, we mean an organization’s capacity to define and pursue, on an ongoing basis, a politically relevant agenda. In intergovernmental politics, organizations facilitate intergovernmental bargaining and logistical co-ordination (they lower the transaction costs for governments). At point 3 on the continuum, supranational organizations may often be the source of successful policy innovation, a form of ‘relative’—but meaningful—autonomy. At the supranational pole, institutions may exercise substantial autonomy, as when they are able to innovate, in policy relevant ways, at times even in the face of member state indifference or hostility.
The second dimension built into the continuum is legal-normative (see Stone 1994). As we move from left to right along the continuum, EC rules achieve higher degrees of clarity and formalization. Consider those rules that govern the production, application, and interpretation of all other rules, such as secondary legislation, within the Community. At the far left of the continuum, rules are few and weak; they do not trump individual governmental interests that conflict with them. As we move along the continuum, rules stabilize state bargaining, delegitimize exit, and — at the level of law — lay down binding standards of conduct enforceable by courts. Many of the rules governing EC policy-making are behavioral, that is, they have resulted from many years of constant interaction between state and supranational officials in a myriad of settings. But many of these rules are also highly formal, codified in treaty law, secondary legislation, and the ECJ's jurisprudence. Within any given policy domain, as we move right the rules governing the interactions of all actors, public and private, grow more dense and elaborate.

The third dimension captured by the continuum is the presence and influence of transnational actors — interest groups, business, knowledge-based élites — on policy processes and outcomes. In intergovernmental politics, national executives mediate between domestic actors and supranational organizations and rules. In supranational politics, transnational actors have a choice of fora in which to exert their influence. They may target national governmental structures — executive, legislative, or judicial — as well as supranational bodies, and they may play one level off against the other.

Taken together, these dimensions are constitutive of supranational politics. If this is so, the group believes, these three factors must move together, and disjunctures that do occur in movement are short-lived. Organizations, rules, and social exchange are closely linked in the development of society and systems of governance (March and Olsen 1989; North 1990; Stone Sweet, forthcoming) and are similarly connected in supranational politics. Organizations produce and transmit the rules that guide social interaction. They structure access to policy processes, defining political power and privileging some parts of society more than others. As supranational organizations acquire and wield autonomy, they are able to shape not only specific policy outcomes but also the rules that channel policy-making behaviors. As supranational organizations and rules emerge and solidify, they constitute transnational society by establishing bases for interaction and access points for influencing policy. As transnational society endures and expands, the organizations and rules that structure behaviors become more deeply rooted as 'givens,' taken for granted as defining political life. Growth in one element of the supranational trio (organizations, rules, transnational society) creates conditions that favor growth in the other two. An expansion of the tasks or autonomy of supranational organizations creates opportunities for political action, which actors and groups will seek to exploit, thus expanding transnational society. As societal actors adjust their behaviors in response to new supranational rules, these rules can gradually be locked-in. If broader, global trends promote the growth of transnational society, there will be a corresponding demand for increased organizational capacity and rules to co-ordinate and to guide interactions.
Why movement occurs

The continuum gives us tools with which to describe EC governance. We have also offered a proposition that would account for some of the dynamics of integration, namely, that movement in any one of the dimensions will tend to produce movement in the other two. In other words, there is an internal dynamic of institutionalization. But important questions remain to be theorized. Why does movement on any of the dimensions occur in the first place? Why do some policy domains move farther and faster toward the supranational pole than others? In this section we offer a theoretical account that can generate answers to such questions.

Our starting point is society, in particular, non-state actors who engage in transactions and communications across national borders, within Europe. These are the people who need European standards, rules, and dispute resolution mechanisms — who need supranational governance. In the beginning, the causal mechanism is quite simple: increasing levels of cross-border transactions and communications by societal actors will increase the perceived need for European-level rules, coordination, and regulation. In fact, the absence of European rules will come to be seen as an obstacle to the generation of wealth and the achievement of other collective gains. Separate national legal regimes constitute the crucial source of transaction costs for those who wish to engage in exchanges across borders: customs and other border controls, differing technical standards, divergent health and environmental regulations, distinct systems of commercial law, diverse national currencies, and so on. Further, the costs of transacting across borders are higher than those involved in contracting within a single member state, to the extent that there exists no secure common legal framework at the supranational level, comparable in its efficacy to that of national legal systems. As transnational exchange rises, so does the societal demand for supranational rules and organizational capacity to regulate. Transactors can exert pro-integration pressure on their own governments, but when these are reticent, transactors can access supranational arenas dominated by the Commission and the ECJ.

Governmental actors clearly have their own interests, which may include maximizing their autonomy and control over resources. They may resist the shift toward supranational policy-making. But as they do so, they inhibit the generation of wealth within their territories by those actors who depend on European transactions. Such resistance is therefore sustainable only at a cost in prosperity (Mattli 1996). Governments can also attempt to slow integration or push it in directions favorable to their perceived interests, but they do not drive the process or fully control it. In a fundamental sense, governments are reactive, constantly adjusting to the integration that is going on all around them.

On this point, the contrast between our theory and intergovernmental approaches to the EC could hardly be greater, but we have not written national governments out of the story. In fact, intergovernmental decision-making is ubiquitous in the EC, present even at the far right-hand pole of our continuum (as it is in Canada and other federal systems). EC summits, intergovernmental conferences, and meetings of the Council of Ministers are practically defined by tough, interest-driven negotiation. But that is part of the problem with intergovernmental
approaches to integration. Adherents of these approaches begin by announcing that the 'grand bargains' are the defining moments of European integration, and then these historic agreements become the object of empirical research. But the grand bargains are, by definition, intergovernmental. The research results are quite predictable when one looks to intergovernmental bargains for evidence of intergovernmental bargaining. Thus the observation that bargaining among governments is ubiquitous in the EC does not settle theoretical controversy. Put differently, the term 'intergovernmental' is useful as a description of a specific mode of decision-making within the EC policy process. But to attend to what is intergovernmental about the construction of supranational governance does not require us to adopt, or to accept the validity of, 'intergovernmentalism-as-theory'.

Indeed, we argue that intergovernmental bargaining in the EC more often than not is responsive to the interests of a nascent, always developing, transnational society. Indeed, the demand for EC rules and regulation provides the subject matter for the bargaining. With very few exceptions, EC legislation concerns, directly or indirectly, the creation of rules that facilitate or regulate intra-EC exchange and communications. The configuration of social interests that will be affected by European policy innovation may vary from state to state, which creates the differences over which governments must negotiate. But rather than being the generator of integration, intergovernmental bargaining is more often its product.

The exclusive focus on grand intergovernmental bargains can also lead to serious distortions of the historical record. The 1970s have generally been regarded as disconfirmation of neo-functionalism; intergovernmentalists typically note that member state preferences diverged during those years and that few of the EC's ambitious plans at the beginning of the decade bore fruit (e.g. Taylor 1983). We do not read the story of European integration as one of stop-and-go, at least not in any general or comprehensive sense. At the height of De Gaulle's power in the 1960s, the ECJ moved aggressively to 'constitutionalize' the treaties (Stein 1981; Weiler 1981, 1991). In the worst days of 'Eurosclerosis' in the 1970s, levels of intra-EC trade and other forms of exchange soared. And, as we would expect, both the amount of legislation and the number of organized EC pressure groups grew steadily through the 1970s (Fligstein and McNichol 1996: 22-3). Integration always proceeded, in some sectors and from some vantage points, despite the Luxembourg compromise and despite the divergence of state preferences.

Empirical research supports the transaction-driven theory of European integration. Stone Sweet and Caporaso (1996) focus on the political impact of the 'constitutionalization' of the treaty system. They find that cross-national exchange, transnational judicial activity, and supranational rule-making rose steadily after the move to constitutionalization by the ECJ (1960s). In analyses of aggregate data, and in case studies of the sources and consequences of the judicial rule-making, they demonstrate the causal link we have proposed: transactors seek to reduce obstacles, which triggers a process leading to the production of EC rules (Stone Sweet and Caporaso 1996).

The telecommunications case is equally clear. By the 1980s, Europe's fragmentation into national telecommunications monopolies was increasingly costly to a variety of actors who depended on reliable, advanced telecommunications facilities
spanning national borders. Telecommunications provide the infrastructure for the modern economy, and businesses from a multitude of sectors needed pan-European telecoms for their transnational activities (trade, strategic partnering, investment, finance, design, production, distribution, sales). These businesses, plus telecoms equipment makers and suppliers of new services and infrastructures, became ready allies of the Commission when it undertook to create a liberalized EC telecoms market. Governments resisted, but found that ECJ rulings and the Commission's use of Article 90 directives (that do not require Council approval) severely curtailed their ability to prevent liberalization and rule-making at the EC level. In fact, intergovernmental bargaining continued in the Council of Ministers, but always under the shadow of the Commission's capacity to bypass the Council with Article 90 (Sandholtz 19%). A remarkably similar story has been told about the liberalization of the European airline industry (O'Reilly, forthcoming). At a time of sustained increase in levels of passenger and freight transported by airlines, supranational organizations, in complicity with business and consumer groups, were gradually able to overcome the resistance of governments that had been hostile to deregulation. Once removed from national control, reregulation - at the European level - proceeded.

Finally, Fligstein and McNichol report that, through the 1970s, both the quantity of EC legislation and the number of EC pressure groups expanded. Most significantly, pressure groups and legislation grew during the 1970s in domains where EC competences would later be enhanced by Treaty revisions. In other words, the interstate bargains that amended the Treaty in the 1980s were a response to the prior growth in transnational activity.

The Treaty revisions of the 1980s took place in the context of a demand for more cooperation at the European level. One can infer that the crisis of the 1980s was partially precipitated by the limits of the institutions and organizations of the EC to deal with these activities.

(Fligstein and McNichol 1996: 31-2)

The transaction-based theory implies a coherent answer to the question, why does integration proceed faster or farther in some policy areas than in others? We would look to variation in the levels of cross-border interactions and in the consequent need for supranational co-ordination and rules. In sectors where the intensity and value of cross-national transactions are relatively low, the demand for EC level co-ordination of rules and dispute resolution will be correspondingly low. Conversely, in domains where the number and value of cross-border transactions are rising, there will be increasing demand on the part of the transactors for EC level rules and dispute-resolution mechanisms. It makes sense, then, that the EC has moved farthest toward the supranational pole with respect to managing the internal market. Intra-EC trade and investment have grown steadily since the founding of the EEC, creating the need for greater degrees of supranational governance in issue areas closely linked to expanding the common market. Naturally, the EC rules for the single market have in turn encouraged increases in the cross-border transactions they were meant to facilitate. In contrast, there are few societal transactions that are
impeded by the absence of a common foreign and security policy (CFSP). Or, put differently, though some argue for the political benefits that CFSP would bring, few societal transactors find its absence costly. There is therefore minimal social demand for integration in that policy domain.

The theory also allows us to explain the general direction of integration in the common market. Business is likely to be the segment for which the material stake in cross-border transactions is greatest and most obvious. Companies with an interest in cross-national sales or investment will press for the reduction of national barriers, and for the establishment of regional rules and standards. By the same token, the consequences of integration for people in their roles as workers and consumers are less transparent. This would explain why European companies have had a greater impact on integration than have labor or consumers (Sandholtz and Zysman 1989; Sandholtz 1992a; Green-Cowles 1993). We can thus account for the decisively neo-liberal (pro-market) character of recent events like the 1992 program and the Maastricht provisions on economic and monetary union. If integration is driven fundamentally by private transactors, and if capital is the group with the clearest immediate stake in intra-EC transactions (not to mention the resources required for political influence), it is not surprising that the major steps in integration should be congenial to those segments of business.

We can now also respecify the spillover mechanism. As the most obvious hindrances to cross-national exchange are removed, or their effects reduced by the transaction-cost reducing behavior of supranational organizations and rules, new obstacles to such transactions are revealed and become salient. With the removal of tariffs and quotas, for example, differences in national regulatory standards – for the environment, health and safety, technical compatibility, and so on – become more apparent as obstacles to exchange. Economic actors seeking to benefit from intra-Community exchange will then target these obstacles, both by attacking regulatory barriers through litigation and by pressuring EC legislative institutions to widen the jurisdiction of the EC into new domains. Transactors will always prefer, other things being equal, to live under (or adapt to) one set of rules rather than six, or twelve, or fifteen. As governments and EC institutions respond, spillover occurs.

Globalization, which is integration of a broader geographic scope, can also stimulate movement toward increased supranational governance within Europe. The integration of national markets (for goods, services and capital) and multilateral approaches to global problems (ozone, climate change, weapons proliferation) can create pressures for integration from above the nation state. Transnational actors are sometimes the conduit through which globalization stimulates advances in European integration. For instance, with the goal of increasing their competitiveness in world markets, European multinationals pressed for active EC high-technology programs (ESPRIT, RACE) as well as the creation of a genuine internal market (Sandholtz 1992b; Sandholtz and Zysman 1989). But globalization can also exert pressure directly on EC organizations. For example, the involvement of the EC in global environmental negotiations has strengthened expansion of Commission competencies and roles (Sbragia 1996).
III INSTITUTIONALIZATION

Once movement toward the supranational pole begins, European rules generate a dynamic of their own, which we call institutionalization. In laying out the continuum, the objective was to establish analytic categories for conceptualizing and identifying movement toward supranational politics. In a subsequent section, we offered a theory as to why policy domains move toward the supranational pole. Our transaction-based theory of movement leads us, when we observe rising levels of transnational exchange, to expect more EC rules. We can thus explain why some policy domains move more quickly toward supranational governance than others. The theory does not tell us what specific rules and policies will emerge, or what organizational form supranational governance will acquire.

In this final section, we propose a theoretical account of why shifts toward supranational governance tend to generate additional movement in the same direction, or at least make it difficult to reverse the shifts that have already occurred. In other words, the EC is not at any given moment simply the organizational instantiation of state interests, combined through negotiation into a lowest common denominator agreement. The supranational content of the EC does not fluctuate up and down to reflect the interstate bargain du jour. Rather, because of institutionalization, EC policy domains can become more supranational without some, or at times a majority of, governments wanting it or being able to reverse it.

Like Haas, we argue that there is a logic of institutionalization. Rules and rule-making are at the heart of this logic. Rules define roles (who is an actor) and establish the social context in which actors' interests and strategies take shape. Rules define the game, establishing for players both the objectives and the range of appropriate tactics or moves. Actors behave in self-interested ways, but both the interests and the behaviors take form in a social setting defined by rules. Actors will try to exploit the rules for selfish advantage, or to change the rules to favor achievement of their objectives. But at any given moment, they take the rules as given. Institutions are systems of rules (Jepperson 1991: 149, 157; North 1990: 3, 6), and institutionalization is the process by which rules are created, applied, and interpreted by those who live under them.

Institutions, contrary to the image of stability frequently associated with them, are in constant evolution. People acting within a rule context inevitably encounter the limits of the rules, that is, situations in which their content is unclear or disputed. Rules may not provide clear guidance for new kinds of transactions or behaviors. Or two actors may disagree as to what the rules require in a specific instance. In either case, actors will then make demands on the dispute resolution processes. They may push for the creation of new rules (legislation). Or they may seek reinterpretation of the existing rules (adjudication). As they interpret and apply the rules, courts, legislators, and administrators necessarily modify them by establishing their effective meaning. The new or changed rules then guide subsequent interactions, as people adapt their behaviors to the rules. The disputes that arise thereafter take shape in an altered rule structure and initiate the processes that will again reinterpret and modify the rules. The new rules guide actor behaviors, and so on (Stone Sweet, forthcoming; Sandholtz 1997).
The logic of institutionalization is at work in the EC and is crucial to understanding integration as a process. As European rules emerge and are clarified and as European organizations become arenas for politics, what is specifically supranational shapes the context for subsequent interactions: how actors define their interests, what avenues are available to pursue them, how disputes are to be resolved. This creates the ‘loop’ of institutionalization. Developments in EC rules delineate the contours of future policy debates as well as the normative and organizational terms in which they will be decided. Since rules are central to institutionalization, the Treaty of Rome is the crucial starting point for subsequent integration. The Treaty established EC rules and rule-making procedures, and constituted EC organizations like the Commission and the ECJ.

We would expect that, in general, integration would occur most readily in policy domains included in the Treaty. Policy domains mentioned in the Treaty have the advantage of a legal basis in the Union’s fundamental rules. Treaty-based policy domains should move more quickly toward supranational governance, other things being equal, than policy areas for which a competence or legal basis would have to be constructed from scratch. Fligstein and McNichol show that ‘most of the arenas in which the EC built competencies were laid down in the Treaty of Rome and the original language and definitions gave rise to organizational structures oriented towards producing legislation in those domains’ (Fligstein and McNichol 1996: 30).

Integration, however, is not limited to those domains specifically called out in the Treaty. Where cross-border activities are of increasing importance, we expect to find the creation and growth of supranational governance. When there is no Treaty-based competence for such a development, the relevant actors will create one. (Conversely, policy domains mentioned in the Treaty but lacking cross-border transactions are not likely to move toward supranational governance.) Rising levels of cross-border transactions generate demand for EC rules and dispute resolution. Member governments can respond by amending the Treaty, or stretching Treaty clauses to cover new legislation. Article 236, for instance, permits the EC to establish supranational governance to achieve the general objectives of the Community. This provision has served as the legal basis for EC action in policy domains not specifically mentioned in the Treaty. Perhaps more important in practice, the ECJ has interpreted the Treaty so as to permit the expansion of supranational policy domains (Weiler 1981). Again: the Court does not choose its questions; it responds to the cases brought, frequently, by transactors seeking clearer EC rules or enforcement of existing rules. The landmark Dassonville line of case law, which underpinned immensely consequential Commission initiatives and intergovernmental bargaining in the move to complete the common market, was sustained by private actors desiring the elimination of national practices that limited intra-EC trade (Alter and Meunier-Aitsahalia 1994).

A clear example of a policy domain becoming supranational despite the absence of a treaty basis is the telecommunications sector. The Treaty of Rome makes no mention of telecoms. In fact, various Treaty provisions (Article 90(2) and Article 222) had traditionally been interpreted as exempting national telecoms monopolies from EC competition rules. A series of ECJ rulings undermined that supposed exemption. The Commission took advantage of the Court’s decisions to attack the national
telecoms monopolies with Article 90 directives. In short, the ECJ’s reinterpretation of the Treaty enabled the Commission, supported by transnational coalitions, to effect a liberalization of telecoms that was faster, more far-reaching, and more co-ordinated at the EC level than almost any of the member governments wanted at any stage along the way (Sandholtz 1996). Or, as Michael Smith shows, interactions within the framework of European political co-operation, which were completely outside the Treaty structure, generated a body of informal rules and practices that significantly shaped government behaviors and interactions (Smith 1996).

Thus, though the Treaty is the indispensable starting point, over time supranational rules and rule-making processes evolve in ways that are not predictable from the ex ante perspective of those who establish them. The new rules create legal rights and open new arenas for politics; in this fashion they structure political processes thereafter. Actors – including governments, private entities, and EC bodies – adapt to the new rules and arenas. This dynamic is wholly absent in the intergovernmentalist account. Intergovernmentalists see governments as the sole mediators between non-state actors and EC policy-making. In contrast, our theory leads us to expect (and we do observe) private actors successfully employing the EC judicial process against member governments and pursuing political strategies directly at the Commission. Intergovernmentalists depict governments as directing the process of integration and establishing its limits. Our approach, in contrast, views governments as powerful actors who cannot always impose their preferred outcomes on other players in the EC political system (transnational actors, the Commission, and the ECJ), who also possess substantial legal and political powers.

Finally, governments are ultimately constrained by rules whose production they do not control. National courts, guided by ECJ decisions, can compel their governments to comply with EC rules they have opposed. For example, though the United Kingdom has taken the most anti-integration position in the Council with respect to social provisions, British courts responding to private litigants and ECJ rulings have forced the government to change domestic policies so that they align with EC laws that Britain opposed (Stone Sweet and Caporaso 1996). Similarly, though member governments bargained with each other with respect to telecoms liberalization, that bargaining took place during the crucial phase under the shadow of the Commission’s newfound capacity, affirmed by the Court, to enact its preferred policies via Article 90 directives (Sandholtz 1996).

The rule-centered logic of institutionalization also suggests why it is difficult, and sometimes impossible, for governments to reverse shifts toward supranational governance that have occurred. The Treaty – the constitution of the European polity – fixes the rule-making processes of the EC, and the ECJ is authoritative interpreter of this constitution. As substantive rules, such as secondary legislation, evolve, actors (including governments, as well as EC bodies and non-state entities) adjust their behaviors. The rules, since the impetus behind them is to facilitate cross-border transactions and communications, lead to new kinds and higher levels of transactions. The new transactions entrench interests. The result is a high degree of ‘stickiness’ in movement along the continuum.

Two logics, or languages, capture the essence of that stickiness. The first has to do
with path dependence, the second with principal-agent relations. Paul Pierson makes two interrelated points: first, that significant gaps emerge between member state preferences and the functioning of EC policies and institutions; and second, that once such gaps develop, states cannot simply close them. The latter point is the crucial one with respect to the difficulty of reversing shifts toward supranational governance. Pierson argues that institutional change is a 'path-dependent' process; once institutional and policy changes are in place, social actors adapt to those changes, frequently making substantial investments in the process. A policy turnabout would entail the loss of these sunk costs, thus raising the costs for governments seeking to unwind supranational governance. Furthermore, decision rules often constitute major obstacles to reversing course. The process of adaptation to change in complex social settings also produces unintended consequences that are difficult to unwind. Thus institutional and policy outcomes become 'locked in,' channelling politics down specific paths and closing previously plausible alternatives (Pierson 1993, 1996).

Mark Pollack assesses the conditions under which the EC Commission can act autonomously, recognizing that the Commission is the most constrained of the EC's supranational bodies (as compared to the Parliament and the ECJ). He employs principal-agent imagery to argue that the administrative and oversight mechanisms that principals (member governments) use to rein in agents (the Commission) can be costly and of limited effectiveness. Furthermore, agents can exploit divergent preferences among multiple principals, especially under more demanding decision rules, like unanimity (Pollack 1996).

The path-dependence and principal-agent logics reinforce our argument that institutionalization in the EC is not reducible to the preferences of, or bargaining among, member governments. The expansion of transnational society pushes for supranational governance, which is exercised to facilitate and regulate that society. Once in place, supranational rules alter the context for subsequent transactions and policy-making. Actors - governments, supranational organizations, and non-state entities alike - adapt their preferences, strategies, and behaviors to the new rules. These adaptations, plus the importance of rules in shaping preferences and behaviors, are what make shifts toward supranational governance sticky and difficult to undo. Finally, because specific policies and organizational forms emerge through a path-dependent process, in which numerous social systems interact in quite contingent ways, those outcomes can only be analyzed through historical, process-tracing case studies. Thus, whereas broad aggregate data reflect the causal link between cross-border transactions and EC rule-making (Stone Sweet and Caporaso 1996), case studies are essential for explaining the specific content and form of EC rules and policies (Pierson 1996; Pollack 1996; Sandholtz 1996; Smith 1996; Stone Sweet and Caporaso 1996).

CONCLUSION

We have proposed a theory of integration that relies on three causal factors: exchange, organization, and rules. Transnational exchange provokes supranational organizations to make rules designed to facilitate and to regulate the development of
transnational society. To the extent that supranational organizations are successful at doing so, specific causal connections between our three factors will be constructed. These connections sustain an inherently expansionary process, not least, by means of policy feedback. As the structure of European rules becomes more dense and articulated, this structure itself will encourage private and public actors at all levels of the Community to forge new, or intensify existing, linkages (vertical and horizontal). Member state governments are important actors in this process. Nevertheless, we argue that the integration-relevant behavior of governments, whether acting individually or collectively, is best explained in terms of the embeddedness of governments in integration processes, that is, in terms of the development of transnational society and its system of governance.

We do not want to be misunderstood on this last point. No one denies that certain elements, or stages, of the European policy-making process are intergovernmental. Governments are repositories of immense resources, both material (e.g. financial) and non-material (e.g. legitimacy). In the EC, national executives pursue what they take to be their own interests, which they express as constituting the national interest. And in the bargaining process, executives from the larger states command greater resources and tend to wield greater influence on EC policy outcomes than those from the smaller states. But noticing governments and power does not entail accepting intergovernmentalism as a body of causal propositions about how integration has proceeded. Although we dismiss as untenable Moravcsik’s proclamation that his version of intergovernmentalism is the ‘indispensable and fundamental point of departure for any general explanation of regional integration’ (1995: 625) we have no trouble recognizing that intergovernmental bargaining is an ubiquitous feature of supranational governance (as it is in many federal polities). Indeed, in our research we constantly attend to the question of whether and how integration shapes the preferences of governments over time, and the extent to which it casts (and recasts) the nature and content of intergovernmental bargaining. In our opinion, Moravcsik has developed a theory of intergovernmental bargaining within a specific institutional context, that of the EC, but not a satisfying general theory of integration.

Our theory accounts for causal relationships between variables that are systematically downplayed or deemphasized by intergovernmentalism and, we argue, these relationships will regularly produce outcomes that significantly impact the trajectory of integration. Intergovernmentalism is rigid: integration proceeds, but nothing essential in European politics ever changes. In contrast, we expect that integration produces new political arenas; that the politics in these arenas will qualitatively differ from purely intergovernmental politics; and that this difference will have an impact downstream, on subsequent policy processes and outcomes. In Moravcsik’s view, supranational organizations, like the Commission, are virtually always ‘perfectly reactive agents’, responding only to the ‘delegation’ of tasks pursuant to the ‘pooling’ of state sovereignty (1995: 616, 621). In contrast, we expect supranational bodies to work to enhance their own autonomy and influence within the European polity, so as to promote the interests of transnational society and the construction of supranational governance. In Moravcsik’s view, ‘Only where the actions of supranational leaders systematically bias outcomes away from the long term self-interest of member-states
can we speak of a serious challenge to an intergovernmentalist view’ (1993: 514; emphasis in original). In response, we expect what intergovernmentalism is not capable of explaining, namely, that, as integration proceeds, the Court and the Commission will routinely produce rules (policy outcomes) that would not have been adopted by governments in the Council of Ministers, or in summitry. And we argue that the long-term interests of member state governments will be increasingly biased toward the long-term interests of transnational society, those who have the most to gain from supranational governance.

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NOTES

1 We recognize the important formal distinctions between ‘European Community’ and ‘European Union.’ However, since most of the activities we refer to in this article occur under the aegis of the European Community, we will consistently use ‘EC’ and ‘European Community.’

2 In addition to the authors (co-convenors of the project), the working group included David Cameron, James Caporaso, Russell Dalton, Neil Fligstein, Paul Pierson, Mark Pollack, Alberta Sbragia, and Michael Smith. Although this article grew out of our group discussions, not all members subscribe to all the claims made in this article.

3 Substantive areas included the free movement of goods, social policy, competition, monetary co-operation, telecommunications, foreign policy and security, and environmental protection. References are to papers presented at the conference, ‘Supranational Governance: The Institutionalization of the European Union’, Berkeley, California, November 1996.

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