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The New Politics of Interdependence: Cross-National Layering in Trans-Atlantic Regulatory Disputes

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Abstract

How are regulatory disputes between the major powers resolved? Existing literature generally characterizes such regulatory disagreements as system clash, in which national systems of regulation come into conflict, so that one sets the global standard, and the other adjusts or is marginalized. In this article, we offer an alternative account, which bridges early literature on interdependence with work from Historical Institutionalism in comparative politics. We argue that rule overlap creates opportunities for regulatory actors to develop transnational alliances in support of an alternative institutional agenda. Over time, the resulting "cross-national layers" have the potential to transform domestic institutions and in turn global rules. International regulatory disputes are less discrete international conflicts between sovereign jurisdictions than ongoing battles among regulatory actors within jurisdictions (and alliances across them). We examine two critical issue areas—surveillance information sharing and accounting standards—which allow us to contrast our argument against standard accounts emphasizing veto points and switching costs, respectively.

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How are global regulatory disputes resolved? Jurisdictions have different—and often incompatible—rules over issues such as consumer protection, the environment, health standards, or production processes (Mattli and Büthe, 2003; Büthe & Mattli, 2011; Farrell & Newman, 2010; Pollack & Shaffer, 2009). Such regulations[1] determine how national and international markets work and often distribute their economic benefits across market actors (Büthe & Mattli, 2011; Krasner, 1991; Posner, 2009).

Existing scholarship generally characterizes such regulatory disagreements as *system clash* between national systems of regulation, in which one system prevails, setting the global standard, and others adjust or are marginalized. They usually emphasize how either switching costs, which make it unattractive for one jurisdiction to change its rules to better conform with another's (Büthe & Mattli, 2011; Drezner, 2007), or veto points, provided by national institutions (Fioretos, 2009, 2010; Gourevitch & Shinn, 2005; Hall & Soskice, 2001; Vitols, 2001), shape actors' preferences and bargaining power.

These accounts largely assume that regulatory preferences result from processes of domestic interest formation external to the theory, and that bargaining takes place between relatively discrete jurisdictions (Büthe & Mattli, 2011; Drezner, 2007; Lake, 2009). However, if we look at the two crucial regulatory polities in the global system—the EU and the United States[2]—we find many cases that are not exhausted by either mechanism, and that end up with neither victorious. A few examples follow: A purportedly intractable dispute over genetically modified organisms has given way to a novel agreement (Young, 2011). An apparently irresolvable conflict over online privacy was moderated by a hybrid regulatory structure, which transformed the apparent options available to both states (Farrell, 2003). After years of U.S. intransigence in financial services disputes, the United States and the EU have negotiated agreements, fostering international rule compatibility, that do not reflect the initial preferences of either (Lütz, 2011; Posner, 2009).

What explains this? This article integrates insights from economic interdependence and historical institutionalism to examine how transnational cooperation can transform global regulatory politics.[3] Rather than treating globalization as a common exogenous shock to distinct national systems, we treat it as a process of increasing *rule overlap* between jurisdictions.[4]

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Such *rule overlap* upsets status quo domestic regulatory bargains, as firms, regulators, and citizens find themselves affected by laws from other jurisdictions (Farrell & Newman, 2014). It also alters the opportunity structures that regulatory actors confront (Joachim, 2003; Nye & Keohane, 1971; Risse-Kappen, 1995). Specifically, it creates incentives for transnational actors (e.g., multinational firms) to demand change, and opportunities for sub-national regulatory actors (e.g., bureaucratic units within the government, or self-regulatory authorities outside it, that can shape authoritative rules) to supply specific kinds of change.

Where national regulatory actors have access to the relevant cross-national forums, they can build alliances with counterparts in the relevant jurisdictions (Cerny, 2010; Djelic & Quack, 2010; Djelic & Sahlin-Andersson, 2006; Risse-Kappen, 1995; Sikkink, 2005). Because not all regulatory actors have access to these forums, the solutions provided will privilege such regulators over others.

Adapting work from historical institutionalism, we describe a new causal process, "cross-national layering."[5] This allows us to show how transnational institutions, arising from cross-national alliances, can over time reshape long-term political relationships among the relevant domestic groups and constituencies, changing domestic institutions and transforming global regulatory disputes. Under interdependence, regulatory disputes are less discrete international conflicts between sovereign jurisdictions than ongoing battles among regulatory actors within jurisdictions (and alliances across them).

We test our arguments against the two major alternatives by examining important and different cases of institutional change in the EU—surveillance and accounting. Switching cost arguments (e.g., "varieties of capitalism") are frequently invoked to explain the accounting case while veto point arguments are used to explain surveillance. Hence, we demonstrate the *prima facie* plausibility of the argument and provide significant evidence as to its potential generalizability. More generally, we build bridges between comparative politics and international relations, examining dynamic aspects of globalization that both often neglect (Caporaso, 1997; Frieden & Martin, 2002).

Global Regulatory Politics as Systems Clash

When does global regulatory cooperation happen and who influences the content of such rules? The dominant literatures focus on the domestic institutions of large markets, emphasizing either switching costs or interest aggregation. Jurisdictions with large markets can leverage market access to

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shape others' regulation (Bach & Newman, 2007; Drezner, 2007; Posner, 2009). Both the United States and the EU, for example, employ equivalency clauses to condition market access on the adoption of compatible rules in other jurisdictions. This can be reinforced indirectly by processes such as "trading up" (Vogel, 1995). These approaches see interdependence between different national systems as causing regulatory clashes, but maintain that these clashes are *resolved* through national bargaining based on market size.

Drezner (2007) argues that market size puts the EU and United States at the center of most global regulatory debates.[6] When the two great powers share preferences, global standards emerge, and when they disagree, rival standards are more likely. Drezner argues that states want to replicate their domestic rule structures globally. Subsequent work operationalizes these preferences by identifying differences in varieties of capitalism, which make switching cheaper or more expensive (Drezner, 2007; Fioretos, 2009, 2010).

Veto point approaches too focus on large markets and interstate interactions but emphasize how domestic and international institutions of interest aggregation shape interest group preferences, which are filtered through veto points so as to constrain international negotiators (Lake, 2009; Mansfield, Milner, & Pevehouse, 2007; Tsebelis, 2002). Interdependence activates the *preferences* of domestic interest groups_for example, importers versus exporters—but it neither affects their bargaining power, nor leads directly to institutional change.

Approaches emphasizing switching costs and veto points have similar empirical expectations across many dimensions. Both emphasize how powerful markets set global rules and rely on jurisdictional and sovereign borders as a means of distinguishing the key regulatory players. They assume that states have relatively stable preferences, which reflect economic fundamentals as refracted through legislative institutions. Switching cost arguments expect global convergence to happen in the rare cases when great powers have similar domestic regulatory structures. Veto point accounts suggest that convergence will happen where there is a "win set" of outcomes acceptable to all actors. We summarize these approaches' causal logic for regulatory disputes in Figure 1.

Although both approaches are intuitively plausible, they are partly belied by the empirics. Cooperation has increased over time, even in cases where great powers have different regulatory systems, switching costs have been high, and the number of veto players has increased (Berger, 2000; Posner, 2009; Young, 2011).[7]

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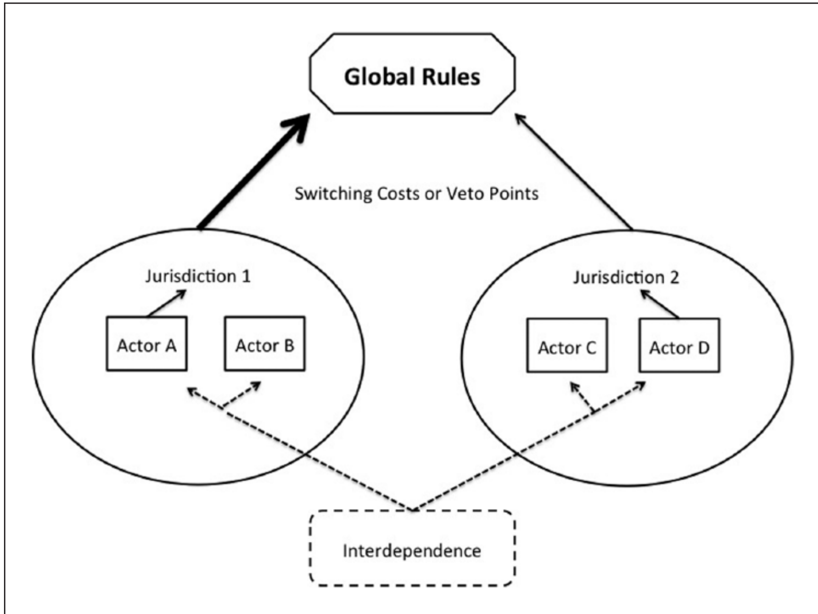

Figure 1. Systems clash model of regulatory politics.

Rule Overlap, Transnational Opportunity Structures, and Cross-National Layering

Our argument emphasizes not clashes *between* systems but the importance of *intersocietal* interactions.[8] Within most jurisdictions, there is disagreement among actors over status quo regulatory bargains. Interdependence can both make these rules costlier, and allow dissatisfied regulatory actors with shared interests and access to transnational forums to create alliances *across jurisdictions* to challenge them. The agreements struck in such forums create cross-national institutional layers that can destabilize domestic institutions and weaken alternative coalitions and thus over time recast global regulatory politics.

Globalization increases interdependence, unsettling domestic institutional bargains. *Rule overlap* between national jurisdictions generates new frictions for existing domestic institutions. Where rules are incompatible, they make contradictory demands of actors exposed to different jurisdictions, most prominently multinational firms. Politically influential actors (such as these firms) press regulatory authorities to resolve the contradictions raised by rule

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overlap. While firms have preferences over which regulator's rules should obtain, these preferences are often subordinated to the more urgent need to create regulatory certainty and "level the playing field." Confronted by rule overlap, businesses generate strong pressures to reach *some kind* of arrangement.

Globalization also changes the political resources of actors struggling over appropriate solutions. Within most jurisdictions, actors disagree over status quo institutional bargains. Absent interdependence, those seeking to change their regulatory status quo have to work within domestic politics. Interdependence both makes the status quo costlier, and allows privileged regulatory actors with (a) shared interests and (b) access to transnational regulatory forums to create alliances *across jurisdictions* to challenge domestic rules (Farrell & Newman, 2014; Shaffer, 2012; Sikkink, 2005). Problems of rule overlap have led to the creation of transnational forums, ongoing semi-formal venues in which regulatory actors discuss problems and seek to coordinate their approaches.[9] Hence, interdependence creates *opportunity structures*, which domestic actors may use either to defend or to reshape national bargains in a globalized world.[10]

Over time, agreements struck in such transnational forums can create cross-national institutional layers that destabilize domestic institutions and weaken alternative coalitions. Such alliances rarely impose formal rules. Instead, they develop soft law agreements or recommend changes to national policies. Even so, they provide participating actors with a platform to develop a joint regulatory agenda, inform each other about the state of play in different jurisdictions, and informally coordinate their regulatory actions across borders, effectively moving domestic reversion points. Actors without access to these cross-national forums will have less information and less legitimacy when they try to leverage international disputes for their own purposes. They will not be able to assure business that their own preferred solutions will resolve cross-national regulatory clashes. The opportunity structures created by interdependence, crucially, *are not equally distributed among regulatory actors*.[11]

This allows us to treat transnational forums as a source of endogenous change *within* national jurisdictions, through "cross-national layering."[12] Facing rule overlap and mounting uncertainty, international business will look to informal transnational agreements to alleviate contradictory demands. These agreements can become a new layer—a cross-national informal institution which overlays domestic rules. Business support for (and compliance with) transnational agreements reshapes the incentives of domestic regulatory actors who were previously inclined to block change. Given business convergence on transnational solutions, these blocking actors may find that

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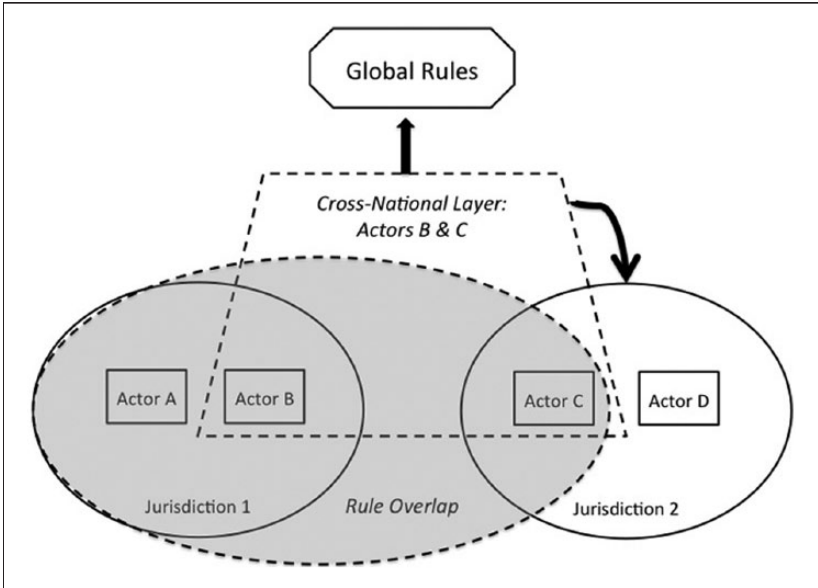

Figure 2. Cross-national layering model of regulatory politics.

their best available strategy is to engage the transnational rule-making process rather than suffer further erosion of influence. Over time, the transnational agreement can subsume or replace the domestic rule, making it ever less relevant to the actual behavior of key actors (e.g., businesses with cross-national exposure).

Cross-national layering, then, has two important consequences. Nationally, it offers an important channel for disaffected regulatory actors to use interdependence to alter domestic institutions. Globally, it brings actors from multiple jurisdictions together, so as to build institutional support in their respective jurisdictions for a particular set of global rules.

Figure 2 summarizes the logic of cross-national layering. Interdependence produces rule overlap as Jurisdiction 1's rules begin to affect actors in Jurisdiction 2. At the same time, interdependence creates opportunity structures for transnational alliances between regulatory actors B and C. The cross-national layer constructed by B and C feeds back into the domestic institutional context of Jurisdiction 2, creating domestic institutional change, thereby buttressing the new global rules.

The logic of cross-national layering offers consistent empirical expectations to guide the empirical analysis.

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E1: Interdependence induced rule overlap tends to create new frictions that will upset the domestic regulatory status quo.
E2: Opportunity structures provide change actors with an alternative political channel to alter domestic institutions.
Corollary: These opportunity structures are not equally distributed among actors.
E3: Cross-national layers offer an alternative to actors facing the uncertainty of rule overlap and thus may leach away support from previously stable domestic institutional arrangements.
Corollary: As the cross-national layer alters domestic institutional arrangements, it will in turn recast global rules.

We assume throughout that actors will take the best advantage they can of those opportunity structures that are open to them. These expectations contrast sharply with those of existing accounts, which stress either the switching costs associated with existing domestic regulatory structures or the role that domestic institutional veto points play in aggregating domestic preferences.[13]

In the next section, we trace the processes of change in two cases in the EU —surveillance information sharing and accountancy. Both cases rely on extensive primary documents. In addition, the authors conducted a series of 25 interviews with key actors in the surveillance domain between 2004 and 2012, including representatives from the major European institutions, data privacy authorities, business representatives, and U.S. policy makers. For the accountancy case, the article draws heavily on the Securities and Exchange Commission (SEC) Historical Society's Oral Histories, a yet untapped archive of interviews with key SEC officials.[14]

The cases were selected to draw as sharp a contrast as possible between our explanation and its competitors. In both cases, a period of stalemate is followed by adjustment by the EU. Existing approaches see changes in European veto points as the key explanatory factor in the surveillance case, emphasizing the institutional changes brought about by the Lisbon Treaty, which provide the European Parliament with the right to consent (or veto) international agreements (Romaniello, 2013; Servent & Mackenzie, 2011; Suda, 2013). In accounting, by contrast, alternative accounts emphasize switching costs, focusing on varieties of capitalism and differences in corporate governance between market-based and bank-based approaches (Gourevitch & Shinn, 2005; Lodge, 2003; Lütz, Eberle, & Lauter, 2011). The varieties of capitalism argument emphasize domestic reform within the bank-based economies as causing preference convergence. The two cases then allow us to contrast our argument emphasizing intersocietal interactions with

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dominant explanations, emphasizing different types of internal changes across two significant and empirically important cases.

We treat the EU as a unified polity, and so look for transnational interactions that reach out beyond the borders of the EU.[15] Applying our cross-national layering account across these two very different domains not only demonstrates the plausibility of the causal argument but also suggests its wider generalizability (Seawright & Gerring, 2008).

Interdependence and Surveillance Information Sharing

The September 11, 2001, terrorist attacks led to clashes between EU and U.S. rules on information sharing as the United States pushed through new anti-terrorism laws that had international consequences for Europe (Rees & Aldrich, 2005). EU institutions initially resisted external pressure, only to later start emphasizing security. Standard accounts argue that this is explained by the changing balance of power between legislative institutions within the EU. Specifically, these accounts focus on the competences of the civil liberties oriented European Parliament, which had only exiguous competences over homeland security issues before the Lisbon Treaty, and an effective veto thereafter as the Treaty allows the Parliament to reject international treaties (Romaniello, 2013; Servent & Mackenzie, 2011; Suda, 2013). Veto point explanations would predict either that the Parliament's new powers would move the EU's set of acceptable outcomes away from security and toward civil liberties, leading to a final outcome of no agreement (if there was no intersection between the sets of outcomes agreeable to the EU and to the United States) or a more privacy-friendly outcome (if there was such an intersection).

Our cross-national layering argument would instead examine whether or not an international forum existed, and which actors had access to it. In EU–U.S. disputes over information sharing, the relevant forums of high level officials were open to security-focused officials and closed to privacy-focused ones. This would lead us to predict that security-oriented actors in *both* the United States and EU could coordinate to build cross-national arrangements intended to weaken domestic privacy arrangements within the EU. These arrangements would provide predictability and find acceptance among affected businesses with interests in both jurisdictions. This, in turn, would lead to the destabilization of the institutional bargaining within the EU, as actors who had previously sought to defend existing institutional structures defected so as to continue to influence rule-making in a modified institutional setting.

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Society for the Worldwide Interbank Financial Telecommunication (SWIFT) and Rule Overlap

Conflicts about overlapping security and privacy rules played out through the organization SWIFT (the Belgium based Society for Worldwide Interbank Financial Telecommunication), which runs a secure messaging service for banks, organizing up to US$6 trillion in interbank transactions daily. After September 11, U.S. officials secretly demanded that SWIFT provide data on financial transactions (SWIFT, 2006). These data underpinned the so-called Terrorist Financing Tracking Program (TFTP), which U.S. officials claimed was crucial to the fight against terrorism (Levey, 2006; Obama, 2010). SWIFT's compliance with U.S. demands broke Belgian privacy laws. This delicate equilibrium persisted until June 2006, when the *New York Times* published details of the arrangement, causing furor among Europeans, and demands for EU-level action (Commission de la Protection de la Vie Privée, 2006; Lichtblau & Risen, 2006). Banks and financial institutions relied on SWIFT—as long as SWIFT was in legal limbo, they too faced uncertainty and possible liability.[16] Pressure from these institutions created strong incentives to reach a compromise.

U.S. and European officials concluded an agreement in June 2007, which made limited concessions to privacy advocates in Europe while data transfers continued (Office of Foreign Assets Control, 2012). The European Parliament was bitterly opposed to the deal but had no competence to overturn it.[17] This deal became the starting point for a new set of institutional dynamics between actors on both sides of the Atlantic, culminating in major changes to European institutions.

The Security Community and Transnational Opportunities

TFTP negotiations were dominated by EU and U.S. officials dissatisfied with the institutional status quo within the EU (Pawlak, 2009). European data regulation had previously been driven by privacy-focused actors—data privacy commissioners and the European Parliament, creating a set of privacy rules that provided exceptions for security-related information, but made data sharing more cumbersome (Newman, 2008). Both U.S. and EU security-oriented officials wanted to remake the European data privacy regime to facilitate regional and international data sharing.[18]

The EU's cumbersome legislative process (Farrell & Heritier, 2003) allowed the European Parliament to block internal legislative changes that might undermine privacy. This was reinforced by the member states' Data Privacy Commissioners, both in their national role and as members of an

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influential consultative EU-level regulatory group known as the Article 29 Working Party.[19]

Change began as E.U. foreign relations experts—who played a significant role in early negotiations—were replaced by security-oriented home affairs officials (Pawlak, 2009). Moreover, the European Commission's priorities had shifted dramatically, thanks to internal changes. For unrelated reasons, the European Commission's data privacy unit had been transferred from Directorate-General (DG) Internal Market in March 2005 to a privacy-focused unit in the DG for Justice, Freedom, and Security, which played the lead role in early negotiations over SWIFT (DG Justice and Home Affairs, 2005). It was soon sidelined in favor of the policing unit within DG Justice, which froze out privacy-friendly officials.[20] In addition, data privacy authorities and the Working Party had no formal role in Home and Justice affairs.

New trans-Atlantic arrangements, dominated by security-oriented actors from the two jurisdictions, emerged to resolve not only the SWIFT problem but to negotiate other aspects of privacy and homeland security (Pawlak, 2009). In November 2006, a High Level Contact Group of senior EU and U.S. officials began discussions over a broad-reaching set of proposals (High Level Contact Group, 2010). The High Level Contact Group issued its first report in May 2008, following it up with an addendum in October 2009. The Group did not reach agreement on definite principles, but laid the ground for the negotiation of a more formal EU–U.S. deal on privacy, which could take the form either of a binding international agreement or of soft law.

This created a tacit agreement between EU and U.S. security officials over a transnational regulatory layer that they hoped would cement relations and ease problems of security cooperation (especially on the European side), by supplementing, modifying, and perhaps over time even supplanting the existing EU privacy framework with one more amenable to security concerns. By creating common principles and procedures, applying them to existing and emerging controversies, and then seeking to make them a formal basis for EU–U.S. relations, these officials hoped to transform both trans-Atlantic relations and EU politics in institutionally congenial ways. As described by one negotiator, the High Level Contact Group was intended to provide "building blocks" for solutions to the problems that kept recurring, and over time create the basis for an enhanced information sharing agreement.[21]

European security officials did not anticipate immediately building a European TFTP system, which they feared would be vetoed by the Parliament. However, they did hope to build trans-Atlantic arrangements that could be layered on top of existing privacy institutions—and, over time tilt the EU's balance away from what they saw as excessive privacy concerns and toward national security.

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Altering Parliament's Preferences

In the midst of these discussions, the SWIFT controversy reemerged. The initial EU–U.S. deal had been based on the United States's direct access to SWIFT data. When SWIFT relocated its U.S. operations to Switzerland, the original deal proved moot. A failure to reach a new agreement on SWIFT would be a "nuclear option" that could plausibly stymie the future development of a trans-Atlantic institutional framework for information sharing.[22]

EU and U.S. officials sought to create an interim agreement as a stop-gap but also to set a precedent for a more general review, which would remake EU privacy law in more security-friendly ways.[23] However, as the Parliament continued to oppose the deal, the Council panicked, seeking and failing to get the agreement through before Parliament got new authority under the Lisbon Treaty (European Parliament, 2010a). The agreement was decisively rejected by the European Parliament in February 2010 (European Parliament, 2010a).

However, the Parliament's position *had* changed; while it continued to complain about privacy breaches, it found itself under pressure from the European financial industry, which emphasized how unhappy banks were with the stand-off, and stressed the "utmost importance" of a renewal of the "legal certainty" that had been undermined by the Parliament's rejection of the TFTP deal (European Banking Federation, 2010).

This, combined with the opportunity to shape post-Lisbon domestic security arrangements, presented the Parliament with different incentives than it had in 2006-2007. Rather than fighting burgeoning EU–U.S. cooperation, it sought a bigger role in shaping it, accepting an arrangement under which it would be "immediately and fully informed" at all stages of the negotiation (European Parliament, 2010b), creating a precedent for future negotiations (LIBE (Civil Liberties, Justice and Home Affairs) Committee, 2010).

This was not a simple product of the Parliament's increased bargaining power after the Lisbon Treaty came into effect, which actually made it *easier* for Parliament to stymie ongoing discussions between the EU and United States (Romaniello, 2013; Suda, 2013).[24] Veto point accounts would have predicted that an increase in Parliament's veto power would have led either to stalemate or a more privacy-friendly agreement.

Instead, Parliament's underlying preferences shifted quite radically. In 2009, European officials had declined to raise the possibility of a European TFTP lest it irrevocably alienate the Parliament.[25] Now, the Parliament made it clear that exactly such a program was its preferred solution. On May 5, 2010, the Parliament resolved to support a

> twin-track approach which differentiates between, on the one hand, the strict safeguards to be included in the envisaged EU-US agreement, and, on the

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> other, the fundamental longer-term policy decisions that the EU must address. (European Parliament, 2010b; see also Servent & Mackenzie, 2011)

and suggested that

> the option offering the highest level of guarantees would be to allow for the extraction of data to take place on EU soil, in EU or Joint EU-US facilities, and ask[ed] the Commission and the Council to explore . . . ways to phase into a medium-term solution empowering an EU judicial authority to oversee the extraction in the EU, on behalf of Member States, after a mid-term parliamentary review of the agreement. (European Parliament, 2010b, p.1)

These suggestions were taken, as they were intended, as an invitation to create a European TFTP program along American lines. The final EU–U.S. agreement incorporated this outcome (under the supervision of the European policing agency, Europol, rather than a judicial authority), while a Council/European Commission Declaration following from the agreement "acknowledges in the longer-term, the ambition for the EU to establish a system equivalent to the TFTP, which could allow for the extraction of data to take place on EU soil," and notes that the United States "has committed in the Agreement to cooperate and provide assistance and advice to contribute to the effective establishment of such a system" (European Council, 2010, p.3).

The transnational deal remade the regulatory bargain over security and privacy within the EU. It allowed the EU to follow the U.S. example by potentially constructing its own independent TFTP capacity over time. This privileges security over privacy concerns as European security officials (and their U.S. counterparts) hoped, and signals a dramatic shift in the Parliament's position.

The cross-national layering argument helps explain both the shift in the Parliament's stance and the final outcome. There was an initial disagreement within the EU between civil rights–oriented regulatory actors (data privacy commissioners, the European Parliament, some parts of the Commission), who wanted to preserve the existing European institutional bargain, and security-oriented officials (in justice and home affairs ministries, in other parts of the Commission, and in the Council) who wanted to remake it. As the latter came to dominate negotiations and trans-Atlantic policy networks, they struck up alliances with U.S. officials who also wished to weaken EU privacy policy, building a new transnational layer, which quickly attracted the support of banks and other transnational businesses, looking for regulatory certainty and stability.

This in turn altered the interests of regulatory actors, most importantly the European Parliament, which had previously sought to support the internal

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pro-privacy status quo. As it was nearly politically impossible to get rid of the transnational agreement—important businesses relied on it—the Parliament had to change its position. Rather than continuing to defend an increasingly fragile institutional *status quo ante*, the Parliament opted to support the *status quo post*, in return for some degree of influence over negotiations. As one skeptical member of the European Parliament describes it, the outcome

> fits the trend whereby whatever instruments the US has for counter terrorism and other law enforcement purposes is copied by the European Union . . . via the back door, a European TFTP will be created. It is the umpteenth example of what we call policy laundering. There have been many examples where either the US or the member state governments who usually work in tandem want something; the European member states know that if they present such a proposal to their national parliaments there is no way in hell they are going to get it, so what they do is they hide behind some international agreement in order to get it.[26]

This long-term shift away from privacy and toward security has been challenged both by practical difficulties in setting up a European TFTP and ongoing revelations, suggesting that the National Security Agency has continued to monitor SWIFT data in ways that contravene the EU–U.S. agreement. However, opponents of these emerging arrangements will likely have to accept some of the victories of pro-security actors if they want to push for broader institutional change.

Interdependence and International Accounting Standards

In 2001, the EU surprised the financial community by endorsing international accounting standards created by the International Accounting Standards Board (IASB) for firms listed within its jurisdiction, resolving a three-decade policy log jam. In response to the EU shift, the U.S. SEC has now recognized these standards for foreign firms listed on U.S. exchanges.

What accounts for this shift? Globalization has certainly increased the demand for harmonized accounting rules (Martinez-Diaz, 2005; Perry & Nölke, 2006)—but has not resolved the question of *which* rules should predominate. These technically dense standards underpin modern finance, providing the information necessary for managers, investors, and creditors to make decisions (Véron, 2007). According to the varieties of capitalism literature, accounting standards play a key role distinguishing neo-liberal shareholder value models from those privileging coordinated patient capital (Perry & Nölke, 2006; Vitols, 2001). Transparency and open reporting (generally speaking) benefit investors, the international accounting firms that represent

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them, and financial analysts. Calculating assets by their historical value, by contrast, helps manufacturers or small businesses manage long-term investments (Botzem, 2012).

Although firms might benefit from coordination on common rules, they must pay the switching costs associated with moving from the old to the new (Büthe & Mattli, 2011). Moreover, domestic regulatory agencies risk losing authority to other regulators or an international standards body. Distributional costs and sovereignty losses, then, have consistently raised roadblocks to international cooperation.

The scholarly debate on EU accounting standards and corporate governance reform has focused on switching costs (Fioretos, 2009; Gourevitch & Shinn, 2005). One literature, following economic theories of globalization, has emphasized how globalization imposes adjustment costs on EU firms that want to remain competitive. Firms following standards developed for patient capital face difficulties raising capital in shareholder value based markets and vice versa (Simmons, 2001). Under this logic, globally oriented companies pressured the EU to shift accounting standards so that firms could more easily raise capital on U.S. markets.

An alternative, domestically focused literature focuses on how switching costs help national institutions persist in the face of competitive pressures, identifying corporate governance arrangements that resist globalization (Gourevitch & Shinn, 2005; Lodge, 2003; Lütz et al., 2011). In some areas, like labor representation on corporate boards, legislative change has been largely paralyzed (Cioffi, 2010). In others, like company law, weak rules have been passed that fail to create real standardization (Deeg & Perez, 2000; Fioretos, 2009).

The accounting standards case, then, presents a striking puzzle for switching costs accounts. For nearly 30 years, global markets and U.S. pressure were unable to get advocates of "patient capital" and a European model to change their standards. However, when change occurred, it was not adoption of the U.S. model but, instead, convergence on an alternative platform of standards developed by non-state actors. Switching costs accounts have difficulty in explaining why *both* the EU and the United States now seem to be converging on a model that was initially chosen by neither actor.

Our alternative explanation highlights cross-jurisdictional struggles between investors, creditors, and regulators over distributional costs and sovereignty losses. While globalization certainly put pressure on national European systems and those systems filtered these pressures, intersocietal interactions between policy actors in the EU and the United States played a decisive role. Specifically, a transnational coalition supporting investor interests built a cross-national layer that over time unsettled internal domestic

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bargains within the EU and the United States and thus allowed a transformation of global rules.

A Transnational Opportunity for Investor Interests

From early on, the IASB relied on a transnational coalition of large accounting firms, who wanted to transform accounting into an investor-protection regime, in which they could expand their markets as firms expanded their multinational presence (Nölke & Perry, 2008).

U.K. representatives also wanted to create an alternative to EU policies that might exclude them. The IASB allowed these bodies to build a coalition with others who preferred an investor-focused regime. Anthony Hopwood, founder of the European Accounting Association, explains in 1994:

> The British accountancy bodies were worried by the potential consequences of what they saw as the imposition of continental European statutory and state control . . . Wanting to have a more institutionalized manifestation of British commitment to a wider transnational and Commonwealth mode of accounting, with the cooperation of its partners in the primarily English language audit community, the IASC was established. (Hopwood, 1994, p. 243; see also Seligman, 2003)

This attracted potential defectors from within countries with less-investor-focused regimes. German representatives on the IASB, for example, came from global accounting firms such as KPMG or Arthur Anderson and multinational companies (MNCs) such as Daimler (Perry & Nölke, 2005).

The IASB thus created its own set of accounting standards. Like the standards used in the United States (the U.S. Generally Accepted Accounting Principles [USGAAP] standards), they favored the interests of investors, rather than the kinds of patient capital characteristic of small-or medium-sized enterprises. However, they also differed from U.S. standards in both their form (which was looser) and their goal (setting an international coordination point that would both buttress U.K. finance against Continental pressures, and mobilize defectors from less investor-friendly regimes).

Developing a Core Set of Standards—SEC Accesses the Transnational Opportunity

The United States, like the EU, had substantial internal divisions over accountancy standards in the 1980s. A core group of regulators including the Financial Accounting Standards Board (FASB), a private standard setter in

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the United States, as well as key players within the SEC, favored the U.S.-dominated USGAAP as the international standard. Foreign jurisdictions increasingly accepted USGAAP without reconciliation. Key U.S. actors, including the FASB and the dominant faction within the SEC, saw the extra-territorial spillover of U.S. rules as promoting USGAAP. They resisted efforts to negotiate common standards with other countries through the IASB.

Donald Kirk, the FASB chair in the early 1980s, for example, argued in 1983 that "we have our plate full with the problems just in this country. I personally am very pessimistic about any super-national standard setting" (Camfferman & Zeff, 2007, p. 163). This skepticism persisted through the 1990s. FASB Vice-Chair Jim Leisenring concluded in 1998 that IASB standards were "sacrificing quality for the sake of convergence" (Camfferman & Zeff, 2007, p. 339). SEC Chairman David Ruder and Linda Quinn, head of Corporate Finance at the SEC, were similarly wary of international harmonization efforts.[27]

The SEC, however, was also developing an explicit international competence. Starting in the 1980s, the SEC began to study and address the consequences of regulatory differences with foreign markets. Several SEC leaders, including Chairman Richard Breeden, Arthur Levitt, and Charles Cox, used international issues to enhance the agency's clout (Seligman, 2003). In 1987, the agency created an international affairs department to better cooperate with peer regulators from other jurisdictions as well as standard setters such as the IASB.[28]

This exposed the SEC to conflicting pressures from different economic interests. On one hand, many within the United States still supported USGAAP standards. On the other hand, the New York Stock Exchange (NYSE), which wanted to attract global companies, saw USGAAP as a competitive disadvantage, especially after the London Stock Exchange allowed foreign companies to use IASB without reconciliation, and lobbied Congress and the SEC to ease the regulatory burden. The NYSE actively promoted the IASB effort to undercut domestic regulatory burdens. As Michael Sutton, chief accountant at the SEC during the 1990s, explains,

> Again, everything really focuses on an intense desire on the part of foreign registrants, and the stock exchanges in the U.S. to make it easier for foreign issuers to come to the U.S. market. There were all kinds of concerns about the U.S. market losing its pre- eminence and more capital going into the London markets.[29]

This lobbying effort persuaded Congress to charge the SEC in the National Securities Markets Improvement Act to study and move forward with support

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for international accounting standards. The SEC's 1997 report made clear its continued skepticism of IASB standards. But the presence of the IASB standards as a transnational layer offered the NYSE a clear alternative to USGAAP, which could mobilize others around. As James Cochrane of the NYSE concluded in 1993, "European companies have indicated that all they need is US acceptance of IASC principles and they'll be knocking down the door of the NYSE and US capital markets" (Camfferman & Zeff, 2007, p. 339).

At the same time, the SEC feared that foreign firms listing on U.S. exchanges lacked adequate regulatory oversight. Engaging the IASB process allowed the SEC to improve standards globally and protect its own domestic regulatory sovereignty. As Sutton continues,

> The stock exchange lobbied rather heavily to influence the Commissioners to accept—at least to get on a path to accept international standards in U.S. filings. And the core standards project was a way of not necessarily accomplishing that, but establishing a process by which . . . there was a critical analysis and a critical look at the important differences between U.S. standards and international standards.[30]

The SEC, through the International Organization of Securities Commissions (IOSCO), engaged with the IASB to refine IASB standards. Members of the IASB and IOSCO attempted to revise IASB core standards, so as to eliminate variation and develop a functioning set of international standards. This collaboration offered both sides important benefits. IASB members wanted to diffuse IASB standards, and saw IOSCO, and implicitly SEC, endorsement of its standards as a way to do this. At the same time, the SEC feared that market internationalization might spur a race to the bottom, which would in turn undermine U.S. market regulations (Singer, 2007). IASB–IOSCO collaboration offered the IASB increased legitimacy and the SEC a partial buffer against regulatory competition (Camfferman & Zeff, 2007).

The IASB's membership—representatives from the Big Four international accounting firms, international banks, and multinational corporations—made adjustment to SEC demands easier. All largely supported the SEC's investor-protection paradigm. Less internationalized continental firms that relied on patient capital were not represented on the board (Botzem & Quack, 2009; Perry & Nölke, 2005). The cross-national forum of the IASB thus privileged certain interests over others.

The IOSCO–IASB interaction narrowed and strengthened the core standards. IASB could credibly argue that their standards formed the basis for

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global convergence. The international faction of the SEC reshaped IASB standards, but was eventually challenged by skeptics (Camfferman & Zeff, 2007). In 2000, the SEC released a call for comment on the standards in which many U.S. players including FASB (the U.S. private sector standard setter) continued to raise concerns about the quality of the standards.

Hence, *contra* the switching costs account, this was not a simple process of market adjustment. Instead, the SEC actively developed IASB standards, even while remaining ambiguous about their ultimate role.

The EU Minds the GAAP—Regulatory Overlap Alters Regulatory Preferences

The SEC neither endorsed nor rejected the IASB standards. The EU change of heart, when it came, was far less equivocal. It endorsed IASB standards for use by European firms conducting consolidated reports and listed on qualifying exchanges (Posner & Véron, 2010).

This U-turn was extremely surprising given previous EU behavior. Up through the 1990s, the Commission viewed accounting standards as an internal market matter. EU harmonization efforts led to loosely worded Directives that did not result in any real convergence between shareholder and patient capital models. The Commission was highly skeptical of the IASB, refusing, unlike the FASB, an invitation to become an observer member. The representative of DG Market responsible for accounting issues, Karel Van Hulle, repeatedly rejected IASB's mission and cast doubt on its work, dismissing the interests of MNCs hoping to list abroad, and describing harmonization as "unthinkable" (Camfferman & Zeff, 2007, p. 425).

During the early 1990s, the Commission found its efforts to create a European regulator blocked by the United Kingdom. Furthermore, the Commission and several member states could not persuade the SEC to recognize European standards (European Commission, 1995).

As regulatory overlap with the United States increased, the Commission began to change track. The finance bubble of the 1990s pulled European firms to list on U.S. stock exchanges, obliging them, under SEC rules, to reconcile their accounts with USGAAP, requiring double reporting that raised many questions about MNC profitability. Daimler Benz in 1993, for example, went from showing 615 Deutsche Mark million profit to a Deutsche Mark 1,839 million loss based on differences in how liabilities were considered under the different regimes. Different reporting requirements created overlapping rules that left multinational firms very unhappy.

As firms switched to USGAAP and national European governments began to accept it for domestic reporting requirements, the IASB became more

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enticing. It not only provided an alternative to straightforward U.S. dominance but also began to represent the interests of MNCs that were defecting from European rules. The Commission shifted its strategy away from a homegrown European standard to the transnational initiative:

> Large European companies seeking capital on the international markets, most often on the New York Stock Exchange, are obliged to prepare a second set of accounts for that purpose . . . Moreover, it involves companies in conforming with [US GAAP] which are developed without any European input . . . There is a risk that large companies will be increasingly drawn towards US GAAP . . . Of the various international bodies working on accounting standards, for the time being only the IASC is producing results which have a clear prospect of recognition in international capital markets within a timescale which corresponds to the urgency of the problem. (European Commission, 1995, para. 1:3, 3:3, 4:4)

The IASB offered a second best strategy for the Commission. Under conditions of regulatory overlap, the Commission realized that it could not develop and control its own regional standards. While delegation to the IASB would involve some sovereignty losses, it would shore up Europe against the extraterritorial extension of USGAAP.

This outcome is hard to explain using standard switching costs arguments. It is surely not a case of simple convergence on the U.S. model. An initially halfhearted embrace of the IASB allowed the SEC substantially to influence its standards, without positively endorsing them. The EU, recognizing that it could not produce its own standards because of internal divisions, decided to adopt IASB standards more forthrightly, albeit through a mechanism which allowed the EU influence over IASB rules too. Hence, the final result was not a win for either the EU or United States. Although both gained from the outcome, each would have preferred to see its own standards prevail.

Nor is it a story about the persistence of national institutions protected by switching costs. Both national systems changed in important ways. In counterfactual terms, without the IASB as a cross-national forum and producer of alternative rules, U.S. firms would have remained attached to USGAAP.[31] In contrast, the EU would have likely faced continued paralysis, as there was no appetite to adopt either the U.K. or German model of accounting. Neither of these predicted outcomes matches the outcome observed.

Our account highlights divergences *within* the EU and United States, and how regulatory actors who were dissatisfied with their existing national bargains used the forum of the IASB to create a cross-national alliance in pursuit of change. U.K. accountancy bodies (which wished to preserve the U.K. sys-

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tem) allied with potential defectors on the European Mainland to create international standards that might spring them from their trap.

This coalition only really influenced outcomes when interdependence and rule overlap began to bite on both sides of the Atlantic. In the United States, stock exchanges pushed against national standards, which they feared were discouraging business. In the EU, firms that needed to cross-list to raise money in the United States found themselves trapped between very different accounting systems that hurt their market credibility. Business actors in both jurisdictions began to press their regulators to adopt IASB standards—not because of their specific content, but because they provided the most obvious solution to this conundrum.

This led to regulatory change in both sides of the Atlantic. If anyone "won," it was not a state, but the coalition that supported IASB activities, a transnational alliance of accountancy bodies, accountancy firms, and others favoring a global accounting standard based in investor protection and shareholder value. The IASB offered public and private interests an alternative policy platform, which favored some interests over others. While it had representatives from "patient capital" countries, these nearly invariably represented interests that were at odds with the dominant approach of their home jurisdiction.

This group succeeded in creating a cross-national layer that altered the domestic *status quo* in both the United States and EU. In the United States, it gradually undermined support for USGAAP in international issues and is inexorably encroaching on domestic standards too. In the EU, it has come to be the dominant standard *tout court*. A transnational set of rules and regulations has altered domestic markets in both jurisdictions in quite fundamental ways and in turn global rules.

Conclusion

In this article, we have argued that models of institutional change need to more fully incorporate the implications of globalization. Existing approaches tend to separate levels of analysis with international relations scholars emphasizing how coercion and competition force adjustment, and comparativists examining how domestic institutions filter global pressures so as to produce varied responses. While globalization does not lead to undifferentiated adjustment or diffusion of global rules, it has consequences invisible to the "methodological nationalism" of many accounts of institutional change.[32] As economic interdependence leads to increasing interpenetration *between* hitherto discrete national political systems, we need to revise our theories to highlight this interpenetration and the important role of cross-national alliances

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and forums. Our findings here illustrate one aspect of what we have termed elsewhere the "new interdependence" (Farrell & Newman, 2014).

Bridging literature on interdependence and domestic institutional change, we build a framework that emphasizes intersocietal interactions. While acknowledging the pressure imposed by interdependence, we emphasize its role in constructing opportunity structures for change agents that hope to unsettle their domestic status quo. At the same time, however, we use insights from historical institutionalism to refine arguments about transnational politics by considering how transnational institutions—often informal—serve as cross-national layers. Empirically, one cannot understand institutional change in either the case of informational surveillance or accounting standards without paying attention to the crucial role of a cross-jurisdictional coalition of actors, which was able to use privileged access to cross-national forums, to shape a new institutional layer and hence influence domestic political dynamics. At the same time, we acknowledge the limits of this theory-building exercise and would encourage future work to expand the sectors under study as well as move from advanced industrial democracies to evaluate these dynamics in the global south. Scholars might also examine how these dynamics work within institutional contexts (such as the EU) that we treat as single regulatory actors (Majone, 1996).

Our arguments pave the way for a concrete research agenda for collaboration between the sub-fields of comparative politics and international relations. While scholars from both sub-disciplines have long called for such efforts, we offer a theoretically informed model of politics that integrates insights from both. In so doing, we add specificity to loose conceptions of intersocietal interactions that existed in International Relations while building cross-national and relational elements into historical institutional accounts.

The next step is to investigate the scope conditions for the key elements of the argument—the importance of relative access to transnational forums. Literature on context effects, for example, stresses the importance of the institutional environment for the likely relevance of a specific causal mechanism. Future work should consider how the density of international institutionalization shapes the role of such intersocietal interactions. Does the presence of a formal international organization, such as the World Trade Organization, limit the importance of soft law bodies? Similarly, we expect that actors are differentially positioned to access such transnational forums. Scholarship on institutional fit offers one set of testable hypotheses here. Jurisdictions that employ self-regulatory oversight for a sector, for example, are likely to be ill-suited to participate in transnational forums of public sector regulators. In short, the historical trajectory of domestic regulation will likely condition the transnational resources of actors.

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To be clear—we do not argue that cross-national layering is the only plausible mechanism of cross-national influence, or the only way to investigate cross-national causal relations (Mosley & Uno, 2007; Murillo & Andrew, 2005). For example, recent work by Kathryn Sikkink (2005) provides an alternative, and in some ways complementary, account of the relationship between international opportunity structures and the efficacy of social movements. Similarly, work on experimentalist governance highlights the interaction between international cooperation and the reordering of domestic institutions (Sabel & Zeitlin, 2010). These emphasize different aspects of politics, respectively stressing norms and ideas and learning. Our argument, by contrast, highlights how timing and history structure politics by shaping access to such transnational interactions, with downstream consequences not only for domestic institutions but also for global cooperation. It is only by opening up a new research agenda, aimed both at identifying plausible mechanisms and, as more data are gathered, identifying the circumstances under which they are more or less likely to apply, that we will make substantial progress in understanding the workings of globalization.

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Notes

1. Adapting Mattli and Woods (2009), we define economic regulation as the organization and control of market activity, through rules promulgated by public or private entities, which are recognized by market actors as the authoritative rule setters in the relevant area.

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2. While China might soon have regulatory power, it has so far been primarily a rule taker (Drezner, 2007).
3. For a broader discussion of the emerging scholarship on the consequences of the “New Interdependence” for regulatory politics, see Farrell and Newman (2014; see also Farrell & Newman, 2010; Fioretos, 2011; Nye & Keohane, 1971).
4. Although globalization has other aspects, rule overlap will have especially important consequences for institutional change, as it both destabilizes existing domestic institutions and creates new opportunities for those wishing to change them. See Berger, 2000.
5. Here, we translate the concept developed by Hacker (2004), Sheingate (2003), Shickler (2001), and Thelen (2004).
6. There is controversy over whether the EU should be considered as a state. While there are complex relations between the EU level and the politics of its individual member states, the EU level is important for most areas of regulation and considered as a polity (Majone, 1996).
7. Drezner (2007) argues that sometimes with high switching costs, states can coordinate on “sham” standards that have little or no substantive content. However, the agreements identified in this research are real and substantial. We are grateful to an anonymous reviewer for pressing us to elucidate on this point.
8. For more extensive discussion, see Farrell and Newman (2014).
9. Slaughter (2004) and Raustiala (2002) provide detailed accounts of these forums, which they call “transgovernmental networks,” emphasizing how they involve “specialized domestic officials *directly* interacting with each other, often with minimal oversight by foreign ministries.”(Raustiala, 2002, pp. 4-5). As they use the term *network* broadly, referring not to social structures with vertices and ties, but instead to informal or semi-formal interactions, we adopt more specific terminology. See also Djelic and Sahlin-Andersson (2006).
10. Our arguments are closely related to Kathryn Sikkink’s (2005) discussion of how open international institutions can provide “international opportunity structures” for domestic actors. Tarrow (1989) includes four major components of an opportunity structure: the openness of political access, the extent of stability in political alignment among the major political players, the availability of political allies, and the existence of political conflict among elites. Börzel and Risse (2003, 63) define opportunity structures as changes in the political environment that “offer some actors additional resources to exert influence, while severely constraining the ability of others to pursue their goals.”
11. Here, we treat this distribution as a given. For more detailed discussion about how opportunity structures might be generated, see Farrell and Newman (2014).
12. This logic is a cross-national variant of the national-level mechanism of “layering” discussed by Shickler (2001) and Thelen (2004).
13. This is the logic of a broad swath of literature including two-level games (Evans, Jacobson, & Putnam, 1993), convergence/divergence (Berger & Dore, 1996), and varieties of capitalism (Hall & Soskice, 2001).
14. See http://www.sechistorical.org/museum/oral-histories/a-d/

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15. Following Majone (1996), we treat the EU as a unified *regulatory* polity, as the EU level has extensive regulatory competences in both these areas.
16. The European financial community was extremely “vocal,” and “raised hell” about the need to resolve the Society for the Worldwide Interbank Financial Telecommunication (SWIFT) dispute (Interview with European privacy official, 2008).
17. Interview with European Commission Official A, 2008; Pawlak (2009).
18. Interview with European Commission Official A, 2008.
19. Interview with European Commission Official A, 2008; Interview with European privacy official, 2008.
20. Interview with Commission Official B, December 2009.
21. Interview with European Presidency official, December 2009.
22. Interview with European Presidency official, 2008.
23. Interview with European Commission Official A, 2008.
24. An alternative hypothesis might look to differences in the partisan composition of the European Parliament pre- and post-2009. However, the partisan composition of the Parliament only shifted moderately and unsystematically (both the Christian Democrats, which were more sympathetic to security interests, and the Green coalition, who were vehemently opposed, gained seats). More generally, the Parliament has tended to act as a single body when institutional gains of influence are at stake. See Farrell and Heritier (2003).
25. Interview with European data privacy official, December 2009.
26. Interview with member of European Parliament, 2011.
27. Interview with Lynne Turner, former Securities and Exchange Commission (SEC) chief accountant, SEC Historical Society, June 16, 2005.
28. Interview with Michael Mann, former head of SEC International Division, SEC Historical Society, June 13, 2005.
29. Interview with Michael Sutton, former chief SEC accountant, SEC Historical Society, June 14, 2005.
30. Interview with Michael Sutton, former chief SEC accountant, SEC Historical Society, June 14, 2005.
31. In contrast, Drezner (2007) argues that non-state forums and organizations only have very limited influence under very restrictive conditions on international regulatory outcomes.
32. Callaghan’s (2010) arguments usefully supplement and qualify our own, highlighting the conditions under which actors in different jurisdictions will or will not want to cooperate with each other.

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