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Defection and Hierarchy in International Intelligence Sharing

JAMES IGOE WALSH *Political Science, University of North Carolina at Charlotte*

ABSTRACT

Intelligence sharing among countries with different technical capabilities and local knowledge is particularly valuable for countering terrorism, transnational organized crime, and the proliferation of weapons of mass destruction. States participating in intelligence-sharing arrangements must balance the benefits of more and better intelligence against the possibility that their partners will withhold or distort the information they share or will pass along to others the information they receive. Participants can balance these benefits and risks by introducing elements of hierarchy into their sharing agreements. Hierarchical arrangements allow a state to monitor more effectively for defection and to reassure others of its own commitments to the terms of their sharing arrangement. I evaluate this argument by analyzing intelligence sharing between the United States and Britain and West Germany during the early cold war, and conclude with some insights the approach sheds on contemporary sharing arrangements and problems.

Introduction

The sharing of intelligence between national governments is at the centre of their attempts to cooperate on contemporary problems such as preventing the proliferation of weapons of mass destruction and stopping the activities of terrorist groups and drug traffickers. The importance of accurate intelligence for devising effective policies to deal with such threats has led scholars and practitioners to devote more attention in recent years to how intelligence collection and analysis can be improved. Almost all of these critiques, analyses, and proposals for change have focused on how governments can strengthen their national efforts. Few analyze intelligence sharing among governments in detail, despite the fact that sharing is a crucial source of intelligence. This paper investigates

why intelligence sharing occurs, the forms that it takes, and how it can shape foreign policy choices.

While governments can secure much valuable intelligence from partners overseas, they also worry that these partners will defect from agreements to share fully and honestly. Defection can take the form of passing shared intelligence to unauthorized third parties, or sending inaccurate, incomplete, or fabricated intelligence to others. The costs of such defection can be high. Partners that do not secure shared intelligence adequately may reveal useful and highly secret sources or methods of collecting intelligence. Receipt of dishonest or inaccurate intelligence might lead a government to take actions that are contrary to its interests. The possibility of defection is a barrier to international cooperation in many issue areas, and overcoming it requires mechanisms that provide states with reliable information about past defection by their partners and the linking of future defection to harm to the defector's reputation. Creating such information mechanisms is particularly difficult in the area of intelligence sharing; the fact that the most valuable intelligence is obtained through means that states wish to keep secret makes it very difficult for them to garner reliable information about the extent to which their partners have abided by agreements to share such intelligence.

Governments seeking to share intelligence often create hierarchical relationships to manage risks that partners will defect. Hierarchical agreements to share intelligence include a dominant state responsible for making most important decisions and for monitoring compliance, and subordinate states that receive benefits such as shared intelligence, foreign aid, and protection from external threats in exchange for following the dominant state's lead. Governments agree to create and to enter such hierarchies, even when they infringe on national decision making autonomy, because they are a reliable way to mitigate concerns about defection and to engage in mutually beneficial cooperation. Hierarchy allows the dominant state some room to directly manage and oversee subordinate states' intelligence collection and analysis. This makes it easier for the dominant state to detect or prevent defection by subordinate states. To entice subordinate states to surrender some authority, the dominant state in turn provides material benefits such as foreign aid or security guarantees and credible guarantees that it will not exploit its position of dominance for short-run gain. Hierarchy is particularly useful in the area of intelligence sharing, where it is otherwise difficult for states to determine if their partners are complying with an intelligence sharing agreement or are defecting.

While hierarchy is a common solution to the problem of defection in the area of intelligence sharing, its value to governments has not been adequately recognized by the specialized literature on intelligence

sharing or the dominant strand of scholarly analysis of international cooperation. I draw on the theoretical approach known as transaction-cost economics or relational contracting to explain the conditions under which states will create a hierarchy to govern their intelligence sharing activities. Initially developed by Ronald Coase (1937, 1960) and Oliver Williamson (1975, 1985) to explore the organization of firms and the implications of property rights, relational contracting has since been used to understand a wide array of economic, political, and organizational issues. More recently, analysts have begun to use relational contracting to explore how governments can engage in cooperation through hierarchical arrangements that transcend, at least in a limited way, the anarchical nature of the international system (see especially Lake 1996, 1999; Weber 1997). I draw on this line of thinking to argue that hierarchy is an attractive option to both dominant and subordinate states when (1) each can benefit from exchanging intelligence but (2) the costs of defection by the other is high and (3) hierarchical monitoring, oversight, and enforcement mechanisms are available at an acceptable cost.

This approach to intelligence sharing yields novel empirical insights. The empirical portion of the paper analyzes intelligence sharing between the United States and Britain and Germany during the early cold war. These cases are useful for evaluating the argument advanced here because many relevant documents have been declassified recently. Both are also the subject of a large historical literature. This allows one to determine the explanatory leverage of the relational contracting approach put forward here has compared to extant understandings of the cases. The existing literature generally describes Anglo-American intelligence sharing during this period as based on a shared division of labour and very open sharing of intelligence. I find that such openness was sustained by the fact that the key arrangements between the two countries allowed the United States to exercise considerable direct and indirect control over its British counterpart. This hierarchy in the relationship has been noted in the historical literature, but how it underpinned sharing and why each state agreed to it had not been adequately addressed. Such hierarchy is explicable with the relational contracting approach put forward here. The United States had greater fears that postwar Germany would defect from agreements to share intelligence. These concerns explain why it negotiated even stronger elements of hierarchy into its sharing arrangement with the Federal Republic than it did with Britain. The German case also demonstrates that hierarchy can be negotiated and entered into voluntarily by dominant and subordinate states because it provides important benefits to both. While the United States could have collected valuable intelligence with its own agencies in Germany, doing so would have been less

efficient than cooperating with a local partner familiar with local conditions. Hierarchy allowed the United States to obtain the benefits of such cooperation while minimizing the chances of defection. Germany also benefited from the hierarchical nature of this agreement, since it placed some constraints on how the United States could act.

These findings imply that sharing in the contemporary era can be carefully managed and negotiated to provide states with valuable intelligence. I take up this point in the concluding section by applying insights from relational contracting to better understand contemporary intelligence sharing between the United States and countries in the Middle East and South Asia as well as among the members of the European Union.

Understanding intelligence sharing

By 'intelligence' I mean the collection and analysis of publicly available and secret information with the goal of reducing policymakers' uncertainty about a foreign policy problem. Intelligence sharing occurs when one state – the sender – communicates intelligence in its possession to another state – the recipient. Intelligence sharing arrangements vary in important ways. Most pairs of countries share little or no intelligence with each other. In some arrangements, such as that between the United States and Great Britain which began during the Second World War and continues today, the parties routinely share intelligence on a wide range of issues of mutual concern. Other agreements are more limited, with the parties sharing intelligence on some topics but not on others. Many contemporary intelligence sharing arrangements between the United States and countries in the Middle East and South Asia, which focus on intelligence concerning terrorist groups, take this form. Some intelligence sharing arrangements involve the exchange of primarily 'raw' intelligence; the sharing between the United States and China of signals intelligence on the Soviet Union during the cold war is a good example. Others focus on trading the conclusions of analysts; the member states of the European Union, for example, share more such finished intelligence than they do raw intelligence. In some agreements one state exercises some direct control over the intelligence collection and analysis conducted by another state. For example, in the early cold war period the United States took a direct role in the management and oversight of the intelligence activities of West Germany, and in recent years has encouraged the restructuring of intelligence and security agencies in Latin America corrupted by drug trafficking organizations.

My objective is to explain this variation in the existence and form of intelligence sharing agreements. The starting point here is that

intelligence sharing is a form of international cooperation that delivers to at least one participating state the benefits of more or better intelligence. The most important barrier to intelligence sharing is the fear that other participants will defect and violate their agreement to cooperate. How do states balance these concerns about defection against the benefits of sharing? A rich literature analyzes the costs and benefits to each country of engaging in intelligence sharing (Aldrich 2002; Johnson 2000; Richelson 1990; Wirtz 1993). Cost/benefit analysis is a crucial starting point for achieving a more general understanding of intelligence sharing. But its application to date to this topic has limitations. Analysts have developed detailed lists of potential costs and benefits, but have not explained systematically how governments weigh or value these or developed research designs beyond the use of illustrative cases. In particular, this work does not address hierarchy as such or explain in detail what function it serves in facilitating intelligence sharing.

Most of the literature on intelligence sharing is practical in orientation and does seek to engage theoretical debates about international politics. But such theories may complement the policy orientation of the extant research on intelligence sharing by illuminating causes and consequences that have been overlooked. A promising theoretical orientation is neoliberal institutionalism. Institutionalists conclude that under certain circumstances states can use bargaining strategies and develop international institutions that create incentives to forgo defection (Axelrod and Keohane 1985; Keohane 1984). For example, states can develop international organizations that define what actions constitute cooperation and defection and that monitor states' compliance with these guidelines. States also may pursue bargaining strategies such as 'tit-for-tat' aimed at punishing defection by their partners or undertaking 'costly signals' that allow one state to determine if another is more likely to cooperate or to defect. Linking agreement across issue areas motivates states to preserve their reputations for honest dealing, as defection on one issue may reduce the willingness of other states to cooperate on other issues. The key mechanism underlying these strategies and institutions is encouraging transparency about others' motives and actions. States are more likely to engage in potentially risky cooperation if they know they will have reliable information about their partners' compliance or defection and about how such partners will behave in the future. But access to reliable information is difficult to obtain in the area of intelligence sharing. The details of most intelligence sharing arrangements are kept secret from third parties. This makes it difficult for one partner to harm another's reputation through an accusation of defection, since doing so necessitates revealing details about the intelligence that has or was supposed to have been shared. The fact that governments surround their intelligence

gathering and analysis with considerable security makes it hard for outsiders, including partners to a sharing agreement, to determine if their partners are living up to the terms of their arrangement. Concerns about security also complicate efforts to reassure partners by undertaking publicly observable commitments that, if violated, would undermine a government's reputation.

The application of relational contracting to intelligence sharing that I develop here builds on insights generated from the work on cost/benefit analysis and from institutional theory. Cost/benefit analysis contributes a list of benefits that states seek and concerns they hold when they share intelligence. Relational contracting has much in common with institutional theory. Both hold that in many situations states' interests are compatible enough to allow the realization of joint gains from cooperation, and that they can develop practices that can help in detecting and punishing defection. Both also acknowledge how the anarchic nature of the international system hinders cooperation. The difference is that institutional theory expects that cooperative arrangements are consistent with anarchy in the sense that they do not infringe on state's ability to make autonomous choices or to subject themselves to a higher power (see especially Keohane 1984). Relational contracting, in contrast, holds that while sovereign states may be formal and legal equals, in practice they can and do develop hierarchical institutions that provide some states with the ability to directly manage and oversee the activities of others. Relational contracting, then, imagines a much larger range of authority patterns and institutions that the assumption of anarchy leads institutionalists to overlook. This is not to say that relational contracting imagines that all or even most international agreements are hierarchical. Instead, it adds to the insights generated by institutionalism about the conditions under which cooperation occurs by specifying the conditions under which both dominant and subordinate states will conclude that a hierarchical arrangement serves their interests.

Gains from intelligence sharing

Intelligence and intelligence sharing are important because decision makers often face a great deal of uncertainty when crafting foreign policy. They may be uncertain about the true intentions of friends and foes, the capabilities of others to deliver help or harm, the full range of policy options available to them, and the outcomes that will result from the implementation of these policies. Decision makers seek relevant and timely intelligence to reduce their uncertainty. National governments devote significant resources to intelligence collection and analysis, but decision makers are rarely satisfied with the quality and quantity of

intelligence made available to them. They therefore often engage in sharing with their counterparts in other countries. Shared intelligence can decisively shape decision makers' perspectives on the problems they face and the policies they select by providing them with important information beyond that available to their national intelligence agencies. The principal benefit from sharing for recipients is the acquisition of intelligence that is valuable to decision makers but otherwise unobtainable at an acceptable cost. Concrete examples would include shared intelligence from other governments' signals intercept stations, reconnaissance aircraft, or satellites that cover areas of the world not monitored by the recipient's intelligence agencies, pooling manpower to analyze an intelligence target that is of interest to both governments, coordinating networks of agents providing human intelligence, or joint investments in the development of new technologies useful for intelligence collection or in expensive intelligence assets such as satellites or listening posts.

Shared intelligence can be very valuable if it sheds light on important foreign policy problems. Recipients are interested in assuring that their partners can provide intelligence based on accurate information and analysis that complements their own intelligence efforts. Shared intelligence that cannot be otherwise obtained at a reasonable cost is useful even if a specific piece of intelligence does not lead the receiving state to alter its foreign policy. For example, shared intelligence might corroborate the intelligence that the receiving state already possesses. In this case, the sharing is valuable if the receiving state believes that the intelligence is accurate, even through this new intelligence might confirm the wisdom of existing policy and create little pressure for change.

The gains from exchange will be greater to the extent that participating states specialize in the acquisition and analysis of intelligence. Specialization allows the participating states to develop greater expertise in the targets and to develop more focused and higher-quality collection and analysis techniques. In the language of relational contracting, specialization leads states participating in an intelligence sharing agreement to develop 'specific assets' in the form of intelligence collection and analysis focused on a smaller set of related targets rather than an intelligence effort that seeks to provide coverage of all issues of interest to policymakers. Developing specific assets in this form enables states to reduce the resources they devote to intelligence while gaining as much or more intelligence from their combined efforts. This assumes that intelligence assets developed for one target cannot be shifted at low cost to another target. Often this is the case; for example, a network of human intelligence agents providing information on one country or issue typically has no valuable information on other countries or issues;

listening posts are often aimed at particular targets and cannot be easily redirected to other targets; analysts are trained in the language and history of one target and require substantial re-training to address other targets, and so on. To provide the maximum benefits, these specialized intelligence efforts should be jointly designed so that they complement rather than duplicate each others' activities. Cooperating states that agree to specialize in their intelligence efforts can collectively generate more and better intelligence than would be possible if they each tried to provide adequate coverage for the same targets.

Some sharing arrangements are reciprocal in that each of the participants shares intelligence with the others. In other sharing arrangements one participant is principally a sender and the other principally a recipient. Senders participate in such relationships in exchange for concessions by the recipient on other issues, such as diplomatic support or foreign or military aid. For example, Britain and the United States developed close sharing of intelligence during the Second World War. The British continued to share much of their intelligence with the Americans after the end of the war in part because they hoped that doing so would lead the Americans to provide them with benefits in other areas, such as the development of atomic weapons.

Defection and intelligence sharing

Defection is an important and widely-recognized barrier to international cooperation. It is a particularly powerful barrier to intelligence sharing because of the difficulties inherent in determining *ex ante* if a partner has defected. Three aspects of the definition of intelligence provided earlier highlight how easy it is for states to defect without being detected. The first is the assumption that policymakers face considerable uncertainty about important aspects of foreign policy, such as the true intentions or capabilities of another actor or the likely consequences of available policy options. Policymakers value and seek out intelligence provided by their own intelligence agencies or those of another state because it reduces this uncertainty. This uncertainty creates a demand for intelligence that a sending state might be able to exploit by altering its intelligence in order to influence the receiving state's subsequent foreign policy choices. Second, intelligence differs from raw information or 'facts'. Intelligence takes raw information and analyzes it, attempting to place it in the proper context and to use it to draw conclusions about attributes of other actors or about the state of the world that are not directly observable (Hilsman 1952, was one of the first to make this point). For example, intercepted signals traffic might seem to need little interpretation. But as Herman (1996: 69–70) notes, even this intelligence source is largely meaningless

without proper analysis: 'armed forces' and other messages are in specialized language which needs interpretation, and the intelligence interest is often less in what is being conveyed to the legitimate recipient than in what can be inferred. Uninteresting military administrative messages are the classic leads for reconstituting order-of-battle. Intercepted conversations on any subject are even more allusive and full of half-stated meanings. . . For reasons of these kinds most of it needs a significant element of interpretation; good intelligence is never handed out on a plate'. Policymakers in modern states rarely seek access to the individual piece of information that comprises intelligence, instead relying heavily on their intelligence analysts to process such information. This analytical component of intelligence may be more easily manipulated by a sending state that the raw information upon which it is based. Third, intelligence draws on both open sources of information – those that are publicly available – as well as secret or clandestinely obtained information that the target of analysis wishes to conceal. Intelligence agencies rarely reveal the full details of their sources even to other agencies of the same government. This practice of keeping intelligence sources secret creates the possibility that the sending state can alter or fabricate secret information that it claims to possess.

Both senders and recipients may defect (see especially Johnson 2000; Richelson 1990). A sender may renege on an agreement to share in three ways. First, a sender may simply lie, that is, alter or fabricate the intelligence it shares with the intent of influencing the recipient's policy choice. A second and related form of reneging occurs when the sender has accurate intelligence but chooses not to share this with the recipient. The motive is the same; the sender withholds intelligence that might lead the recipient to implement a policy choice that harms the sender. Third, the sender might exaggerate the accuracy of its sources, claming to have quite precise and useful intelligence that it does not in fact possess. Recipients also can betray the interests of senders in the ways that they utilize shared intelligence. A recipient might deliberately share intelligence with a third party. This constitutes reneging since intelligence sharing agreements usually prohibit sharing with other states or actors. In such cases the recipient believes that its interests are best served by passing along the intelligence in violation of the agreement, perhaps as a way to influence the third state's foreign policy, but the original sender would find this to be contrary to its interests. A recipient also might inadvertently share intelligence in its possession with others. Individuals that have access to its intelligence may be operating under the control of a third state or other outside group and violate their government's policy by sharing this intelligence with their controllers. This possibility poses a considerable problem for sending states, which must carefully evaluate

the loyalty of individuals and politically influential groups in the receiving state before sharing intelligence.

The costs of defection can be very large for both senders and receivers. Recipients may be deceived into providing valuable political, intelligence, and economic benefits to senders that provide them with poor intelligence. More important than this, however, are the potential indirect costs of sharing with a sender that defects. A recipient may base very important foreign policy decisions involving the use of force on flawed or misleading intelligence shared by other states. Costs for sending states can also be substantial. Recipients of their intelligence might deliberately or inadvertently share it with hostile third parties, or reveal valuable sources and methods of intelligence to enemies.

These costs vary with the degree to which the participating states have developed specialized and complementary intelligence efforts. While such specialization increases the joint gains from cooperation, it also raises the costs considerably if a partner defects. The objective of specialization is to allow the partner to provide most of the coverage of a topic of mutual interest, freeing resources that can be devoted to another target (or another purpose entirely). Defection can remove access to the partner's specific assets and seriously weaken the ability to gather useful intelligence on a target. As a stylized example, consider an arrangement in which two states agree to share intelligence on the same target country. One partner specializes in the provision of high-resolution reconnaissance images of the target's military facilities, while the other focuses on the development of a network of human agents within the target's government. Defection by either partner will harm the other's ability to generate a complete intelligence picture of the target. If the partner specializing in reconnaissance defects, perhaps by redirecting its imaging facilities to another target of more immediate interest, the other may be left with little reliable information about, say, the target's production of missiles. Conversely, if the partner specializing in human intelligence defects, perhaps by failing to adequately secure its network, the other partner may lose valuable information about the goals or intentions of the target's leadership. Thus while specialization can produce powerful joint gains, it also makes the partners far more vulnerable to defection and more willing to pay costs and to negotiate agreements that will mitigate the chances of such defection.

Hierarchy in intelligence sharing

Relational contracting sheds important light on the practice of intelligence sharing because of its heavy focus on the possibility of defection in

situations where participants have difficulty making credible commitments (foundational works are Coase 1937, 1960; Williamson 1975, 1985; important applications to international politics are Lake 1996, 1999; Weber 1997). Kenneth Waltz (1979: 88) has defined anarchy as a situation in which 'none is entitled to command; none is required to obey'. Institutionalists follow in Waltz's footsteps in assuming that the international system is anarchic, and thus only conceive of 'anarchic' cooperative arrangements in which each participant is able to make autonomous decisions about how to implement the agreement. Hierarchical relationships, in contrast, have a dominant party with responsibility for making major decisions, and a subordinate party or parties responsible for complying with these decisions. States negotiating an intelligence sharing agreement are unable to foresee all the developments that might impinge on their joint venture. Participating states therefore always possess some leeway in how they interpret and implement the terms of their agreement to cooperate. Dominant states fear that their subordinates will exploit such ambiguities to defect. Hierarchy reassures the dominant state that subordinate partners will comply with the letter and spirit of their agreement to cooperate in three ways (Williamson 1985: 20). First, hierarchy gives the dominant power the right to interpret the agreement, which minimizes the subordinate state's opportunities to exploit ambiguities and unexpected developments. Second, hierarchy allows the dominant state to create and maintain oversight mechanisms to ensure the subordinate state's compliance with the terms of their intelligence sharing agreement. Third, the acceptance of a hierarchical relationship by a subordinate partner implies that it gives the dominant power the right to legitimately punish defection without the right to retaliate.

Relational contracting focuses on three variables to explain the conditions under which states will develop hierarchy to govern their relations: (1) the gains to each state from cooperation, (2) the costs of defection, and (3) the costs of creating and managing a hierarchical relationship. Hierarchical arrangements are most useful to participants when there exist substantial benefits from cooperation, the costs of defection are also high, but effective hierarchical arrangements can be created at a reasonable cost. Hierarchy makes it easier for each participant to capture some of the large available joint benefits of cooperation by reducing the chances that partners will impose substantial costs by defecting. As with many other types of cooperation, the benefits of intelligence sharing increase with the frequency with which the participants exchange intelligence and the range of issues their agreement includes. Benefits also increase if the participants can develop a division of labour, with each specializing in aspects of their joint

collection and analysis efforts. But the costs of defection also increase with the frequency and range of sharing and with specialization by making participants more dependent on their partners. The most valuable partners – those with large quantities of valuable intelligence and with whom partners can jointly develop complementary technical and human intelligence assets – can do the most damage to their partners when they defect. The solution in such cases is to develop a hierarchy between the states sharing intelligence.

In the context of intelligence sharing, participating states can structure their agreements in five ways to minimize the chances and costs of defection by other participants. First, they can limit the intelligence that they share only to specific topics or sources where the participating states' interests are most closely aligned, and decline to share intelligence on issues where their interests are in greater conflict. Limiting intelligence sharing to issues of common concern reduces the incentives of participating states to cheat. A second and closely related way to limit defection is to clearly specify the topics and types of intelligence that participants will share. This helps to create a clear and mutually agreed upon standard which can be used to determine what actions do and do not constitute reneging. These first two actions acknowledge that participating states' interests may diverge sufficiently to create irresistible benefits from defection, and attempt to structure the agreement so that it avoids such situations.

The additional steps reduce defection by introducing an element of hierarchy into the relationship and limiting the decision-making autonomy of the subordinate state. States can devote resources to monitoring their partner's compliance with any sharing agreement. Active and direct monitoring is particularly important in the area of intelligence sharing. The reason, as discussed earlier, is that it is unusually easy for senders or recipients to conceal their true actions and knowledge. For example, absent some sort of monitoring a sending state can fabricate or manipulate intelligence it shares at little cost and without the knowledge of the receiving state. Conversely, recipients find it a simple matter to clandestinely send on shared intelligence to third parties without the knowledge of the sending state. Monitoring in this context involves the intelligence services of states participating in a sharing arrangement directly overseeing the actions of their partners. They might require that their counterparts provide some of the raw information upon which they base their conclusions so that its accuracy can be evaluated, or be careful to compare shared intelligence with other intelligence in their possession before using it as the basis for any foreign policy decisions. In other cases they may insist on playing a direct role in the management and oversight of another country's intelligence service, supervising the activities of their

counterpart's collection activities, and vetting the sources and employees of their partner services.

Fourth, states can structure the agreement so that there are punishments for reneging. Participants accused of cheating by their partners of course can be threatened with the termination of benefits, such as shared intelligence. Intelligence sharing arrangements often include provisions that, because they are hierarchical in nature, effectively provide the dominant partner with additional leverage. For example, it is quite common for one party to a sharing arrangement to directly or indirectly finance the intelligence collection and analysis effort of their partner. Intelligence sharing arrangements can also provide partners with valuable 'back channels' to top government officials for bilateral negotiations on other issues. Partners to a sharing arrangement can threaten to terminate these additional benefits in cases of reneging.

Finally, national governments can seek to restructure the intelligence and security bureaucracies in countries with which they share intelligence. Dominant states can use their superior wealth and knowledge to create incentives for the subordinate government to, for example, reform their security agencies in ways that ensure that staff exhibit support for the state's foreign policy. One mechanism for implementing this step is training. Dominant states can offer to train officials from partner states in appropriate security procedures. Training can also involve attempts to socialize students from other states into the goals and routines of the training state. Another mechanism is providing incentives for partner states to restructure and reorganize their security bureaucracies. States can provide their partners with funds, equipment and technology, and organizational blueprints to alter the format of such agencies. The motive is to replace or supplant existing agencies that are seen as not sharing the objective of sharing intelligence with the partner state, or are staffed with personnel that cannot be trusted with shared intelligence.

Hierarchy is not free. Both dominant and subordinate states must pay costs to negotiate and manage a hierarchical relationship. They should do so only when the benefits of hierarchy in terms of reduced defection outweigh these negotiation and management costs. The costs of hierarchy are easiest to see for the subordinate state, which must surrender some freedom of manoeuvre and submit itself to the decisions of and monitoring by the dominant power. Sovereign states hold the same rights and responsibilities under international law. Why, then, would a state submit to a subordinate role that provides it with less control over the terms and scope of an intelligence sharing agreement? Subordinate states recognize and accept their inferior status because doing so sustains mutually beneficial cooperation with the dominant state by minimizing the chances that either party will defect. Subordinate

states can receive important benefits in exchange for accepting their reduced status, such as economic aid or protection from external threats. Submission to a hierarchical relationship reassures the dominant state of its willingness to comply with the terms of their intelligence sharing agreement, ensuring it will continue to accrue such benefits. Subordinate states would prefer to avoid the restrictions on their actions that hierarchy imposes. But this is often unrealistic; the dominant state will only agree to cooperate if the subordinate agrees to the limits that a hierarchy imposes. Participation in a hierarchy may be the best available outcome for such states.

Dominant powers must pay costs as well to create and sustain a hierarchy. They must devote resources to closely monitoring subordinates' compliance with the terms of their intelligence sharing agreement, to providing the benefits outlined in their agreement to share, and to punishing defection. For one state to effectively play the role of the dominant partner, it must control considerable political and economic resources of value to the subordinate state. Such power resources allow the dominant state to more credibly threaten effective punishment when it detects defection. They also allow the dominant state to offer more valuable benefits to subordinates, such as security guarantees, military aid, and so on. In addition to providing subordinate states with shared intelligence or other benefits, the dominant power must entice the subordinate power into entering the agreement by taking steps that make clear it will not use its greater power to exploit the junior partner. Dominant states can engage in cooperative ventures that deliberately expose them to possible defection in order to demonstrate their faith in subordinate states. One mechanism for reassuring the subordinate state is to encourage each participant to specialize in some aspects of the intelligence collection and analysis effort. Another mechanism is the joint development and management of intelligence assets such as listening posts or networks of agents. Both specialization and joint investments give the subordinate state more potential to defect and thus more influence over their dominant partners. While dominant states are more powerful than subordinates, this does not mean that they *always* insist on creating hierarchical arrangements that provide them with most rights to manage and interpret the intelligence sharing agreement. The reason is that dominant states would prefer to avoid the costs associated with creating and managing a hierarchical relationship. When partnering with a state unlikely to defect, dominant states can and should agree to less hierarchy in their relationship. The degree to which a dominant state desires to create a costly hierarchical relationship should thus increase with its estimates of the subordinate state's likelihood of defection.

Expectations

Figure 1 summarizes the decisions that potential recipients and senders must make when they contemplate sharing intelligence. A recipient state first must be convinced that a potential sender has access to valuable and accurate intelligence, since this is the primary benefit from such cooperation. The value of the shared intelligence provided to the recipient must be greater than any reciprocal benefits, such as diplomatic support, foreign or military aid, or intelligence, that the recipient provides the sender. No or little sharing occurs if the recipient or sender sees no or modest net benefits from cooperation. The recipient and sender next must evaluate the likelihood that their potential partner will defect. If the perceived costs and likelihood of defection are much smaller than the benefits of cooperation, the states should prefer an 'anarchic' intelligence sharing arrangement. Such an arrangement lays out the intelligence that the sender is expected to provide and the reciprocal benefits the recipient exchanges, but lacks monitoring or enforcement provision that impinge on the decision making autonomy of either partner. If one state fears that the other may defect, it next considers creating a hierarchical agreement to govern the intelligence sharing arrangement. A hierarchy is attractive if the costs involved in creating and maintaining it are outweighed by the benefits of having access to shared intelligence.

Figure 1 also clarifies the differences between the relational contracting explanation put forward here and approaches to international cooperation – such as institutional theory – that base their analysis on the assumption that the international system is anarchic. The analysis in the first two branches of the figure is consistent with this understanding of international politics in the sense that both perceive states as entering cooperative arrangements when the benefits such cooperation provide are outweighed by the costs of cooperation in terms of reciprocal benefits and defection. Institutionalism downplays the opportunities for and consequences of creating hierarchical institutions in international politics. It assumes that states will avoid striking bargains with partners judged likely to defect. But as argued above this does not exhaust the options that are available to states when seeking to cooperate. Relational contracting draws attention to hierarchy by adding the third branches to the decision trees in figure 1. Participants in a sharing arrangement also can develop hierarchical institutions to govern their relations and minimize their partner's ability to defect. We are thus likely to see more cooperation on intelligence sharing than institutional theory expects, because even pairs of states that are quite wary of each other's motives may be able to develop hierarchical arrangements to govern their relations in a mutually beneficial way.

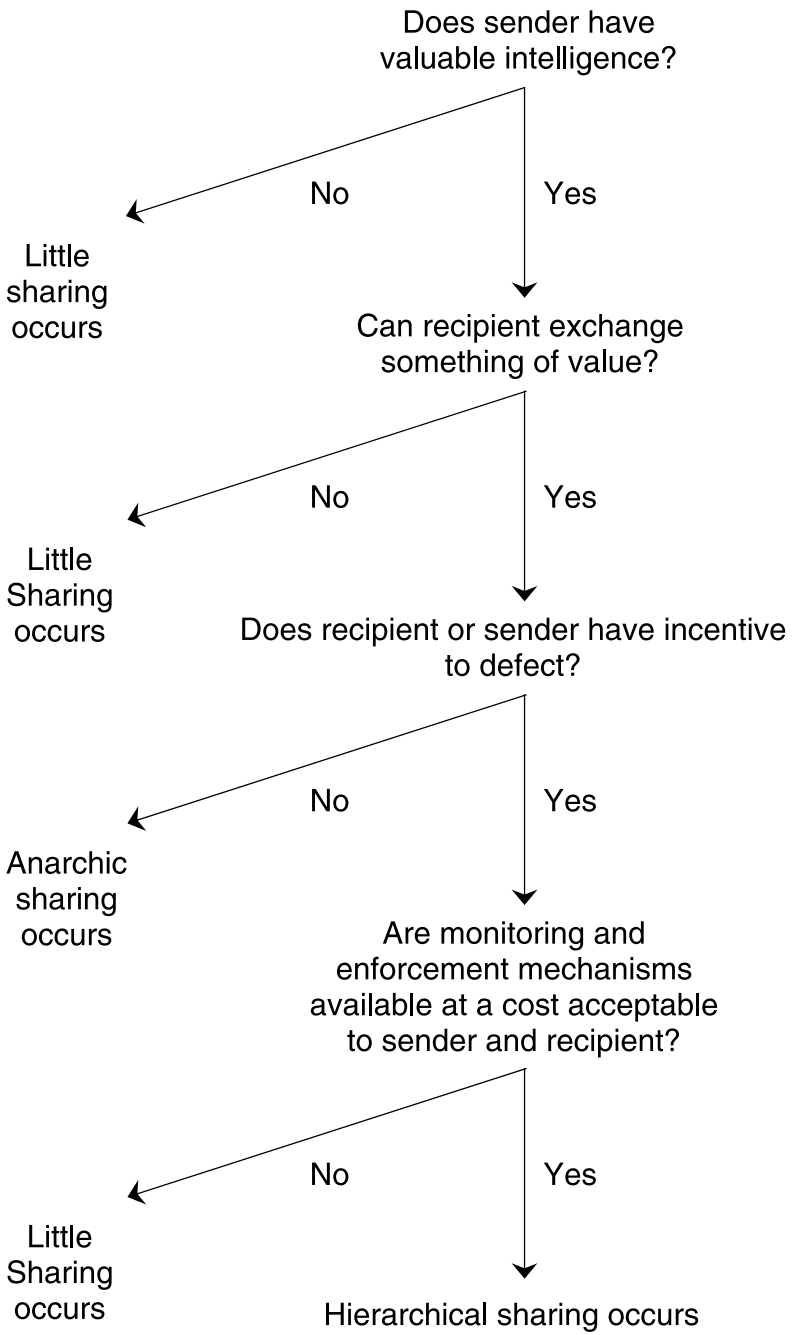

FIGURE 1. *Deciding to share.*

Intelligence sharing in the early cold war

This section evaluates what light relational contracting sheds on how and why states share intelligence by comparing American efforts to share with Britain and Germany in the early cold war period. These cases are useful for two reasons. First, there is an unusually large number of primary sources available about the American side of the relationship; I therefore focus most attention on American decision making in the account that follows. Most governments are reluctant to release much detailed information about their intelligence sharing arrangements. But many American government documents concerning cooperation with the nascent west German intelligence organization have recently been declassified as part of an investigation into links between American intelligence and war criminals in the early cold war period (see Breitman et al. 2004). Many documents concerning Anglo-American cooperation are also in the public realm. The exceptional degree of access to American decision makers' private speech and internal deliberations during this period provide much more evidence that can be used to evaluate the theoretical claims made here against competing accounts.

Second, the two cases have characteristics that provide important explanatory leverage. Anglo-American intelligence sharing is a 'least likely' case for the existence of hierarchy. In the existing literature, the cooperation between American and British intelligence agencies is seen as among the closest and most equal in modern history due to the two states' similar foreign policy interests, their complementary intelligence capabilities, close personal and organizational ties between the two countries' military, diplomatic, and intelligence officials forged during the Second World War, and the fact that British intelligence services provided influential advice and served as an important exemplar during the formative years of the American intelligence community. Finding evidence that governments built hierarchy into this relationship out of concerns about defection lends considerable support to the explanation advanced here. It also demonstrates that the application of relational contracting can shed new light on a case widely discussed in the intelligence literature, which has focused little attention on the existence of or rationale for hierarchy in Anglo-American intelligence sharing.

The German case allows a cross-case comparison as well as an additional window on the comparative advantage of relational contracting. Relational contracting theory and institutionalism make divergent predictions about the outcome of the case. American policymakers had good reason to worry that their German counterparts would defect. In such a situation, institutional theory would expect no or minimal

cooperation because the mechanisms upon which it focuses, such as greater transparency through costly signals of intent or third-party monitoring, would be difficult to implement successfully due to the secrecy needed to ensure that important intelligence is not revealed to third parties. Relational contracting theory, in contrast, holds that American decision makers would consider creating a hierarchical arrangement precisely to overcome the limitations of traditional forms of international cooperation, and would actually do so if the benefits of shared intelligence outweighed the costs of creating and maintaining a hierarchy.

American intelligence needs

By early 1947 the Truman administration had defined the United States' paramount interest as ensuring that continental Europe would not be dominated by a hostile great power. Germany and the Soviet Union were seen as the states with the economic and military potential to become a European hegemon. Since defeated Germany was occupied by the United States and its allies, France and Britain, as well as the Soviet Union, it posed little immediate threat. The Truman administration instead saw the Soviet Union as the most significant challenge, and supported the creation of the North Atlantic Treaty Organization, and a west German state allied to NATO, to counter Soviet influence. The interests and polices of the United States towards postwar European security defined the types of intelligence that the United States sought from other countries. The United States needed accurate intelligence on the Soviet bloc's political intentions, military plans and capabilities, and research and development of new military technologies such as atomic weapons and long-range missiles. Technical intelligence gathering capabilities, such as signals intelligence listening posts and facilities for clandestine aerial surveillance of Soviet-controlled territory, were important means of collecting politically and militarily useful information. The Soviet Union and its clients were largely closed to foreigners and the powerful and suspicious internal security apparatus of eastern European states made it almost impossible for western governments to cultivate local sources. But Soviet bloc defectors and refugees in some western European countries were an important source of human intelligence (Aid 2002: 28–30).

West Germany

West Germany possessed two assets that would make its intelligence useful to the United States. First, a key American intelligence priority was

intelligence on Soviet military activities in their German occupation zone and throughout eastern Europe, ideally well-developed enough to warn of Soviet military mobilization (Powers 1979: 38; European Command 1948b). West Germany's position on the front line of the east-west confrontation meant that listening posts on its territory were ideally positioned to monitor emissions from Warsaw Pact military forces. By 1948 the United States Army was building a signals direction finding network across western Germany. German signals intelligence operations provided valuable intelligence to the American commanders in Germany on Soviet air force activities during the Berlin airlift of 1948 (Critchfield 2003: 86, and Report of Investigation 1948). Second, significant human intelligence was also available in western Germany. Millions of refugees and defectors moved west during this period, and some had valuable information about Soviet bloc military and scientific capabilities. There were also many former German Army intelligence officers that had close wartime experience in what was now Soviet-controlled territory. A group of these officers, led by the former head of the German Army's eastern front intelligence Reinhard Gehlen, in 1946 began reconstituting their intelligence operations under the supervision of the United States Army in order to supply the United States with intelligence. This intelligence was particularly valuable to the United States, which had little information about basic facts of the Soviet military. The Gehlen organization also served to interrogate thousands of individuals from eastern Europe at displaced persons camps in western Germany, providing one of the only large-scale sources of immediate intelligence about the Soviet Union to the United States. Later it came to operate most of the signals intelligence listening posts manned by German personnel and began recruiting networks of agents throughout eastern Europe (Reese 1990: 50; Simpson 1988: 43, 63; Memorandum from Karlsruhe to Special Operations 1948).

American intelligence authorities valued the intelligence supplied by the Gehlen Organization but regularly questioned the degree to which they could trust their west German collaborators. The most immediate issue was the trust for members of the Gehlen Organization itself. Some had been members of the Nazi party, and some American military intelligence officials opposed collaboration out of fear that much of its staff was of questionable political loyalty or could be subject to blackmail. At other points the Americans were concerned that the Organization in particular, as well as much of the rest of the West German government, was penetrated by Soviet bloc intelligence services. For this reason the Army's Counterintelligence Corps in Germany mounted a large-scale operation to identify Communists in western Germany and warned the Central Intelligence Agency, which by this point was responsible for

liaison with the Gehlen Organization, that it should seek to better ensure the security of its German counterpart (Reese 1990: 90–97; Critchfield 2003: 197).

The second American worry concerned the new west German polity's foreign policy orientation. Of most concern was the emergence of nationalist opposition to the decision to divide Germany. John McCloy, the American high commissioner for Germany, would write to Washington as late as 1951 that 'most of the established political parties have also been stockpiling the merchandise of nationalism. . . . They seek to draw the followers of the extreme rightist forces or to prevent losses of their own, by attempting to appear as nationalistic as the extremists. . . . The consequences of such a course, if long continued, must be general disaster' (quoted in Tetens 1953: 105). Even the pro-American government of Konrad Adenauer, which supported the decision to divide Germany but also called for unification free of Soviet domination, on occasion seemed suspect on this score. A Central Intelligence Agency report in 1949 noted that 'the proposed new German Government is still an unknown and untested entity with many points of disagreement, real and potential, between German leaders and the occupation authorities', ('Political and Economic Changes in Western Europe Since the Last Conference of Foreign Ministers', in Central Intelligence Agency 1982: reel 1, 15) while another report observed that 'few Germans, given the opportunity, would hesitate to play off the US against the USSR in an endeavour to achieve unification on their own terms' ('Germany', in Central Intelligence Agency 1982: reel 2, IV-1). Over a year later the Central Intelligence Agency continued to worry about western Germany's adherence to American policy, fretting that 'German national aspirations are not likely to be realized in sufficient degree and in sufficient time to justify in German eyes a pro-western policy which would exclude a modus vivendi with the East. . . . Powerful political forces, both those supporting and those opposing the Government, will seek a position of neutrality between East and West' ('Political Orientation of the West German State', in Central Intelligence Agency 1982: reel 2, p. 1).

The combination of valuable intelligence with concerns about defection led the Americans to insist on exerting a significant degree of direct control over all intelligence operations conducted by the Gehlen Organization, even after the creation of the west German state in 1949. Prior to this date, United States Army Intelligence and then the Central Intelligence Agency ran the Gehlen Organization directly. They financed the Organization's activities and had American staff based permanently in the Organization's headquarters to oversee its daily activities, monitor its expenditures, and receive intelligence reports (European Command

1948b). In part this direct supervision was dictated by the Americans' unwillingness to trust the Organization to operate independently. But this sort of arrangement was not unusual during the occupation period, when American civilian and military authorities were constituting and directing new German central government organs.

The creation of the Federal Republic in 1949 naturally raised questions about if and how control over the Gehlen Organization should be transferred to the new west German government. While most other government bureaus were transferred to German control, the Gehlen Organization was not. The CIA and Army concluded that security problems made such a transfer too risky. Army Intelligence conducted counter-intelligence operations against the Gehlen organization throughout this period. The CIA concluded that the Gehlen Organization was providing quite valuable intelligence to the United States, especially on developments in the Soviet Zone (Helms 2003: 89). Yet there were also serious concerns about the degree to which Gehlen and his colleagues shared the same goals as the Americans. James Critchfield, the CIA official responsible for investigating the value of the organization in this period, would later write that while the Organization produced intelligence on the Soviet bloc that was as good or better that that produced by the western powers, he also noted that '[l]ife with the CIA would have been much easier for Gehlen had mutual trust been an element of the relationship from the start' (Critchfield 2003: 127).

The CIA decided to reduce its direct control over the Gehlen Organization only modestly. Under the new division of responsibilities, the CIA retained responsibility for developing intelligence requirements, while the Organization would carry out intelligence collection and analysis. The Americans insisted on retaining the practice of attaching CIA personnel to each department of the Organization, receiving all the Organization's intelligence reports and evaluations, and learning the identity of the Organization's personnel (Reese 1990: 107–111). This last demand in particular caused particular friction between the Americans and Gehlen. The Americans worried that Gehlen, in his drive to rebuild a German intelligence service, might hire military or intelligence personnel with close connections to the Nazi regime who could be blackmailed (Helms 2003: 89). The CIA also restricted the targets of Gehlen's intelligence collection activities, refusing to allow the Organization to collect intelligence in western Germany and limiting overseas counterintelligence activities. The CIA insisted on closer management of the Organization's activities in eastern Germany and decided to approve operations in other areas of Soviet influence on a case-by-case basis. These stipulations were explicitly intended to 'give us a degree of control

and an insight into their operations which has been non-existent in the past'. Gehlen would press throughout the early 1950s that his organization become part of the west German state with continued CIA funding, but the agency decided to continue its more active and direct monitoring (Critchfield 2003: 157). This arrangement persisted until shortly after Germany's admission to the North Atlantic Treaty Organization in 1955, when the Organization became independent of American control and transformed into the west German intelligence service, the Bundesnachrichtendienst (BND).

In exchange for its control of German intelligence activities, the United States provided West Germany with considerable benefits. The intelligence sharing arrangement was part of the larger American-German political and security relationship, in which West Germany effectively agreed to limit its freedom of action in the area of security policy in exchange for American support for the creation of the Federal Republic. The United States financed a large portion of the Gehlen Organization's activities and paid for the construction of listening posts along the intra-German border (Memorandum for the Director 1948; Memorandum to Chief 1949). The United States also did not in the end press the West German government to very actively pursue the removal of supporters of the former Nazi regime from the country's intelligence services. By the early 1950s the United States had ceased to insist on thoroughly checking to insure that west German intelligence did not hire former Nazi war criminals, and dozens of the Gehlen Organization's staff were former SD or Gestapo officers (Breitman et al. 2004: 377). The most important concession made by the Americans was to engage in active collaboration with German intelligence in the first place. The United States' dominant role in western Germany in the late 1940s and early 1950s, especially in areas such as intelligence that touched upon security policy, would have allowed the country to simply develop its own intelligence organization in the country rather than engage in a hierarchical relationship with an independent German organization. Permitting West Germany to develop its own intelligence apparatus, even one with the hierarchical controls created by the Americans, did expose the United States to the possibility that its partner could defect. This also demonstrates that hierarchy is not the default option for states, even when they have the capabilities to insist on it. Direct collection by its own intelligence agencies would have been the most reliable way for the United States to gather intelligence in Germany, and west Germany could have done little to stop this. Instead, though, the Americans concluded that the gains from cooperation with local experts outweighed both the costs of potential defection and of creating a hierarchical relationship.

Great Britain

Britain also had important assets that made its intelligence useful to the United States, although to a greater extent than in Germany much of its intelligence apparatus duplicated that of the Americans. Britain brought to its cooperation with the United States its own intelligence capabilities and the (admittedly much smaller) capabilities of Canada and Australia. Britain's experience as a colonial power gave it access to territories around the world that were useful for the collection of intelligence on the Soviet Union. The distance and isolation of the Soviet Union from the United States meant that American intelligence agencies needed access to listening posts and bases for aerial and oceans surveillance in the Arctic, Asia, and Europe. Current and former British colonies were useful for this purpose, although the United States could also draw on the territories of friendly states in Europe, the Middle East, and east Asia for listening posts and bases for reconnaissance aircraft (Aldrich 1998: 344; Aldrich 2002: 87; Smith 1993: 224–5). Britain also had a large and experienced set of intelligence agencies that, like their American counterparts, sought to provide global coverage of important political, military, and scientific developments. While the American intelligence effort in the early cold war period was much bigger and better-funded, officials felt that their budgets, particularly for signals intelligence, were too small and prevented needed expansion in the crucial European theatre (Aldrich 2002: 77).

American and British interests in European security were closely aligned after 1947, which reduced American concerns about British defection. A report on this question prepared by the CIA concluded that '[w]hile the UK has differed occasionally with the US in the emphases on and approach to the German problem, the UK Government was and is in fundamental agreement with that of the US. . . . [T]here has never been any doubt about British disposition to resist Communist expansion' ('Political and Economic Changes in Western Europe Since the Last Conference of Foreign Ministers', in Central Intelligence Agency 1982: reel 4, 4). Britain and the United States worked closely together on all of the major questions of European security, including the decision to create a west German state, the negotiation of the North Atlantic Treaty, the permanent deployment of American forces in Europe (including the basing of aircraft armed with atomic weapons in Britain), and German rearmament.

Britain was seen as trustworthy in terms of its internal security as well as its foreign policy interests. There were in fact individuals in the British civil service and scientific establishment that communicated important secrets to the Soviet Union during the 1940s (Newton 1991; West and

Tsarev 1999). The discovery of these networks in the early 1950s did not scuttle Anglo-American sharing. American officials did not view this as strictly a 'British' problem. Instead, they concluded that the Soviet Union had managed to penetrate both the United States and Britain, as well as Canada, with roughly equal degrees of success in the 1930s and 1940s (Ranelagh 1986: 147). The United States government was intensely concerned about agents of foreign governments within its own apparatus, and therefore may have viewed similar penetrations in other countries whose political systems and foreign policy interests were largely aligned with its own as normal, understandable, or unavoidable (Aldrich 1998: 342). When told by the Canadian prime minister in September 1945 that Canada had information about Soviet espionage in Britain and Canada, Truman responded that such activities 'would not be surprising' and that 'there must be similar penetrations by the Russians into the conditions in the United States' (quoted in Yergin 1977: 154).

The United States engaged in close intelligence sharing with Britain. In September 1945 the Secretaries of War, Navy, and State wrote Truman that during the war the United States and Britain 'collaborated closely in regard to cryptanalytic techniques and procedures and exchanged fully the intelligence derived from cryptanalysis. The results of this collaboration were very profitable'. They advised the president that 'in view of the disturbed conditions of the world and the necessity of keeping informed of technical developments and possible hostile intentions of foreign nations [two lines redacted] it is recommended that you authorise continuation of collaboration between the United States and the United Kingdom in the field of communications intelligence'. Truman agreed, and within weeks detailed negotiations opened in Washington, culminating in the series of understandings known as the UKUSA agreement by June 1948 (quotations from Collaboration with the British in the Communication Intelligence Field 1945).

While this agreement remains classified, it is widely believed to follow closely the declassified 1943 BRUSA accord on wartime intelligence sharing (see BRUSA Agreement 1997). The UKUSA agreement is a tiered arrangement in which sharing between the United States and Britain (along with Canada and Australia) is closer than with other countries that joined later. It established common security procedures and technical terms, code words, and training across the participating countries, ensuring that shared intelligence was handled consistently and securely. The agreement assigned each party a region of the world to cover. Sharing among the partners was extensive. In general, governments chose not to share intelligence only if it concerned bilateral or commercial issues, dealt with sensitive counterintelligence information,

or had been obtained from a third state (Richelson and Ball 1990: 142–6, 257). The United States and Britain also jointly managed a far-flung ocean surveillance network and collaborated to monitor foreign radio broadcasts. The two countries apparently agreed not to engage in covert political operations against each other or to recruit agents among the other country's nationals (Meyer 1980: 165–6), although it is not clear if these limits also prevented each party from monitoring the others' communications.

The Anglo-American intelligence sharing relationship was less hierarchical than that between the United States and West Germany. The reason for this is that the American authorities judged that the similar foreign policy interests of the two countries, and the absence of a powerful domestic Communist movement, made Britain less likely to defect from the agreement. The United States thus saw less need to invest in a hierarchical relationship to ensure Britain's compliance. But the UKUSA accords do include important elements of hierarchy. The agreements contain safeguards that protect the interests of both senders and receivers, and was agreed with concerns about defection in the back of the negotiators' minds. For example, the agreement is believed to include rules about how widely a receiving state can disseminate shared intelligence within its government. These rules protect the interests of both the dominant partner, the United States, and the subordinate partner, Great Britain. Limits on intelligence dissemination make it less likely that information will be shared deliberately or inadvertently with third parties. The basing of substantial numbers of American personnel in Britain and in British-controlled territories to staff collection apparatuses, to engage in common training, and to work at the technical level with their British counterparts ensured direct American access to most raw signals intelligence. The United States bore a much larger share of the costs of creating and maintaining shared technical intelligence collection efforts, providing it with an important source of potential leverage. At the same time, the rules and practices of the UKUSA agreement also place some potentially costly limits on American behavior. The expectation that participating governments will share most of the intelligence they collect in some fashion provides far more benefits to Britain than to the United States, since it gives the former access to much of the intelligence collected by the latter's far larger and better-financed intelligence agencies. These provisions also create a clearly articulated expectation about what sort of behavior does and does not violate the agreement. American attempts to withhold such intelligence from Britain would be a clear signal that dominant power was intent on managing the relationship in a way that ignored important British interests.

Conclusions from the case studies

What light do the case studies shed on the ability of states to form useful intelligence sharing arrangements in the shadow of possible defection by their partners? American intelligence agencies valued the German contribution in the areas of signals intelligence, the interrogation of refugees and defectors, the general knowledge of Soviet infrastructure, military systems and doctrines, and for human intelligence from Soviet-controlled eastern Germany. Particularly appealing to the United States was the fact that the west German intelligence effort was highly focused and specialized in areas important for American security but where the United States military and intelligence agencies had few valuable assets. The case evidence is quite clear that American decision makers in many agencies also worried about the extent to which they could trust the Gehlen Organization and the western German government. Mistrust was driven by concerns about the political orientations of members of the Gehlen Organization, their susceptibility to blackmail because of past activities in support of Nazi rule, potential popular support for the anti-American Communist and right-wing parties, and the possibility that the Adenauer government would accede to Soviet proposals for a reunified neutral Germany.

American authorities attempted to capture the benefits of sharing by carefully structuring their relationship with the Germans to avoid the costs of defection. This included reserving authority for generating the Organization's intelligence requirements and priorities. Such control allowed the Americans to ensure that their German partners kept their intelligence effort focused on the Soviet presence in eastern Europe, which was particularly valuable to the United States, and gave the United States the power to prevent west Germany from seeking to expand its intelligence coverage to areas such as western Europe or the Middle East. The Americans also carefully monitored Germany's compliance with its leadership by providing much of the budget and demanding regular accountings for expenditures, and effectively engaging in counter-intelligence through disclosure to the CIA of the identities and past activities of the Organization's staff and through secret monitoring of the Organization's activities by Army intelligence. The crucial innovation here on the part of the Americans was the insistence on the development of a hierarchical relationship with their German counterparts. This allowed the Americans to better ensure that their partner was acting in a manner consistent with the United States' interests and fully sharing relevant intelligence. Supervising many of the German intelligence services' collection priorities and practices ensured that they focused on targets of concern to the United States; counter-intelligence activities

were designed to prevent reneging by disloyal German employees or agents; requirements for financial controls and accounting allowed the Americans to track the true activities of the German service and provided them with a source of power in the form of threatening to withdraw or reducing American funding. American officials viewed hierarchy as the most efficient way in which they could enlist German help in their intelligence collection and analysis efforts. Hierarchy was preferable to sharing through anarchic institutions, which would have placed few restraints on German incentives to defect. It also was a more attractive option than developing, at considerable expense of money and time, a full-fledged American government intelligence apparatus in Germany that would have duplicated the capabilities available to the Federal Republic. Hierarchy was preferable to direct intelligence collection and analysis because the partial autonomy granted to the Gehlen Organization persuaded the German government and the leaders of the nascent German intelligence apparatus to see substantial benefits from, and therefore to support, collaboration with the Americans.

The value-added of relational contracting comes from its explicit attention to the possibilities of hierarchy in international politics. Since institutionalism does not directly theorize the possibility of hierarchy in international cooperative agreements, it would lead one to expect that concerns about German defection would have led American authorities to eschew cooperation with Germany or to have collected intelligence with United States agencies in Germany. Relational contracting, in contrast, devotes attention to how hierarchy can help resolve concerns about defection, and generates novel expectations about how such hierarchy can allow states to engage in mutually beneficial cooperation that they might otherwise view as too risky. One might argue that the outcomes of the cases simply reflect power imbalances between Germany and the United States. Perhaps the United States preferred to build elements of hierarchy into *all* of its intelligence sharing relationships to counter incentives to defection. The American occupation of Germany gave the United States the power to insist on such an arrangement and Germany little power to resist it. There is certainly something to this perspective. The fact that the United States occupied Germany made it less costly for the Americans to create a hierarchical intelligence sharing arrangement with the former. The United States would have had to make much larger concessions to secure a similarly hierarchical relationship with a Britain which was dependent on American support but not completely reliant on its ally for its existence as a sovereign state. But important elements of the final outcome and the decision making process are not consistent with this. The United States provided benefits such as financing, allowing Germany to create an intelligence apparatus, and so

on in exchange for German agreement to subordinate itself to American leadership. Particularly important in this context is the fact that the United States *jointly* with Germany created or expanded expensive technical collection facilities, such as listening posts, that provided crucial intelligence on Soviet activities. This indicates American willingness to co-opt rather than coerce their German counterparts. While the United States clearly did have greater power resources than Germany, it negotiated rather than imposed hierarchical sharing on its partners.

American officials were less worried that their British counterparts would have incentives to act in ways contrary to American interests. They thus were willing to accept a less hierarchical intelligence sharing arrangement in which Britain was more of an equal partner with the United States. Furthermore, the potential costs to the United States of British defection were mitigated by the fact that Britain's intelligence strengths and weaknesses overlapped in important ways with the United States. For example, American officials had less motivation to directly oversee counter-intelligence in Britain than they did in Germany, despite the fact that it knew that the Soviet Union had highly placed agents in both countries' intelligence agencies. The reason for this difference was that the Americans viewed their own government as vulnerable to penetration by the Soviet Union as well. The Soviets might gain some of the same intelligence from its agents in Britain as it did from those in the United States. The additional loss of security involved was more modest than in the case of Germany, where a Soviet agent could betray equally valuable intelligence from a different source. Even in this case, however, the Americans were careful to structure the UKUSA agreement to reduce concerns about British reneging. UKUSA included common security procedures that the parties regularly reviewed, limitations on the dissemination of shared intelligence within participating governments, and prohibitions against spying on other participants. These elements of hierarchy served both to reassure the United States about Britain's commitment to the relationship, and to convince the British that the Americans would not exploit their dominant position. The importance of hierarchy for underpinning and sustaining the Anglo-American intelligence relationship has gone largely unrecognized by existing research on the case.

Implications

Lessons from relational contracting and the cases considered here have important implications for how we understand contemporary intelligence sharing arrangements and challenges. I close by considering briefly some implications for intelligence sharing to support the counter-terrorism

policies of the United States and its major allies. These countries have identified transnational terrorism as a key threat to their security. Effectively countering terrorism requires access to accurate intelligence, but such intelligence is difficult to obtain. Terrorist groups have very strong motivations to, and are skilled in, keeping their activities and plans secret. Technical means of intelligence collection, such as satellite imagery and signals interception, are less useful against terrorist groups. These difficulties make intelligence sharing all the more valuable for the United States and its allies. Often the only actors with reliable intelligence are regional governments that have long experience interacting with the target of interest, and are able to draw on their own police, immigration, and intelligence agencies to collect intelligence on terrorists and others acting from their territory. But many such governments in the Middle East, South Asia, and other parts of the world have political interests that diverge significantly from those of the western powers. It therefore seems likely that otherwise mutually beneficial exchanges of intelligence may be blocked by concerns about defection.

While the governments involved have managed to keep many of the details of contemporary intelligence sharing practices secret, the information in the public domain seems consistent with the relational contracting explanation developed here. In particular, the United States appears to have attempted to introduce elements of hierarchy into its relationships with national intelligence agencies in the Middle East and South Asia. The United States provides substantial subsidies to some national intelligence sources in the region, presumably giving it some influence over their priorities and actions (Kaplan 2003). It is known that the United States also cooperates closely with states in the region to capture, detain, and interrogate suspected terrorists. Less often commented on is the fact that this cooperation is designed to give the United States substantial oversight over its partners' activities. American intelligence services apparently supervise a network of secret detention facilities in friendly countries and operate aircraft to ferry detainees to these locations and cooperate closely with foreign counterparts to track, capture, and interrogate suspects (Mayer 2005). This marks an important change from the earlier practice of relying on local intelligence services to carry out unsupervised interrogations and seems to respond directly to concerns about defection. For example, American intelligence expressed frustration that their Saudi counterparts would not allow Americans to observe or participate in the interrogation of suspected terrorists in the mid-1990s.

Relational contracting also can provide practical advice about how to improve intelligence sharing arrangements. Consider intelligence sharing among European countries to counter terrorism. Such sharing is

particularly important because the free movement of goods and people in most of the European Union makes it more difficult for national intelligence agencies to track terrorists and those who support and fund their activities. Key barriers to effective sharing in the European Union are that national governments continue to worry that other member states will not share all of the relevant intelligence in their possession or will pass on shared intelligence to third parties. While the European Union has developed offices and practices to encourage the sharing of intelligence, it has taken few steps to design institutions that would counter these concerns about defection. Developing oversight mechanisms that more effectively allow member states to monitor each other's collection and sharing activities and to punish violations would make the Union's sharing arrangements more effective.

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JAMES I. WALSH
Department of Political Science
University of North Carolina at Charlotte
Charlotte NC 28223
e-mail: jwalsh@uncc.edu