



ERIC A. POSNER  
ALAN O. SYKES

Economic  
Foundations of  
International  
Law

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**Economic Foundations of International Law**



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# Economic Foundations of International Law

Eric A. Posner  
and  
Alan O. Sykes

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*For Emlyn, Nathaniel, and Jacob*  
—E. P.

*For Maureen, Maddie, and Sophie*  
—A. S.



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# I

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## Basics



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## Introduction

Recent years have witnessed a torrent of new writing that uses concepts from economics to analyze international law. The economic or rational choice approach to public international law assumes that states are rational, self-interested agents that use international law in order to address international externalities and obtain the other benefits of international cooperation. This approach also emphasizes that because no external enforcement agent such as a world government exists, international law must be self-enforcing. States must believe that if they violate international law, other states will retaliate or in other ways respond negatively. This self-enforcement constraint is the major analytic distinction between international law and domestic law, where it is usually safe to assume that parties can rely on the government to enforce the law.

Although the economic approach to international law is only about ten years old, a large literature has already accumulated.<sup>1</sup> Many of the earliest works focused on the question of compliance, asking what reason rational states have for complying with international law. Since then, scholars have turned their attention to substantive areas of law—human rights, the law of the sea, the laws of war, environmental law, and so forth—and general themes such as the role of adjudication and of international organizations. The purpose of this book is to gather together and build on many of the ideas from this body of work and to present them in a manner suitable as an introduction for students and as a reference work for scholars. We mainly have in mind law students and law professors, but we hope that political scientists, economists, and other scholars who work in international relations will find this book useful as well.

Some background about the intellectual antecedents of this work will be helpful. Most scholars who write about international law take a doctrinal approach, in which they analyze legal sources for the purpose of determining what the law is. Where scholars ventured outside the doctrinal realm, they tended to be influenced by currents in legal philosophy and legal history. Most

international law scholars ignored the revolution in (domestic) legal scholarship of the 1960s and 1970s, which introduced social science methods, and in particular economic methods, to legal scholarship. Only international trade scholars, in the spirit of their enterprise, imported economic ideas into their field. Economic analysis of public international law began only in the 1990s and, after a slow start, accelerated in the early 2000s.

A parallel stream of scholarship has been produced by political scientists. International relations theorists discovered rational choice in the 1980s, much earlier than international law scholars. Their earliest work, however, focused not on international law but on more general questions of international cooperation.<sup>2</sup> In the late 1990s, political scientists turned their attention to international law, and since then a great deal of writing on this topic has emerged.<sup>3</sup> The work of international lawyers influenced by economics and political scientists overlaps but is not identical. Political scientists (like economists) are oriented to producing descriptive hypotheses about how states and other international actors behave and testing them using statistical methods. Much political science scholarship tries to test which of the different schools of international relations (realism, constructivism, and so forth) best explains international behavior, a topic of little interest for lawyers. Lawyers are oriented to normative argument and also tend to examine international law in a more fine-grained way, focusing on particular rules and doctrines rather than general institutional patterns.

This book focuses on the law-oriented literature. In addition to summing up prior work, we hope to produce a springboard for future scholarship. International law is a vast subject, and its importance is increasing. It is sufficient to point to the major role of international law in the conflicts and wars that emerged from the 9/11 terrorist attack and in international efforts to address climate change. These are two of the most important issues of our time. “Globalization” has become a cliché, but it is undeniable that interactions among states have increased enormously over the last twenty years, and this has produced urgent questions for international law. This book provides an intellectual framework for thinking about these questions in a rigorous way.

The book aims for breadth, not depth. Given the scope of the topic, we can address international law only by simplifying it for analytic purposes. Readers who seek a more comprehensive and precise introduction to international legal doctrine should consult a standard treatise on international law.<sup>4</sup>

This book has five parts. In this, Part I, we provide a brief introduction to economics, international law, and the economic approach to international law.

In Part II, we survey the general structural and institutional features of international law. In Part III, we focus on some traditional international law topics such as the treatment of aliens, the laws of war, and human rights. Part IV addresses international environmental law, and Part V addresses international economic law.



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## Fundamentals of International Law

International law is the system of laws that governs the relationships of states. States make international law by entering treaties with each other and by recognizing customary norms. International law creates obligations primarily for states: states comply with or violate international law. The one exception to this proposition is international criminal law, a body of law that states have created but that imposes duties on individuals.

### What Is a State?

The state is the central agent of international law. Putting aside complexities that we will address later, states make international law; they decide whether to comply with or violate international law; they are the victims of international law violations; and they demand and pay reparations on account of international law violations. But what is a state? We can start with the legal definition of the *state* in international law: “Under international law, a state is an entity that has a defined territory and a permanent population, under the control of its own government, and that engages in, or has the capacity to engage in, formal relations with other such entities.”<sup>1</sup> One might begin by noting that every state has a territory defined by borders with a population within those borders, but we immediately see difficulties. The people who “belong” to the state (“citizens,” “subjects,” “nationals”) do not necessarily stay within the borders, and foreigners may come onto the state’s territory. To be more precise, then, the state has some set of rules that identify the people in the subset of the world population that have certain substantial rights and obligations under domestic law—including, nowadays, the right to enter the state’s territory after leaving and the right to remain in the state.

But there is more to be said about the population. One can identify territories without populations (like Antarctica) and populations without territories—the

Kurds, the Palestinians, Jews before the establishment of Israel. Certain groups of people identify with each other along religious, ethnic, or territorial lines: they think of themselves as having special obligations to each other, as belonging together, and with a right to inhabit some specific territory usually. The Kurds are scattered across a territory that includes parts of Turkey, Iraq, Iran, and other countries, but they do not have a state because they lack something more. Not all Jews believe that there must be a Jewish state, but many do, those living in Israel especially. At one time, it was thought that all national or ethnic groups were entitled to their own specific territory where they have historical ties. This idea lives on under the rubric of “self-determination,” a concept that can be found in various international documents including human rights treaties. But it turns out that the idea is not practical: there are too many different national and ethnic groups, which, thanks to intermarriage and migration, overlap in complex ways, with many people disagreeing about who belongs in what group; plus, people occupying territories to which some other group has historical ties rarely yield to those claims, often claiming, with varying degrees of accuracy, that they have historical ties to the land as well. We will discuss this problem in more detail in Chapter 5.

There are two more criteria in the legal definition of a state. A state must have a government: some institution must maintain order among the people who live on the state’s territory. Some states lack governments; they are called “failed states.” Today, Somalia is an example of a failed state. Last, states must enjoy the recognition of other states. This criterion is crucial. Otherwise, certain self-governing population-territory packages that are not states would seem to be states: Quebec is an example.

### Sources of Law

We have discussed some of the complications that surround the idea that states are the primary agents of international law. As always, the analogies and dis-analogies to domestic law are instructive. People make law through their representatives; states make law directly. We do not need to worry about individuals breaking apart or merging; states, by contrast, break apart and merge. Yet states, unlike individuals but like corporations, are indefinitely lived. The persistence of states contributes to the stability of the international system, yet their susceptibility to failure, breakup, and reconfiguration can play havoc with it.

Nonetheless, the state is the starting point for understanding international law. States make international law, and they are bound by it. Hence, when international lawyers try to figure out what international law is, they begin by

looking at the activities of states—treaties, of course, but also custom and the various official statements that states make through their governments. The method for examining these phenomena comes under the doctrine of “sources.”

When a lawyer seeks to determine what domestic law is, the method is straightforward. In the United States, one starts with statutes and judicial opinions. There is rarely any doubt whether a particular rule is a matter of federal statutory law or not—one just consults the U.S. Code—but if doubt arises, a set of constitutional rules guides one to the answer. The statute must emerge from Congress, after a vote, and usually with presidential consent. A number of other constitutional rules may deprive the statute of validity; these one learns by reading judicial opinions. One also consults judicial opinions for interpretations of statutes and for the common law. Again, various straightforward rules allow one to distinguish legally authoritative documents (statements issued by a duly constituted court or panel, after a vote, involving a case or controversy) from other documents (for example, speeches of judges, articles written by judges, and so forth). In a well-functioning domestic legal system, the method for determining the source of law is transparent.

In international law, matters are more complicated. Let us begin with the doctrine:

- (1) A rule of international law is one that has been accepted as such by the international community of states
  - (a) in the form of customary law;
  - (b) by international agreement; or
  - (c) by derivation from general principles common to the major legal systems of the world.
- (2) Customary international law results from a general and consistent practice of states followed by them from a sense of legal obligation.
- (3) International agreements create law for the states parties thereto and may lead to the creation of customary international law when such agreements are intended for adherence by states generally and are in fact widely accepted.
- (4) General principles common to the major legal systems, even if not incorporated or reflected in customary law or international agreement, may be invoked as supplementary rules of international law where appropriate.<sup>2</sup>

The two main sources of law are treaties and custom. A state that has ratified a treaty is bound by it. Customary international law is essentially the customary behavior of states. As we discuss in the next section, to discern custom-

ary international law, the lawyer must examine the statements and behavior of states—with the statements contained in all manner of official documents and practice just a matter of observation. Other sources are even more vague. The decisions of international tribunals may, but need not, be sources of law. The decisions of domestic courts that address international law may be a source of international law. The common constitutional and legal norms of states may be a source of international law. So may be the writings of scholars.

Why are the sources of international law more complicated than the sources of domestic law? The beginning of an answer is that there is no international constitution that determines how international law is made. International institutions, such as the United Nations, largely lack legislative power, and international courts do not fit into a neat hierarchy, so they may deliver conflicting interpretations of even the most basic principles of international law. But why is there no international constitution, and why are there no international institutions such as a legislature? A simplistic but adequate answer for present purposes is that people will allow themselves to be governed by nation states but not international institutions, in part because people do not trust each other across vast areas of territory, or do not identify with each other, or do not feel bound to each other—these are all roughly synonymous ideas. States rarely yield sovereignty to international institutions; they do not trust such institutions for the same reason that national populations do not trust people who live in other states.

As we noted above, however, states do gain by cooperating with each other. International law just is the manifestation of interstate cooperation when states choose to use legal forms to govern their cooperation. International cooperation can be fluid. States often write down the terms of their cooperation in treaties, but they often do not. When they do not, cooperation can take place in a more informal way, reflected in custom or just in oral promises or in promises that are written down but not formally designated as law. The process of identifying these often implicit rules of conduct is akin to identifying the customs and social norms that govern a community of individuals. One starts by looking at how people behave and what they say, and one makes inferences on the basis of these actions and statements. Similarly, international lawyers attempt to infer from the statements and practices of states how those states cooperate with each other, which in part involves predicting how states will react in light of new, often unforeseen events.

Oliver Wendell Holmes famously said that the law is a prediction of what judges do, and one might just as well say that international law is a prediction of what states do. One needs a theory to make such predictions. In the case of

international law, the formal method directs one to look for indications of state consent—explicit, in treaties; implicit, in custom. But in reality one tries to figure out what states' interests are and how states overcome conflicts so that they can jointly advance their interests. The indicia of state consent help in this process—consent reveals a state's perceived interest in a particular setting. So do the other sources of law—the internal legal rules, the general principles, and so on—help one understand the interests of states, as well as their capacities, and the limits on cooperation. More important still is an understanding of how states behave; what history has suggested they can and cannot do; how much they can cooperate and the limits of cooperation.

### **Bodies of Law**

We have discussed the doctrine of sources: it is a doctrine, or really a set of doctrines, that cuts across the many different substantive bodies or fields of international law. Other rules of general applicability include the law of state responsibility (which governs the conditions under which states are liable for the actions of individuals), the law of remedies (which governs the remedies that states must offer to states that they have wronged), and the law of treaties (the set of rules for interpreting and enforcing treaties). Then there are bodies of law that are organized by substance: international environmental law, including the law of the sea and the various treaties addressing climate change; international humanitarian law (the rules governing the use of violence during hostilities); the law of use of force (the rules governing when states may go to war); international economic law, including trade and investment law; international human rights law; laws governing the treatment of aliens, including tourists, business people, and refugees; and much else.

### **Institutions**

International law lacks most of the institutions of domestic law, including a legislature, an executive with general powers to enforce the law, a hierarchically organized judiciary, a significant bureaucracy, and an army. But many international legal institutions exist. The United Nations contains a General Assembly, which cannot make law but serves as a forum for discussion and signal sending, and a Security Council, which is an executive agency with the power to enforce the peace. States have set up a number of courts, some of them temporary, including the International Court of Justice, the International Criminal Court, and the World Trade Organization (WTO) dispute settle-

ment mechanism. And there are countless other institutions—committees, commissions, organizations, bodies—which typically have no formal legal power to make, adjudicate, or enforce the law but in practice have some influence on the development of the law and its application in particular cases. These institutions are not hierarchically organized, so there is no boss at the top who can command them to cooperate or bring them into line. Nor is there a clearly defined sovereign who can revise or reorganize them through constitutional change. The untidiness of the international legal structure no doubt accounts for skepticism among some commentators about its efficacy, but it would be a mistake to assume that these institutions have no power at all.

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## Economic Analysis of International Law—the Essentials

As explained in Chapter 2, public international law is created by two or more states, by custom or more commonly by treaty, to govern interaction among those states. With few exceptions (such as international investment law and international criminal law), only states have the right to invoke and enforce public international law, and only states are bound by it. Thus, states are the key actors in public international law.

But what exactly is a “state” from the standpoint of economics? Why do states exist? What do they want from each other, and why do they need a body of “law” to govern their interaction? Indeed, absent a world government to compel states to obey the law, what good is having a body of law anyway? These are the most basic questions that economic analysis of public international law must confront, and we will begin our treatment of them in this chapter after introducing some basic economic terms.

### Background Concepts and Terminology

Many readers might be put off by economic theory, with its forbidding array of mathematical equations and impenetrable jargon. But that would be a mistake. Economic theory makes progress by simplifying human behavior, not by making it more complex, and the basics of economics are easy to understand.

Economists assume that individuals act in their rational self-interest. This assumption is obviously a simplification; human behavior is much more complex. But it provides a useful starting point for thinking about difficult problems. A person is assumed to have a set of goals (called *preferences*) and limited resources (called the *budget constraint*). He uses those resources to satisfy his preferences to the extent possible. In order to satisfy his preferences, a person must frequently buy goods and services. He buys that bundle of goods and services that best satisfies his preferences given his budget constraint. If prices

change, the person's behavior will change predictably. For example, if the price of tomatoes rises, then the person will (normally) buy fewer tomatoes and use the money he saves to buy something else that he prefers. In theory, the consumer makes purchases of any good up to the point where the *marginal cost* of the good—the price paid for the last increment—is just equal to the *marginal benefit* of consuming an additional increment of the good.

Law and economics was born when economists realized that the law, in effect, raises or lowers the cost of certain behavior. Criminal law raises the cost of criminal activity and so should reduce its incidence. However, much of the law has a different purpose—it facilitates behavior that makes people better off. For example, contract law eases the process of entering agreements for the exchange of goods and services. Exchanges make people better off because they trade something they value less for something they value more. When people make exchanges, they incur certain *transaction costs*—the costs of negotiating, writing down the agreement, and so forth. Contract law reduces transaction costs by supplying *default terms* that (in theory) parties would agree to if they negotiated over them—for example, the market rate of interest for a loan.

Economists evaluate legal institutions by using two normative criteria. Under the Pareto criterion, a law is desirable if it makes at least one person better off without making anyone else worse off. Under the Kaldor-Hicks criterion, a law is desirable even though it produces losers as well as winners, as long as winners gain more than the losers lose. For example, a vaccine program might cause health problems for a few people while benefiting a large number of people by protecting them from a serious disease. The program satisfies the Pareto criterion if the people who are harmed can be identified and fully compensated out of the gains from the people who benefited. The program satisfies the Kaldor-Hicks criterion even if this compensation does not occur as long as the monetized value of the health gains for the winners is greater than the monetized loss of health for the losers. When economists talk about *efficiency*, they have one or the other criterion in mind. Efficiency in both cases is a useful standard for evaluating laws and other government projects, but we agree with most scholars that it is not the only relevant criterion. An equitable *income distribution* is certainly among the other considerations that most people regard as important. That said, one must always ask what is the best *policy instrument* for achieving a more equitable income distribution. Inefficient laws are often inferior to other policies relating to taxation.<sup>1</sup>

A central problem in modern life is that when people act, they often create *externalities*. Negative externalities arise when a person engages in an action that is privately beneficial but that harms others: for example, a factory that



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