A MODEST PROPOSAL: STATEHOOD AND SOVEREIGNTY IN A GLOBAL AGE

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All the world's a stage and all the men and women merely players . . . .1

1. INTRODUCTION

The juridical conceptions of statehood and sovereignty are currently a "hot button" topic in the legal arena for reasons not difficult to discern.2 The cast of characters vying for roles on the world stage and the nature of the roles to be played are currently expanding so rapidly that observers can hardly keep up. As new

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1 WILLIAM SHAKESPEARE, AS YOU LIKE IT, act 2, sc. 7.

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Published by Penn Law: Legal Scholarship Repository, 2014
players enter the scene, our notions of the role of the State are challenged. The rapidity of the changes taking place and the often ill-defined mechanisms through which they are effected make it difficult to fully comprehend their effects on the traditional state-centric model of international law. This difficulty in turn leads to many seemingly contradictory assertions about the proper positioning of the State as a player in the international legal order.

One position, which I refer to as the "demise-of-the-State" camp, rejects the idea that the State can remain the supreme player in the international arena as non-state participants in that system move inexorably towards "globalization" or "internationalization." While recognition of the interconnection of States is by no means new, demise-of-the-State proponents take the argument to the extreme. They argue that recent technological advances in areas such as communications have linked the fortunes of States in ways which make or soon will make national borders insignificant. As the transnational flow of goods and services gains momentum, States will lose their ability to exercise independent control over matters traditionally within their power.

Pointing to the increased use (or at least increased formation) of non-state organizations to monitor transnational issues such as trade and the environment, demise theorists claim that a state-

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3 See, e.g., Kenichi Ohmae, The End of the Nation State: The Rise of Regional Economies 11 (noting that "nation state has become an unnatural — even a dysfunctional — organizational unit for thinking about economic activity" and that nation states are no longer "meaningful units of participation in the global economy of today's borderless world"); Thomas G. Weiss & Jarat Chopra, Sovereignty Under Siege: From Intervention to Humanitarian Space, in Beyond Westphalia? State Sovereignty and International Intervention 87 (Gene M. Lyons & Michael Mastanduno eds., 1995) [hereinafter Beyond Westphalia]; see generally Brand, supra note 2.

4 See generally Vincent Cable, The Diminished Nation-State: A Study in the Loss of Economic Power, Daedalus, Spring 1995, at 23 (arguing that globalization has caused nation-states to lose their sovereignty to regional and global institutions); see, e.g., Richard N. Cooper, The Economics of Interdependence: Economic Policy in the Atlantic Community (1968) (analyzing the consequences for economic policy of changes in the structure of international economic intercourse among industrial countries); Ernst B. Haas, Beyond the Nation-State: Functionalism and International Organization (1964) (exploring the relationship between aims of nations and "a growing mutual deference and institutional mingling").

5 See Vivien A. Schmidt, The New World Order, Incorporated: The Rise of Business and the Decline of the Nation-State, Daedalus, Spring 1995, at 75 (acknowledging that nation-states have sacrificed their own independence as they have increased that of business through international trade organizations).
centric model of international governance is outmoded. Instead, other entities must address many concerns traditionally within the exclusive purview of States; this severely limits the role to be played by the State on the world stage. There are abundant metaphors\(^7\) to describe a world where state primacy is no longer central to the international legal order. Demise-of-the-State theorists focus their attention on the need for legal structures with a global reach which recognize and accommodate the changing shape of this new world.\(^8\)

In seeming opposition to the demise-of-the-State position, some theorists believe the State is and will remain the lead actor on the international stage, a position I refer to as the “primacy-of-the-State” camp.\(^9\) This position is reinforced by changes in the world map in the past decade. As long-standing political orders such as the Soviet bloc crumble, new groups fight for national independence and international recognition of their statehood with varying degrees of success.\(^10\)


\(^7\) A partial list might include “global village,” “space-ship earth,” “new world order,” “borderless world,” “new international legal order,” and “global system of law.” See Brand, *supra* note 2, at 1696.


\(^9\) See, e.g., ALAN S. MILWARD, THE EUROPEAN RESCUE OF THE NATION-STATE 445 (1992) (noting that even when European Community member-states have surrendered sovereignty, “they have produced an arrangement which left almost all political power with the nation-state”); Schmidt, *supra* note 5, at 101 (“[T]he nation-state will continue to be the prime interlocutor in an increasingly complex world, and the only one that speaks with authority to both supranational and subnational authorities.”).

\(^10\) For the most part, the republics of the former Soviet Union have received international recognition as States. However, for some, great sacrifices have yet to result in status as “States.” See Yeltsin Rejects Chechnya as an Independent Country, BALT. SUN, Sept. 30, 1997, at 1997 WL 5532354, at *1 [hereinafter Yeltsin Rejects Chechnya] (reporting that Russian President Boris Yeltsin recently “ruled out . . . any agreement with Chechnya that would recognize the separatist republic as an independent country”). Another example is the Kurdish battle for statehood against Iraq. See The Kurdish Dilemma, THE
These "demise-of-the-State" and "primacy-of-the-State" positions seem to directly contradict one another: while one posits the irrelevance of the State, the other stresses its continued importance. Closer examination reveals, however, that the two may not oppose one another so diametrically. As is often the case, each position reflects some of the reality of today's world. What the divergent positions highlight is the need to re-examine the traditional conception of what it means to be a "State." Subsumed within that analysis is the issue of the traditional perception of "sovereignty" as it articulates a role for the State in the international system.

This re-examination of sovereignty has begun in earnest in some places.\textsuperscript{11} Many of the changes mentioned above, including the emergence of new States and new state groupings, are readily apparent to most observers and are being considered in the ongoing discussion of sovereignty. Other changes, however, are less obvious, and yet may have as important, if not more important, ramifications for a state-centric international legal model. Rapid advances in technology and communication and the increasing openness of markets worldwide have created a new pool of non-state players on the international stage.\textsuperscript{12}

One of the most powerful new actors in the international arena is the capital-controlling private sector.\textsuperscript{13} International
capital markets are becoming essential sources of funds for many States. The increased demand for funds, coupled with the extreme liquidity of these markets, is enabling money managers to emerge as important non-state actors with the ability to affect state policy and action. Extremists have begun to recognize the power of the purse wielded by these actors, calling it a "new kind of national security crisis." However, these new roles of power, and the consequences of their emergence, are not being addressed adequately.

Not so long ago, legal scholars could state without fear of contradiction that "[w]hether a State is nationalist, socialist, free market or whatever is a matter of its self-determination and domestic jurisdiction." Today, this seems to vastly overemphasize state power. The reality is that in our current world of interconnected markets and rapid capital mobility, all States face stiff competition for the capital inflow they need. Monetary and other policy decisions which affect a country's economic well-being are no longer the sole province of the sovereign, but are increasingly affected by the direct and indirect demands of external actors. In the fierce battle for investment capital:

Whichever country has the most stable government, the most efficient economy, the most Westernized legal system, the most convertible currency and the most educated labor force, gets rewarded with investment capital from the super [global] markets. Those countries that don't get their house in order are left as roadkill on the global investment highway.

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16 See generally Cable, supra note 4.
While practitioners in other fields, particularly economics and political science, are focusing on the changes wrought by international financial actors, international legal scholars lag far behind. They fail to meaningfully address crucial issues, much less resolve them. This Article examines some of the changes occurring on the world stage. It focuses on the emergence of powerful non-state actors and the consequences the existence of these new actors may have on the juridical understanding of sovereignty. Section 2 describes the traditional conceptualizations of "statehood" and "sovereignty." It then argues that this state-centric model must be refined into a "bundled" model to reflect today's realities. Section 3 focuses on economic power as a critical element in describing one aspect of this "bundled" model and distinguishes the various mechanisms through which States receive foreign funds. It suggests that these methods and their effects can only be understood within the context of the revised model. To demonstrate this, Section 4 examines the receipt of portfolio investment by using the Mexican Peso Crisis of 1994-95 as an example. The Peso Crisis illustrates that the traditional understanding of the exercise of sovereign powers grossly overstates today's reality, and that unfettered economic self-determination is no longer possible for States. Section 5 describes current responses to the changes on the international stage and contends that those responses are inadequate.

18 Areas under consideration include, among others, exchange rate policies and currency unification. See Ilene Grabel, Marketing the Third World: The Contradictions of Portfolio Investment in the Global Economy, in POST-KEYNESIAN FOUNDATIONS IN THE ANALYSIS OF THE INTERNATIONAL ECONOMY (J. Harvey & J. Deprey eds., forthcoming 1997) (manuscript at 28-29, on file with authors) (discussing various methods of regulation, including use of stringent capital controls, volume- or price-based restrictions on purchases and sales of portfolio investment, or a "uniform, global transaction tax"); John R. Freeman, Address at the Annual Meeting of the American Political Science Association (Aug. 29 - Sept. 2, 1990).

19 See, e.g., DAVID FOLKERTS-LANDAU & TAKOTOSHI ITO, INTERNATIONAL MONETARY FUND, INTERNATIONAL CAPITAL MARKETS: DEVELOPMENTS, PROSPECTS, AND POLICY ISSUES 1 (1996) [hereinafter IMF 1996 REPORT] (stating that the report "does not take up questions about the potential role of international financial institutions in dealing with the consequences of the growing scale and speed of international capital flow to and from emerging markets").
This Article does not attempt to determine the appropriate role the multitude of non-state actors gaining power on the international stage should take. Rather, its goals are to highlight that, with or without recognition, changes are being wrought in the international legal order, and to encourage open dialogue about both theoretical and practical responses.

2. STATE-CENTRIC AND "BUNDLED" MODELS

2.1. Traditional "State-Centric" Definitions of "State" and "Sovereignty"

The words "state" or "sovereignty" immediately bring to mind certain connotations. Traditional legal theory holds that the State is the primary actor on the international stage and that each State possesses equal sovereign powers. While many possible definitions of "State" exist, a "State" is commonly described as "a person of international law [which] should possess the following qualifications: (a) a permanent population; (b) a defined territory; (c) government; and (d) the capacity to enter into relations with the other States." This definition derives from the historical development of States and the concept of sovereignty as it has developed from the Middle Ages.

After the Reformation, monarchs began to assume ultimate authority within their defined territories. "A new era of equal sovereigns began with the 1555 Peace of Augsburg and became more formalized in the 1648 Peace of Westphalia." Monarchs were the source of all power in their realm, with the authority to control virtually every aspect of their subjects' lives. As the

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20 See, e.g., Nagan, supra note 2, at 144-45 (listing thirteen different ideas with which the term may be associated).

21 See U.N. CHARTER art. 2, para. 1 ("The Organization is based on the principle of the sovereign equality of all its Members."). Of course, it should be noted that different conceptions of relations among world powers existed at the time. See ASIL 1994 Report, supra note 11, at 51-52 (giving remarks of Professor Thomas M. Franck, who noted that "independent, sovereign actors bound by no authority, temporal or otherwise" no longer exist).


23 Brand, supra note 2, at 1688.

24 See generally LOUIS HENKIN, INTERNATIONAL LAW: POLITICS AND VALUES 9-10 (Developments in Int'l Law No. 18, 1995) (providing historical background).
law of nations developed, the ultimate authority of monarchs grew from exclusive concern with power exercised over subjects to include external influence.25

Early proponents of this definition of sovereignty apparently believed that some limitations on this absolute power existed.26 Nevertheless, this definition provided the foundation for a state-centric legal order, long dominant in the international arena.27 Thus, in traditional theory, sovereign attributes are typically thought to include the ability to exercise exclusive jurisdiction over citizens of the State, equality with other States, and the power to structure policies constrained only by the impact of those policies on other States or by agreements entered into with other States.28 These attributes reinforce the identification of the State as the sole legitimate actor on the world stage, defining "sovereignty" as the primary mechanism through which a State maintains its standing with other state actors.

2.2. A Reconceptualization of the State-Centric Model

In light of the changes in the structure of the international legal arena, the present understanding of sovereignty must expand. While interstate relations will always be an important element of international law, the exclusively state-centric approach is no longer sufficient. Some modifications to this framework have already occurred with the explicit inclusion of non-governmental organizations in numerous international agreements.29 More

26 See Friedrich Kratochwil, Sovereignty as Dominium: Is There a Right of Humanitarian Intervention?, in BEYOND WESTPHALIA, supra note 3, at 21, 23 ("Although the sovereign is still subject to natural law and bound by his conscience, he now emerges as a lawgiver who faces an (at least in this respect) undifferentiated set of subjects.").
27 Even international agreements which arguably detract from this model depend upon it for their legitimacy; virtually all treaties and international agreements are executed by States, and membership in international organizations is typically open only to States. See U.N. CHARTER art. 4, para. 1 ("Membership in the United Nations is open to all ... states.").
29 See, e.g., U.N. CHARTER art. 71 ("The Economic and Social Council may make suitable arrangements for consultation with non-governmental organiza-
change is necessary, however. A theoretical framework is needed to accurately reflect the changes occurring on a practical level. Consequently, the position that States deal only with other States, and that States are the only meaningful actors on the international stage, must be abandoned.

The category of recognized actors should be expanded to admit the new entities now exercising considerable power. Doing so requires recognizing that non-States may possess some powers previously considered "sovereign." Uncoupling "statehood" from "sovereignty" facilitates a scheme in which a State can cede some "sovereign" elements while remaining a full, legitimate international actor. Simultaneously, other non-state entities can wield powers traditionally reserved to the sovereign without being considered "States."

This uncoupling does not "assume some artificial life for the state, as though the state is more than a bundle of powers and responsibilities." Rather, it allows explicit recognition that a State may allocate portions of its bundle of powers to other actors without becoming any less a State and that those actors receiving direct or indirect allocations of power do not thereby become "States." This "distribution of power" model also helps explain the co-existence of the "demise-of-the-State" and the "primacy-of-the-State" positions. Instead of becoming less important, the State will find new ways to behave in an environment which includes additional powerful participants.

If we can successfully detach our conceptions of statehood and sovereignty from one another and expand our recognition of significant actors on the international stage, what will happen to the existing model? Will statehood and sovereignty continue to have any relevance to international legal discourse? Some would argue, particularly with respect to sovereignty, that both terms

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30 Trachtman, supra note 2, at 402 (arguing that "sovereignty' and the 'state' are congruent' and that those who separate the two "assume some artificial life for the state").
should be banished from the vocabulary of geopolitics. Nevertheless, most scholars agree that the notions of statehood and sovereignty continue to be relevant and are destined to be a part of the dialogue regarding international legal relations for some time to come. Given the likely longevity of the terms, it will be useful to ascribe meaning to them which comports with the behavior of participants in the international system. The current rigid articulations of the terms, however, do not accomplish this task.

A functionalist conceptualization of sovereignty which reflects this reality can be premised on a model that any American-schooled attorney would find easily accessible. Drawing on a favorite example from the average first-year law school Property class, sovereignty can be understood as a combination of several powers, rights, and obligations, just as property ownership is a “bundle of sticks” that are divisible and transferable between original and subsequent owners. When one property owner transfers the right of an easement to another, other attributes inherent in the land remain with the transferor. The recipient is not characterized as an “owner” through possession of the easement. That designation remains with the transferor.

Incorporating this understanding into the traditional definitions of “statehood” and “sovereignty” would bring international legal scholars in line with political scientists and international relations theorists who conceive sovereignty as “an elastic term” not incompatible with “individual rights, nonstate actors, or permeable boundaries.” Thinking of sovereignty as a “bundle

31 See, e.g., HENKIN, supra note 24, at 10 (stating that sovereignty is “a term largely unnecessary and better avoided” in international law); Weiss & Chopra, supra note 3, at 100 (“Even if sovereignty is still the working assumption at the highest levels of government, current challenges to the concept lead to the conclusion that it is becoming a dead letter of international law.”).

32 See ASIL 1994 Report, supra note 11, at 1-2; see also Nagan, supra note 2, at 144-45.

33 Some may argue that the definition of terms is not relevant and that, regardless of the phraseology, the actors in question will continue their behavior. See Nagan, supra note 2, at 144-45. I agree wholeheartedly with the idea that non-state actors will exert influence even if we refuse to modify the state-centric model which denies them significance. However, that should not prevent an attempt to create a model which includes them while simultaneously changing the terms of the dialogue.

34 Weiss & Chopra, supra note 3, at 100.

https://scholarship.law.upenn.edu/jil/vol18/iss3/2
of sticks," however, fails to establish the definition of sovereignty just as thinking of property ownership in a similar fashion does not cement what it means to "own" a particular asset. Recognizing that sovereignty, like ownership, contains many constituent elements may help explain why and how "sovereign sticks" can be passed to non-state actors in the growing ranks of players in the international arena.

This approach leaves us with several important considerations. First, what fixed attributes must an entity possess for it to be considered a "State"? Can a minimum threshold be established? Second, what elements constitute the "bundle of sticks" of sovereignty? Are there any elements of sovereignty that are non-delegable if a State wishes to maintain its status? Third, to whom may those "sticks" be passed? The international community has long been comfortable with the idea that some powers may be ceded to international organizations through entry into international agreements. However, the international community may balk at accepting other entities as recipients of sovereign status. Finally, in what manner may the "sticks" be passed? Will the mechanism of passing the "sticks" be significant?

2.2.1. A "Sovereign" Bundle of "Sticks"

Recognizing sovereignty as being comprised of a bundle of "sticks" facilitates a more accurate understanding of an international legal order populated by many different actors wielding differing degrees of power and control. States, while still the central feature of the model, comprise but one subset of actors; other, non-state actors assume some of the powers traditionally associated with "statehood" or "sovereignty." Of course, this model of passing power from State to State, from State to organizations of States, or from State to non-state actors, assumes

that an identifiable “State” will continue to exist and that all will recognize it as such, regardless of how many “sticks” have been passed. Therefore, it is necessary to consider the necessary elements of “statehood.”

2.2.1.1. “Claim” v. “Exercise” Elements

Attributes of statehood must consist of those “sticks” necessary to claim state status. These are distinct from those “sticks” used by a State in the exercise of its power.36 “Claim” attributes do nothing more than create a minimum threshold. Although an entity cannot be designated a State without them, their presence tells us little about the behavior of that State or how it uses its powers.

This inquiry requires consideration of the use a State makes of its “exercise” elements. Although debatable, the starting point for distinguishing “claim” and “exercise” components is the traditional definition of a State as set forth above. From there, we can refine further the stated elements of a permanent population, a defined territory, a government, and the capacity to enter into interstate relations. These criteria contain numerous powers and rights, and Professor Louis Henkin succinctly captures many of these.37 Henkin “decomposes” the concept of sovereignty in an attempt to identify those elements which “constitute essential characteristics and indicia of Statehood today.”38 Included on his list are independence, equality, autonomy, “personhood,” territorial authority and integrity, and impermeability.39

Henkin’s list contains both “claim” and “exercise” attributes. The task now is to separate the two, designating “claim” components as “statehood” elements and “exercise” components as “sovereignty” elements. As with any attempt to place concrete

36 Daniel Turp articulated this distinction between a claim to sovereignty and the exercise of sovereign power. See ASIL 1994 Report, supra note 11, at 86. I prefer to use “State” or “statehood” as the object of the claim on the status prong rather than the claim to sovereignty that Turp suggests. I also prefer sovereign power as the action being undertaken on the “exercise” prong as this terminology better tracks the “bundle of sticks” model and simplifies the conceptualizations of “statehood” as fixed and determinate, and of “sovereignty” as fluid.

37 See HENKIN, supra note 24, at 10.

38 Id.

39 See id.
labels on intangible concepts, this effort at parsing is likely subject to endless criticism. Centuries have passed without resolving the analogous problem in property law of determining attributes essential for "ownership." The answer there depends entirely on how "ownership" is defined, just as the determination of elements essential for "statehood" rests on the meaning attributed to the term "state." Nonetheless, we should not allow our recognition of alternative articulations to prevent us from engaging in this inquiry. It is of less concern to this author that everyone agree on the particular placement of an element; rather, it is more important that this model explains the ability to transfer power into non-state hands by passing off "exercise" elements exists and is exercised frequently.

2.2.1.2. The "Claim" Elements for "Statehood"

A review of Henkin's list, which identifies certain essential attributes of statehood, reveals that only a few elements are actually necessary to mark that status. The vast majority of characteristics associated with a "State" may be reallocated to other States, state groupings and even non-state actors. This reallocation may be carried out in varying degrees without undermining the statehood of the allocating State, or wholly conferring such status on a non-state recipient. Therefore, further distillation of the elements is necessary.

2.2.1.2.1. Independence

"Independence," as used by Professor Henkin, means "separateness, distinctness from other such entities . . . physically and politically." When considering "independence" as a "claim" element of sovereignty, it is helpful to distinguish physical and political independence. To the extent that "independence" of a State defines its physical identity and separateness, independence can be seen as a central "claim" attribute of statehood.

41 Although it is possible to place different labels on similar concepts, some may argue about the ensuing categorizations. Regardless of the titles used, however, the conceptual premise holds.
42 HENKIN, supra note 24, at 10.
A demarcated geographic territory enables the baseline identification of the “State” entity to occur and creates a physical sphere controlled by one State. Even this bare minimum prerequisite for statehood may be disputed.\textsuperscript{43} However, its acceptance in the international community is clearly evidenced by the actions of the former Soviet-bloc countries that sought to establish territorial boundaries to be considered as independent entities.\textsuperscript{44} Even when those seeking statehood do so from outside the defined physical territory, as with governments in exile, they depend on the existence of a definable territory as a foundation of their legitimacy. Control over a physical territory thus defines an entity entitled to seek statehood.

Control over physical territory also creates boundaries for weighing state action. The existence of determinate boundaries demarcating one State from another underlies much of the international legal structure and dictates in large degree the state’s ability to act with political independence. Under international law, the behavior of a State depends largely on whether its actions take place within or outside of its territorial boundaries.\textsuperscript{45} For instance, actions based on religious or cultural reasons carried out within a State’s boundaries will be tolerated if exercised exclusively within that State’s territory, although such actions might not be accepted outside the territory.\textsuperscript{46} Thus, the physical indepen-
dence of a State continues to act as a central defining characteristic.

However, as discussed below, it is clear that what occurs within a State's defined territory may be strongly influenced, if not mandated, by another State or non-state actor. Therefore, the traditional meaning of independence as "freedom from the influence, guidance, or control of another or others,"\textsuperscript{47} is not an essential element of statehood. Independence itself must be viewed as being comprised of several "sticks." As the following discussion of autonomy will highlight, total political independence is not a "claim" element of statehood. A State may pass off some "sticks" of political independence without losing its claim to that status so long as it retains some identifiable physical territory.

2.2.1.2.2. Identifiable Government

An identifiable government, a necessary complement to independence, is another "claim" element. If personhood is to have any meaning, there must be some individual entitled to assert it both domestically and internationally. The presence of an identifiable government enables the voice of a State to be heard so that it may assert the necessary claims. Although the issue of what kinds of government the world community will recognize may, at times, be controversial\textsuperscript{48} and the parties in power may change rapidly, some identifiable group must exist to represent the entity claiming statehood.

\textsuperscript{47} AMERICAN HERITAGE DICTIONARY 917 (3d ed. 1992).


Controversy also arose when President Jimmy Carter announced in 1978 that the United States would normalize diplomatic relations with the People's Republic of China and that U.S. diplomatic relations with the Taiwan would end. See BARRY E. CARTER & PHILLIP R. TREMBLE, INTERNATIONAL LAW 470 (2d ed. 1995) (noting that the withdrawal of recognition from Taiwan in favor of the People's Republic of China "ended nearly 30 years of a complicated relationship between the United States, Taiwan, and the [People's Republic of China]").
2.2.1.2.3. Population

Although not included as a distinct element on Professor Henkin’s list of essential attributes, existence of a population is a typical prerequisite to statehood. Without a population, there can be no actors to take roles in the government necessary to assert the “claim” elements of statehood. While it is possible to imagine that the identifiable government and the population of a State are coterminous, a realistic understanding of state structure includes the existence of a population governed by an identified government. Indeed, underlying each of Henkin’s attributes is an assumption that the entity possessing such elements has some determinate population. Although the population need not be fixed and stable, some group of people must constitute the State.

2.2.1.2.4. Personhood

Perhaps the ultimate “claim” element, and one closely related to independence, is personhood. It is critical to understand for our model of statehood that personhood, like independence, enjoys a very limited meaning. Personhood means only the recognition of that entity as an international actor. It identifies those entitled to claim statehood. Personhood does not describe what powers, rights, or obligations attach to the achievement of that status. That will be addressed in the consideration of the “exercise” elements of sovereignty.

The functioning of the international legal order begins, although it does not end, with the notion that States are the main participants and certain roles are open only to States. There-

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49 See HENKIN, supra note 24, at 10.
50 See U.N. CHARTER art. 2, para. 1; id. art. 9, para. 1; id. art. 93, para. 1. Scholars generally agree that the international system “was premised on the idea that States were the central actors,” but that other actors have become increasingly prominent. Gene M. Lyons & Michael Mastanduno, Introduction: International Intervention, State Sovereignty, and the Future of International Society, in BEYOND WESTPHALIA, supra note 3, at 5-9.
51 Full membership in many international organizations, for example, is limited to States. See, e.g., U.N. CHARTER arts. 3, 4; Articles of Agreement of the International Monetary Fund, July 22, 1944, 60 Stat. 1401, 2 U.N.T.S. 39 (entered into force Dec. 27, 1945) [hereinafter IMF Articles]. Weiss and Chopra argue, however, that such non-state actors as international organizations, corporations, national independence movements, and even individuals have attained recognition as international “persons.” Weiss & Chopra, supra note
fore, entities seeking access to the international arena must establish the legal fiction of personhood which allows them to effectuate this right of participation.

What then is "personhood"? Personhood is perhaps best understood through an analogy to corporate law: use of the corporate form to establish a legal fiction. Upon the filing of proper documents and receipt of official approval, a company can gain recognition as a fictional entity, a corporation. Personhood serves a similar function for States. It gives form to an entity which permits other States to recognize that entity as another State. Personhood is a prerequisite to statehood, but does not mandate it. Many groups may identify themselves as "persons" under international law but still do not receive recognition as a State. For example, the Kurds in northern Iraq claim personhood for their group because they recognize that it is essential to making a claim for recognition as a State. However, they have not yet received international recognition as a State.52 Another situation highlighting the interplay between personhood and statehood is the uncertain status of the Palestinian Authority.53 Although most would agree that the Palestinian Authority has qualities inherent in personhood, the international community has not yet granted it status as an independent State. These examples illustrate that personhood is ultimately a prerequisite, but not a guarantor, of statehood.

These four elements — independence as established by a defined physical territory, personhood, an identifiable government and population — are the essential "claim" elements of state status. Once an entity claims statehood successfully, the issue of determining what powers, rights and obligations the new status confers on the entity arises. That question is best answered by examining the remaining elements identified by Henkin, elements relating to the "exercise" of sovereign power.

3, at 98.
52 See Kurdish Dilemma, supra note 10, at *1.
53 See Douglas Jehl, In Hebron Accord, The Future Begins to Take Shape, N.Y. TIMES, Jan. 19, 1997, at 6 (recognizing that "more and more, the emerging Palestinian area is beginning to resemble a state" although "officials remain wary about using that charged word").
2.2.2. The “Exercise” Elements of Sovereignty

The “exercise” elements of sovereignty are parts of the bundle of “sticks” inherent in statehood. Unlike the “claim” elements, the “exercise” elements are allocable. A State may directly or indirectly pass some or all of these elements on to other actors. Since this distribution occurs regularly on the international stage, the notion of allocable “exercise” elements should not prove problematic to the construction of a new theoretical model. In fact, it would be more troubling to rely on the prevailing theoretical structure of international law, since it does not accurately reflect reality.

2.2.2.1. Autonomy

Autonomy refers to a State’s ability to act independent of external control, unless it openly consents to such imposition. Autonomy, in layman’s terms, traditionally means the freedom to act independently, to choose a course of action without constraints. Autonomy for sovereignty purposes is far more limited. Since every action taken by a State affects its position in the international community, full unfettered autonomy does not and cannot exist in international law. From explicit prohibitions on state action, as in laws prohibiting genocide and torture, to the implicit check of international opinion and response, constraints on autonomy are endemic. Many state actions have far-reaching ramifications, and every State must consider carefully the repercussions of its decisions prior to selecting its course of action. For example, a State needs to consider possible penalties for choosing a particular trade regime, or what international response

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54 See HENKIN, supra note 24, at 11.

55 Indeed, “autonomy” is defined as “the condition or quality of . . . not being controlled by others or by outside forces,” or as “independence.” AMERICAN HERITAGE DICTIONARY, supra note 47, at 126.

56 See HURST HANNUM, AUTONOMY, SOVEREIGNTY, AND SELF-DETERMINATION 20 (1990) (noting that “some fundamental human rights norms have achieved the status of customary international law of jus cogens, including the prohibition against genocide and systematic racial discrimination”). Hannum further asserts the legitimacy of the power of international bodies to review the human rights situation of any country, “as human rights cannot be said to fall ‘essentially within the domestic jurisdiction’ of a state within the meaning of article 2(7) of the U.N. Charter.” Id. These international laws and norms prohibit such practices by all States, regardless of signatory status. See id.
will arise if it decides to pursue particular political agendas. These limitations on state autonomy, which also inhere in individual autonomy, do not mean that the term has no meaning as an “exercise” element of sovereignty. States may pass some of their “sticks” of autonomy to external actors voluntarily or involuntarily, but may also retain many for themselves. The process through which international legal structures are created illustrates how this division and distribution is possible. As States recognize the need to coordinate their behavior, they voluntarily enter into “groupings.” Through this conscious exercise of their autonomy, States create laws governing their own actions and together craft frameworks for international organizations.

Additionally, international legal documents consistently recognize the autonomous nature of States. Even when acting in concert, States retain a large degree of autonomy in their decision-making. The international legal structure protects that autonomy to the fullest extent possible. The United Nations Charter, for example, states that “[n]othing contained [herein] shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state.”

Of course, autonomy is not, and cannot be, absolute. This comports a view of autonomy as an “exercise” element of sovereignty, comprised of numerous “sticks” and transferable to various other entities. The “sticks” may be passed directly, such as when a State signs an international agreement limiting its actions, or indirectly, when a State is constrained through operation of international law. Examples of the latter include the genocide and torture prohibitions, and forcible restrictions on the exercise of a basic function of autonomy, such as the enforcement of no-fly zones over Iraq during the Persian Gulf War.

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58 U.N. CHARTER art. 2, para. 7.

59 See, e.g., U.N. CHARTER; O.A.S. CHARTER.

A State may also pass a portion of autonomy without any overt recognition. This occurs when external actors exert political or economic pressures that constrain States. This covert transfer of autonomy is more problematic than the others because, often, it is not explicitly acknowledged. The lack of acknowledgement prevents passage from being properly factored into policy decisions and perpetuates the illusion that only States matter. The difficulties in this type of transfer of the autonomy element of sovereignty are discussed in greater detail below.

2.2.2.2. Impermeability

Impermeability is another “exercise” attribute of sovereignty. Stemming from the imperium that princes held within their own territories, impermeability considers the lack of impact that actions taken by others may have within a State. As an initial premise, absolute impermeability dictates that other actors may not interfere in a State’s relations with its citizens. The territorial boundaries of a State create a region within which, in theory, no external actor may directly intrude.

This premise clearly overstates the nature of impermeability today. While there is still great strength in the idea that a State is the final authority over actions taking place within its territory, full impermeability cannot exist in modern society. The very nature of an increasingly globalized, interconnected world disposes of the possibility of a State operating in isolation, even within its own defined territory. With advanced technology, intrusion no longer requires physical presence.

61 See HENKIN, supra note 24, at 12 (stating that “territorial inviolability and the state’s authority within it” came to be seen as aspects of the impermeability of statehood).
62 See id.
63 See id. (defining traditional impermeability as a rule that “other states may have no dealings with any of the inhabitants of another state without its consent”).
64 The worldwide attention on the Tiananmen Square uprising in 1989, made possible primarily through television and other modern modes of communication, provides a vivid example of such intrusion and its impact. See generally Emily MacFarquhar, On the Defensive: As Washington Debates Whether to Get Tough, China Braces Itself, U.S. NEWS & WORLD REP., May 27, 1991, at 37 (describing China’s response to foreign criticism).
Instead, States pass some "sticks" of impermeability to others through their participation in the international community. As demonstrated by a State's entry into human rights treaties, which grant bodies such as the United Nations the power to monitor and sanction States for internal actions, some of this transfer is purposeful. Furthermore, intrusions into state impermeability can occur when one State attempts, through its own laws, to govern affairs in other States. A good example of this is the controversial Helms-Burton legislation recently enacted in the United States. Many other examples could be cited to show that States are never wholly impermeable. It is sufficient, however, to recognize this attribute as an allocable portion of sovereign power — an "exercise" rather than a "claim" element. Even though another actor may exert influence within a State's territory, it is not necessarily the case that State is no longer a State. Rather, we recognize that a portion of the sovereign element of impermeability has been reallocated or, alternatively, reappropriated.


Generally, such international treaties express humanitarian principles in order "to safeguard civilians and nonmilitary property, prohibit certain methods of excessively cruel and destructive warfare, and restrict the testing and use of certain types of weapons." Neil A. F. Popovic, Humanitarian Law, Protection of the Environment, and Human Rights, 8 GEO. INT'L ENVTL. L. REV. 67, 71 (1995).

66 See 22 U.S.C. § 6034 (1997). As a result of Helms-Burton, "for the first time, foreign companies that profit from American property expropriated in Cuba will be liable in American courts." Linda Robinson et al., Cuba Takes a Stiff Belt: Washington Wants to Hurt Castro by Punishing Foreign Firms on the Island. But Will They Go?, U.S. NEWS & WORLD REP., July 29, 1996, at 36. This legislation prompted British Foreign Secretary Malcolm Rifkind to assert that "[n]o one country has the right to tell firms in another country how they should behave in third countries." Id. at 36-37.
2.2.2.3. Equality

The final element on Professor Henkin’s list of attributes is equality. This element, much like autonomy and impermeability, remains a theoretic ideal of international law: that each State be considered fully equal with one another. However, in practice, absolute equality does not exist. States differ in many respects, including size, structure, and economic strength, each of which affects the states’ stature and power in the international community. If equality were viewed as a “claim” element, it could only be in the Orwellian sense that all States are equal, but some are more equal than others.

Equality is an “exercise” element rather than a “claim” element. States are not truly equal, but rather, pass some of their right to claim “equality” to other actors in order to become more equal and to attempt to level the playing field through group action. For example, recognizing that absolute equality cannot exist, States band together in regional organizations such as the Organization of American States (“OAS”) to achieve a more “equal” footing with larger, more powerful States or state groupings. The idealized notion of equality of States remains a central tenet of international law. The practical achievement of some approximation of ideal equality is obtainable, however, only through allocation to others of some of the “sticks” comprising

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67 Henkin certainly identifies other elements, but those addressed here capture the essential components of sovereignty. See HENKIN, supra note 24, at 10.

68 The term “sovereignty” has been discussed in the Meeting of the American Society of International Law as being “used as a surrogate for what was really ‘statehood,’ and of various attributes ascribed to the traditional state, such as ‘independence,’ ‘equality,’ ‘autonomy,’ ‘domestic jurisdiction,’ and ‘reserved domain,’ ‘self-determination,’ or ‘non-intervention.’” Richard B. Bilder, Perspectives on Sovereignty in the Current Context: An American Viewpoint, 20 CAN.-U.S. L.J. 9, 12 (1994). See also J.D. van der Vyver, Statehood in International Law, 5 EMORY INT’L L. REV. 9, 73 (1991) (stating that the classification of general international legal norms entails “principles establishing the main sovereign rights of states and peoples (equality and self-determination of peoples, non-interference”).

69 See GEORGE ORWELL, ANIMAL FARM 123 (4th Signet Classics ed., 1960) (“All animals are equal but some animals are more equal than others.”).

70 See O.A.S. CHARTER art. 9 (stating that member States are “juridically equal, enjoy equal rights and equal capacity to exercise these rights, and have equal duties”).
the equality element.

Properly conceived, then, the list of elements attributed to state status can be distinguished as "claim" elements and "exercise" elements. "Claim" elements create the minimum qualifications necessary for an entity to establish state status. Although "exercise" elements inhere in that status, a State may allocate them to other actors. This distinction does not diminish the importance of the State as an international actor. It simply permits recognition of the emergence of other, non-state actors on the world stage. Having recognized this shift from a pure state-centric model to one that recognizes non-state actors, the inquiry then shifts direction. To which actors are the "sticks" of various elements of sovereign power passed? What actors have already emerged? Do others wait in the wings?

3. OPERATION OF THE "BUNDLED" MODEL IN GENERAL

3.1. To Whom May a State Pass Sovereign "Sticks"?

If States may reallocate portions of their sovereign powers without diminishing their state status in any way, are there restrictions on entities eligible to exercise these powers in place of the State? A traditionalist answer might be that only other States or groupings of States can receive the "sticks." However, a model separating state status from the exercise of sovereign powers permits us to approach this question differently. Transferable powers may be exercised by any non-state entity because the acquiring entity does not achieve statehood simply by receiving the "sticks" of statehood.

A return to the property law analogy demonstrates this on a more practical level. States that enter voluntarily into international political and economic groupings, such as the United Nations or the General Agreements on Tariff and Trade ("GATT"), pass some of their "sticks" of sovereign power to these larger entities. These bodies then act on behalf of their member States. While there is some dispute over the proper scope of their actions, there is no doubt that these types of entities have full authority under international law to exercise what was once considered strictly state power. At the same time, no one can contend that the GATT's administrative body is state-like because of its substantial

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71 See Trachtman, supra note 2, at 399-400.
influence in the establishment of trade terms. Powers may be reallocated from States without creating new States as a result of such reallocation.

Of course, entities like the United Nations are composed of States, so the transfer of elements to these member states does not fundamentally undermine the centrality of the transferring State. Much greater alterations to the traditional model are effected when the "sticks" are passed to entities not composed exclusively of States. Unlike well-established intergovernmental organizations, the traditional model does not readily recognize these newer entities as appropriate recipients of sovereign "sticks." However, they do fit neatly into the reconceptualized model. One kind of entity that has already received some degree of recognition is the non-governmental organization ("NGO"). A prominent example is the International Red Cross, which is recognized by the international community and which receives some "sticks" of sovereignty from States so as to take actions within their respective territories.7

Another important category of non-state actors capable of exercising allocated powers are non-governmental entities who participate in directing the international flow of capital. Among others, this group includes commercial banks, company executives responsible for foreign investment, and international portfolio managers.73 The behavior of these actors differs significantly from NGOs, but it is indisputable that through power of the purse, these entities have the capacity to wield substantial influence over the domestic and international economic policies of States. This ability to exert financial influence shows that States reallocate some power to these actors, whether the realloca-

72 See Dianne M. Kueck, Comment, Using International Political Agreements to Protect Endangered Species: A Proposed Model, 2 U. CHI. L. SCH. ROUND-TABLE 345, 354 (1995) (noting that "[t]he conventions consistently guarantee the International Red Cross the ability to carry out its traditional functions"); Donat Pharand, Perspectives on Sovereignty in the Current Context: A Canadian Viewpoint, 20 CAN.-U.S. L.J. 19, 29 (1994) ("Intervention by the Red Cross and other humanitarian organizations, to come to the rescue of victims of armed conflicts, is specifically provided for in one of the Geneva Conventions of 1949 and the two Optional Protocols of 1977.").

73 Examples include entities such as Morgan Stanley and Quantum Fund, and their managers.
tion is formally acknowledged or not.\textsuperscript{74}

International law explicitly acknowledges and accommodates some of these shifts in financial power. For example, the extensive systems of international regulation over banking activities\textsuperscript{75} and limited recognition of business corporations on the international legal stage demonstrate the ability of States to acknowledge their reallocation of "sticks."\textsuperscript{76}

Other transfers, however, are not yet acknowledged.\textsuperscript{77}

Recognition of the changes in allocation of power is critical to the accurate portrayal of today's international stage. Whether explicit recognition of the shift away from a state-centric model will alter the functioning of the new model is discussed further below. What is clear, however, is that the game and the players have changed. To better understand the new framework, all relevant parties and the "sticks" they can receive should be identified. In

\textsuperscript{74} It is true that financial and mercantile interests have long had a significant voice in international affairs. Currently, however, the demarcation between politics and finance is blurred and the international influence and importance of economic interests is rapidly expanding.

\textsuperscript{75} A major source of international banking regulation is the Standing Committee on Banking Regulations and Supervisory Practices, now commonly known as the Basle Committee, which was formed by the central bankers of the Group of Ten ("G-10") industrial countries. The objectives of the Committee are "to share information about banks and regulatory systems" and to ensure "that no international bank would be permitted to escape supervision." Ethan B. Kapstein, \textit{Shockproof: The End of the Financial Crisis}, 75 FOREIGN AFF. 2, 3-4 (1996).

\textsuperscript{76} Given the recognition of multinational corporations as significant players in the international arena, attempts to regulate them have been underway for some time. To date, these attempts have proved unsuccessful. Nevertheless, the willingness of states to engage in this exercise shows that the international structure can expand from the state-centric approach. \textit{See}, e.g., U.N. CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS, U.N.C.T.C. CURRENT STUDIES, U.N. Doc. ST/CTC/SER.A/4 (1988); \textit{see generally} Ernst-Ulrich Petersmann, \textit{Sovereignty, International Law and the United Nations Code of Conduct on Transnational Corporations, in FOREIGN INVESTMENT IN THE PRESENT AND A NEW INTERNATIONAL ECONOMIC ORDER 310 (Detlev C. Dicke ed., 1987) (discussing the U.N. Code of Conduct).

Further evidence of the importance of these non-state economic actors is the recognition given to them by some international courts. \textit{See}, e.g., Texaco Overseas Petroleum Co. v. Libyan Arab Republic, 53 I.L.R. 389 (Dupuy, Arb. 1977); BP Exploration Co. v. Libyan Arab Republic, 53 I.L.R. 297 (Lagergren, Arb. 1974).

\textsuperscript{77} As discussed above, although private money managers now wield significant powers, state authorities are loath to admit their influence. \textit{See infra} Part 3.4.3.
order to identify the new players and the roles they play, we must understand how these “sticks” are passed and how this mechanism of transfer will affect the larger framework of international law.

3.2. The Mechanics of Transfer of “Exercise” Elements

The methods by which a State may reallocate “exercise” elements are numerous, and it is critical that they are properly understood and identified. As discussed below, the prevailing international legal model fails to recognize transfers of power that occur every day. This failure perpetuates a system where unacknowledged actors have enormous influence. If the ability to reallocate power and the mechanisms by which these power shifts occur are understood and dealt with ex ante, appropriate measures can be taken to integrate these unacknowledged actors into the international legal framework. States and other participants in the system need to know all available information in order to determine the best course of action in the international arena. This requires an understanding of who the players are and the powers they possess.

It also requires understanding what is meant by “transfer.” As used herein, “transfer” includes all methods by which “exercise” elements change hands. A transfer may involve an intentional act by a State, or may occur without such an act when a transfer of an “exercise” element assumes it. A State may acknowledge a transfer, or may deny it even if other actors recognize the reallocation. The different methods of transfer that exist are discussed below.

3.2.1. Open, Intentional Transfers to State Groupings

As mentioned above, States allocate some of their “exercise” elements each time they join an international organization. By becoming a member of the larger entity, a State reduces its ability to act freely. For example, a member of the GATT may not arbitrarily impose non-conforming export tariffs on their goods. See GATT, supra note 35, pt. I, art. 1 (1).
only by fear of retaliation, by the State’s treaty obligations. For a number of reasons, this type of transfer is the least problem-atic for those concerned with maintaining the “primacy-of-the-State.”

First, the transfer is made to an entity comprised entirely of other States. This does not necessitate the recognition of any additional actors who could detract from the centrality of States. Second, the decision to join such an organization is itself an exercise of sovereign power. A State assesses the relative costs and benefits of membership and acts accordingly. That many States do choose to join highlights the allocative nature of sovereignty. That States willingly participate in a “pooling of sovereignty” raises another important aspect of this open, intentional transfer of power to state groupings: it is not an all-or-nothing process. In many cases, States retain significant authority to negotiate with the larger body. For example, typically States may selectively make reservations to treaty provisions with which they choose not to comply. Since the allocative process is open and intentional when state groupings are involved, structures and processes exist to accommodate and facilitate allocation.

Open, intentional transfers of power to entities comprised of other States fit neatly into a traditional model of international law that includes the allocative aspect of sovereignty. This is so because such transfers retain States as the primary players, dealing with one another in familiar ways. However, other increasingly common methods of transfer exist which do not fit as comfort-ably in the traditional model. As discussed below, these additional allocative processes would be easily accommodated by a model distinguishing “claim” and “exercise” elements in state powers.

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79 Even States that do not sign, or that make reservations to treaties, face constraints on their behavior if the collective body sets a standard for behavior because the non-signatory might then be found in violation of customary international law. For example, all states are subject to the ban on genocide. See Convention on the Prevention and Punishment of the Crime of Genocide, Dec. 9, 1948, art. 1, 78 U.N.T.S. 277, 278.

80 See ALAN JAMES, SOVEREIGN STATEHOOD: THE BASIS OF INTERNATIONAL SOCIETY 1 (1986) (discussing the enhanced sovereignty of Britain as a member of the European Economic Community).

3.2.2. *De Facto Transfers Involving Non-State Actors*

3.2.2.1. *Overt Transfers*

Some transfers of sovereign power to non-state actors have already been mentioned. Such transfers occur when States allow non-governmental organizations ("NGOs") a role on the international stage. This allocative process differs from state-centric transfer of sovereign power in two ways. First, the recipients of the "sticks" are not other States or state groupings. The presence of a non-state actor immediately alters the pure state-centric model, challenging the centrality of the State. Further, States may not openly acknowledge that the reallocation occurs, perhaps because the traditional framework cannot easily accommodate the shifts of power. Lack of recognition does not mean the reallocation does not occur. NGOs undoubtedly do exercise powers in the international community. For example, Amnesty International, a non-state actor, has a presence and exercises some degree of influence in many parts of the world, even though many States argue against its legitimacy.82

NGOs are beginning to gain acceptance and to exert more influence in the international community,83 despite the fact that their proper function remains a topic of some debate.84


83 See, e.g., WORLD BANK, NONGOVERNMENTAL ORGANIZATIONS AND THE WORLD BANK: CORPORATION FOR DEVELOPMENT (Samuel Paul & Arturo Israd eds., 1991) (noting that “recent years have witnessed the emergence of . . . NGOs as an increasingly visible and forceful presence”).


Others, however, allege that such entities have no role to play. Agree-
though the endemic reluctance to recognize non-state actors perpetuates this debate, it does not obscure the fact that a reallocation of power has occurred with the emergence of this group. By their nature, NGOs work strenuously to have their voices heard and positions implemented on the world stage. Their success demonstrates an overt reallocation of sovereign "sticks," even if States do not acknowledge it. The presence of unified vocal groups serving as the recipients of transferred sovereign power enables their general recognition as increasingly important actors on the world stage.\(^8\) It also highlights the need to fashion appropriate roles for NGOs.

A different type of overt transfer occurs when States choose to privatize various state-owned industries. Although privatization may take several forms, each results in the sale by governments of state-owned business enterprises, and a transfer of operations and assets from the public sector to the private sector. Indeed, "[p]rivatization changes the distribution of power within a society, as it diminishes control of the economy by the [s]tate and by [g]overnment appointed managers."\(^8\)

Thus, through the privatization process, States allocate some of their "sticks" to the market. These shifts are overt and typically are subject to strict controls by the government effecting the sale.\(^7\) Further, the purchaser of the privatized business, or the recipient of the State's "sticks," is ordinarily subject to post-transaction regulation by the State to ensure that the extent of transfer is not excessive.\(^8\)

\(^8\) See Schoener, supra note 82, at 564 (discussing the role of transnational NGOs in bringing about the demise of the Argentine junta).


\(^8\) "Perhaps the greatest effect of privatization is that the government maintains a new role as regulator." \textit{id.} at 668.
3.2.2.2. Covert Transfers

Another type of de facto transfer occurs when "sticks" are passed not to an organized entity, but to disparate actors who may not be clearly identified. This type of transfer frequently involves private economic actors and often takes place in a non-public fashion. While many kinds of covert transfers may occur, in the interest of simplicity, this Article focuses on one: a significant covert transfer daily in the area of economic investment activity.

On today's global stage, money is power and there are many private actors who control pools of capital large enough to be of significant concern to States. As demand for this capital increases, pressure is placed on States to implement particular policies to create favorable investment climates. Thus an indirect, covert reallocation takes place as States yield some degree of control over their economic programs and policies to those who direct international capital flows.

Due to the mechanics of the shift, this transfer is rarely, if ever, acknowledged. Unlike a transfer to an NGO, no unified group is eager to identify itself as a recipient of the "sticks." Since this is an indirect transfer, no immediately identifiable negotiating partner sits across the table. Instead, "market forces" drive decisionmaking. Believers in a free market will find nothing wrong with this result, and this Article is not a challenge to such a system. However, for purposes of structuring a framework that accurately captures the relevant actors on the international stage, the players in the market must be identified.

89 Other examples include reallocation of "sticks" to multi-national corporations or to anti-governmental groups demanding changes in policy.

90 See Cable, supra note 4, at 27 ("Global financial markets have several major implications for the economic sovereignty of countries. Capital is now so mobile that markets will ensure that holders of financial assets receive roughly the same, risk adjusted, real return everywhere. Any country that offers significantly lower returns will experience capital outflow and a rapidly depreciating exchange rate... Any government that attempts an alternative, 'reflationary' strategy and neglects these financial market fundamentals... risks a financial crisis. The sheer scale of profit-seeking finance capital that can be mobilized in currency markets far exceeds what any government, or even governments acting in concert, can put against it.")).
One critical set of players whose presence has neither been adequately addressed nor acknowledged is international money managers, private actors with control over the tremendous resources in pension and mutual fund accounts. These actors, through their power over portfolio investment, are changing the international framework. While States may outwardly appear to be making independent economic policy decisions, there are money managers behind the scenes who operate much like stage directors orchestrating the movements of actors.

These "'hot' money players . . . who deal in what might be called impatient capital" have force the passing of "sticks." This may not always lead to bad consequences; in fact, the desire to create favorable investment climates often leads to sound, strong economic policies. However, as we will see, it may also have the opposite effect, as with the Mexican Peso Crisis. To understand the power of money managers at a basic level, a brief examination of portfolio investment and its role in international capital movements is necessary. The role of portfolio investment can best be understood through a comparison of the various types of international capital movements.

3.3. The Relative Exercise of Sovereign Power in Various International Capital Movements

Since their emergence as recognized entities, States have been concerned with their role in the international order and with increasing their stature therein. Economic strength is one clear indicator of state power. To enhance their position, States throughout history have entered into legal and other arrangements to protect and further their economic interests. Although these agreements span a wide universe, for the purposes of this Article they fall into two categories based on the identity of the parties.

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92 For instance, Mexico liberalized trade policies and investment regimes, exchange controls and took other, arguably "good" economic policy steps to attract foreign investment. See Enrich Carrasco & Randall Thomas, Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis, 34 COLUM. J. TRANSNAT'L L. 539 (1996).

93 See, e.g., GATT, supra note 35; Organization of Economic Co-operative Development Declaration on International Investment, 15 I.L.M. 967 (1976).
The first category includes agreements between States in multi-
and bilateral contexts. The second category encompasses
structures States put into place, or actions they undertake, to
attract capital from non-state actors.

Each mechanism of transferring capital from one country to
another enables the capital provider to impose some constraint on
the recipient government’s ability to act freely. It is the rare case
when no conditions are imposed on the receipt of funds. However,
important differences exist between and within the
categories, both as to the precise nature of the constraints imposed
and more importantly, as to the ability of the recipient to
negotiate given those constraints. It is the relative ability of a
sovereign to exercise its traditional powers in the creation and
operation of each type of capital transfer agreement which has
relevance for our conceptualizations of statehood and sovereignty.

3.4. Capital Movements Involving State Actors

3.4.1. Direct Exercises of Sovereign Power

When both parties involved in a capital movement transaction
are States, the receipt of foreign capital is premised on one-on-one
negotiations between the recipient and the provider. These
negotiations may be between two States when the transfer is
bilateral. They can also be between one State and a representative
or representatives of a group of States when the transfer is
multilateral. This negotiation format enables the recipient State
to exercise its sovereign powers directly. As discussed below, this
does not mean that the recipient State will not have to accept
certain terms and conditions as the cost of receiving capital.
Rather, it permits the State to retain the fullest possible bundle of
“sticks” while making a free and conscious decision as to which
“sticks” shall pass.

Among others, this group includes trade arrangements, such as the
GATT and the World Trade Organization ("WTO"), international currency
exchange systems, such as those facilitated by the IMF and Organization for
Economic Co-operative Development ("OECD"), and bi- and multilateral aid
programs, including those administered by the World Bank.

Included in this category are regulations governing foreign direct
investment and other actions taken by States to encourage inflows of foreign
capital.
3.4.1.1. Similarities Between Bi- and Multi-Lateral Capital Transfers

This Article categorizes both bilateral and multilateral private fund flows as those transfers in which the recipient State may exercise direct power, because the recipient’s role in each of the bi- and multilateral processes are the same. When the capital provider is another State, the process represents the paradigm of a state-centric international system. Individual States, each representing their particular interests, meet and conduct the steps necessary to structure their international affairs. The individual State thus retains its primacy. However, capital is often provided not directly from one State to another, but through the mechanism of an international organization. Therefore, the nature and role of these institutions must be examined to determine where and how they fit into our evolving model.

3.4.1.2. Overview of a Representative International Financial Institution

Although many different international financial institutions ("IFIs") exist, their fundamental structures are similar. IFIs are groupings of States formed to further the members' interests by pooling their resources. The decision to join an IFI by practical necessity involves some passage of sovereign "sticks." States determine whether to engage in such a passage based on a cost-benefit analysis of power and authority ceded as the "price" of membership, as compared to the power and rights gained through belonging to the IFI. A brief overview of the costs of membership to States and the benefits that accrue with such status is provided in the following overview of the International Monetary Fund ("IMF"), one of the most important IFIs.

The Bretton Woods Conference in 1944, attended by the world's major economic powers at that time, was the birthplace of the IMF. Together with the International Bank for Reconstruction and Development ("World Bank") and the GATT, the

IMF oversees and facilitates economic cooperation and provides international financing. The IMF's "core mission" was stabilization of the international monetary system. The "cost" of membership in the IMF includes a tangible payment of a subscription or quota and an intangible ceding of sovereign power through acquiescence to the obligations imposed on all members.

These obligations include a commitment by each member State to "direct its economic and financial policies toward the objective of fostering orderly economic growth." This may not seem to place any undue demands on any one State, as every State could be expected to articulate its policy goals in a similar fashion. A critical point, however, is that for IMF members, it is the IMF rather than the State itself which defines what constitutes "orderly economic growth."

For example, a State may believe that altering its exchange rate would make its exports more attractive on the world market and thereby encourage economic growth. However, if the State is a member of the IMF, its ability to freely alter the exchange rate will be constrained by its agreement to "avoid manipulating exchange rates . . . to gain an unfair competitive advantage over other members." If the State acts in a way which the IMF believes violates this pledge, the IMF may declare the State ineligible to use the IMF's general resources. The power of the IMF to sit in judgment over a State's economic policy is just one example of a stick passing or a cost incurred as a condition of membership.

Benefits of membership in the IMF are both direct and indirect. Directly, a member State gains the right to call on IMF resources under its tranche policies and other special facilities.

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97 Since the 1970s and the abandonment of the par value system, exchange rate management has been the IMF's primary goal. See BRETTON WOODS COMMISSION, BRETTON WOODS: LOOKING TO THE FUTURE A-3 (1994).
98 See IMF Articles, supra note 51, art. III, § 1.
99 See id. art. IV.
100 Id. art. IV, § 1(i).
101 Id. art. IV, § 1 (iii).
102 See id. art. V, § 5.
103 The Fund's tranche policies permit members to withdraw their quota subscriptions as needed in four tranches. The first is provided as of right, the remainder are conditioned on member compliance with performance criteria.
The precise terms under which funds will be distributed varies depending on what is sought and who is making the request. In all cases, however, the minimum precondition for access to IMF funds is membership.

Indirectly, members benefit to the extent that the IMF fulfills its primary objectives of promoting international monetary cooperation, facilitating trade, and lessening the duration and degree of disequilibrium in the international balance of payments of members. While non-members may also share these indirect benefits by free-riding, this does not diminish their positive effect on members. Another indirect benefit of membership is the status that membership confers on a State: to be considered a full participant in the international arena, membership in the IMF is essential.

This combination of increased status and tangible financial benefits outweighs the attendant costs of membership, thereby explaining the near universal desire to join IFIs. It is clear that the decision to join an IFI (or for that matter any international organization) involves the passage of some "sticks" of sovereign power and therefore is one step removed from the pure state-centric model. However, it is only a small step. The members of IFIs are States; therefore the basic premise that States are the primary actors is retained, as the States act collectively.

3.4.1.2.1. Differences Between Bi- and Multilateral Transfers

Whether acting individually or collectively, States that provide capital often place conditions on access to their resources. In many ways, the identity of the provider of capital is not an

Repayment of amounts borrowed is expected within three to five years. See id. art. V., §§ 1-8.

Special facilities for member borrowing include the Extended Fund Facility, which provides greater amounts for longer durations than the tranches, and other special facilities designed to meet particular needs. See JOHN H. JACKSON ET AL., INTERNATIONAL ECONOMIC RELATIONS 1026-28 (3d ed. 1995) (giving an overview of the funding mechanisms).

See IMF Articles, supra note 51, art. V.

See id. art. I.

Of course, the cynic will note that the costs of membership may be significantly lower in practice than in theory because States may simply ignore Fund directives.
important factor in considering the allocation of sovereign “sticks.” There are some differences, however, which should be identified. By attaching conditions to the receipt of funds (i.e., conditioning a grant of five million U.S. dollars on the maintenance of an inflation rate of eight percent or lower), the provider requires the passage of sovereign power. The precise nature of the “sticks” passed by the recipient will obviously depend on the extent of conditionality: the more restrictive the conditions imposed, the greater the degree of power ceded. The identity of the donor as bi- or multilateral makes a difference because of its relative ability to impose conditions.

The primary difference between the conditionality imposed by bilateral and multilateral donors is what criteria they may consider in making an aid determination. Multilateral donors frequently may not, either explicitly or implicitly, assess particular factors. For instance, according to its charter documents, the World Bank must base aid decisions on economic criteria and must ignore political and social conditions in recipient countries.108 The IMF oversees only economic policies and must “respect the domestic social and political policies of members.”109 Thus, for instance, the aid may depend on the maintenance of a non-inflationary interest rate, but not on the removal of restrictions on the press.

These restrictions on IFI conditionality (which serve to encourage membership) prevent the passage of some sovereign “sticks.” In theory, the recipient of funds from these lenders does not pass “sticks” relating to such issues as human rights conditions or the ability to exercise civil rights. How much difference exists in practice is subject to debate, but under our model, the identity of the donor affects which “sticks” a donee may pass.

When aid is given in a bilateral context, these constraints are not applicable. For example, the United States will consider such issues as the alleviation of poverty, the promotion of self-sustaining economic growth, and the encouragement of individual civil


109 Articles of Agreement of the International Monetary Fund, opened for signature Dec. 31, 1945, art. IV, § 3(b), 60 Stat. 1401, 1404.
and economic rights when making development aid decisions. Because the fund-providing State acts solely on its own behalf, it may demand as many "sticks" from the recipient State as it chooses.

3.4.1.2.2. Commonality in Transfers

Although the number and nature of the "sticks" passed will vary depending on the identity of the donor, all conditionality placed on private fund transfers requires some allocation of sovereign attributes. This reallocation comports with a model where the "exercise" elements of sovereignty may be shared and therefore, is one step removed from the state-centric, traditional model. However, this scheme remains close to the traditional model in several important ways.

First, when the donor is another State as in the bilateral context, the transaction fits in the traditional model of state-to-state relations. When the donor is a grouping of States, the model is not very different, as discussed above. Further, the receipt of funds or other resources from a State, or coalitions of States, typically involves an ongoing process of negotiation. Terms and conditions are openly discussed and the recipient State plays an active role in the process, even if it ultimately must accept what it views as unfavorable conditions. The active, open participation of the State enables it to retain some part of the sovereign power of autonomy, as it (in theory) chooses voluntarily whether to accept the conditions imposed and works to affect what those conditions may be in the first instance.

If resources were provided to States only through the above described types of transfers, our model of international law would need to incorporate the notion of the passage of sovereign "sticks." Yet simultaneously, the model could remain essentially state-centric, a model in which States exercise directly their powers through an open negotiation process that involves other States, individually or collectively. Of course, these types of transfers are not exclusive; many other avenues for providing resources exist and must be evaluated for their impact on the traditional model.

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3.4.2. Capital Movements Involving Non-State Actors: Indirect Exercises of Sovereign Power

The direct exercise of sovereign authority possible in bi- and multilateral fund transfers decreases in varying degrees when the funds flowing to the recipient come not directly from other States or state groupings, but from private actors. Common forms of this type of capital movement are direct foreign investment and portfolio investment. The recipient State continues to play an important role in the transfer process, but the mechanisms through which it exercises its power differ.

3.5. Direct Foreign Investment

Direct foreign investment typically occurs when a foreign investor gains a measure of direct control of an entity through ownership of assets or the control of a majority of outstanding stock. The quest to attract direct foreign investment may involve a State in a one-on-one negotiating process. This format is similar to that in which it engages in the bi- and multilateral transfer context, if the State is the owner of the asset in which the foreigner seeks to invest. Even where this occurs, an important difference between the two situations is that the co-negotiator is likely to be a non-State. The involvement of a non-state actor requires taking a step away from the pure state-centric model.

Often, direct foreign investment will directly involve not one, but two non-state actors. This results when the recipient State is not the owner of the assets being invested in. In that situation, it is reasonable to ask why one should have any concern over the role of the State and its ability to keep its sovereign “sticks”: it is not a participant in the process. However, that position

111 Funds may also flow from private charitable groups, but that process is not relevant to this discussion as such groups typically do not overtly seek receipt of exercise elements. For example, the Red Cross and other humanitarian donor agencies provide funds with little or no conditionality. See generally Kueck, supra note 72, at 354-55 (discussing the international legal status of the Red Cross).


113 If the recipient State owns the asset and the investing entity is a State, the transaction could belong in the bilateral transfer category.
severely misstates the State’s role in the direct foreign investment process.

While a State may not actively participate in a negotiation for direct foreign investment, it plays an essential, albeit indirect, role in that process. The State must craft legal regulations governing this type of investment so that potential investors can assess costs accurately. In this role, States walk a fine line. On one hand, States want to draft regulations favorable to foreign investors because of the constant need for capital and resources. On the other hand, because direct foreign investment involves giving equity control over assets situated in the State to foreigners, States typically seek to exercise some control over the extent and nature of ownership permitted.

The nature of the constraints imposed depends in large degree on the level of development of the economy of the recipient country. Regulatory constraints common in more developed economies include outright bans or strict percentage restrictions on foreign ownership of certain types of industries considered critical to national security. Restrictions applied in countries with less developed economies include bans on the entry of foreign investment, limitations on the ability to repatriate profits from the enterprise, and requirements that the foreign investor have local partners. Regardless of the precise constraints, the ability to impose them is a clear exercise of sovereign power.

This power to take unilateral action in creating regulations governing direct foreign investment seems like a fuller exercise of sovereign authority than is utilized in multi- or bilateral fund transfer negotiations. After all, at the time regulations are drafted, no one else sits across the bargaining table to directly pressure the State to take any particular action, unlike the bi- and multilateral capital transfer scenario. Nevertheless, the search for direct foreign investment funds is very competitive and creates what has


\[\text{115} \] See David W. Leebron, A Game Theoretic Approach to the Regulation of Foreign Direct Investment and the Multinational Corporation, 60 U. CIN. L. REV. 305, 305 (1991) (applying game theory to the risk of expropriation by host country governments in foreign investments).
been termed an “investors’ market.”\textsuperscript{116}

Within this market, States seeking investment capital face severe constraints on their ability to regulate. Investors who face restrictions on equity ownership or on their ability to draw profits realized on funds invested in the country are likely to shift those funds to a more receptive country. Of course, not all investments can be easily relocated, particularly those dependent on natural resources or requiring large infrastructure investments. The cost of compliance with a State’s investment regulations will be factored into any investment decision. The higher the costs, the less likely investors are to place their funds in that State. States are aware of these factors when implementing or amending their regulations, and so face a strong incentive to decrease (or, face a limit on their ability to impose) burdensome regulations.\textsuperscript{117}

The nature of this diminution of a State’s ability to act freely is significantly different than that facing a State engaged in bi- and multilateral transfer agreements. Regulations governing foreign direct investment are not typically drafted as part of a negotiating

\begin{flushright}\textsuperscript{116} This competition affects both the initial ability to attract investment capital to a State and the ability to retain funds in the State, or to preclude “capital flight.” ASIL 1994 Report, supra note 11, at 447 (comments of Professor Franck).
\end{flushright}

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The degree of the constraint, of course, depends on the other factors in the investment decision equation. States that offer investors extremely attractive markets are therefore less likely to cede power to potential investors. A prime example is China, which refuses to alter control policies to win investment despite considerable external pressure. See generally Henry J. Graham, Foreign Investment Laws of China and the United States, 5 J. TRANSNAT’L L. & POL’Y 253 (1996) (exploring the difficulties of the emerging Chinese foreign investment laws as compared to those in the United States).
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process with potential investors. Indeed, a State may never acknowledge explicitly that it is factoring foreign investors' interests into its regulatory decisionmaking process. This, on the surface, comports with a state-centric model. However, some critical considerations lurk beneath that surface. States are not free in any real sense in today's investment climate to impose whichever regulations they desire. If they need funds (and they often do), the necessity constrains their regulatory discretion. Thus, some "sticks" are reallocated from the State to the providers of foreign direct investment funds.

This indirect reallocation of control calls for a view of sovereign "sticks" as distributable, as in the earlier examples. It also demands recognition of non-traditional actors as legitimate recipients of those "sticks." Thus, we must move further away from a pure state-centric model. While there is some recognition of this shift in specific instances, its impact on the broader structure of international law has not been articulated. This may be due in part to the indirect nature of the shift which makes it more difficult to pin down. An inherent unwillingness to recognize the growing importance of non-state actors may also contribute to this difficulty. The danger in failing to acknowledge this change is highlighted in the context of portfolio investment where money managers who receive many sovereign "sticks" are routinely not acknowledged.

4. SPECIFIC OPERATION OF THE "BUNDLED" MODEL

4.1. Portfolio Investment

Portfolio investment for purposes of this article refers to private investment in a State's capital markets by foreigners. While once considered an incidental source of funds, many States now depend on the attraction and retention of portfolio investment for their economic well-being. The numbers clearly reveal the growing importance of this source of financing. Portfolio investment in emerging markets increased by almost $30 million U.S. in one decade: from $5.6 million in 1985 to $33.7 million in 1995. During the same time period, although official development funds to the same countries increased from $37 million to $64 million, official funds constituted only 27.8% of aggregate net
resource flows in 1995 as compared to 53.2% in 1985.118

As a result of the disparity in rates of increase, private investments (as opposed to official funds) now account for three-quarters of all financial flows. Within the private funds category, it is portfolio investment funds which dominate.119 The bottom line of these shifting trends in investment profiles is that portfolio investment is increasing in both actual and comparative magnitude. The managers of portfolio investment now control vast resources whose value cannot be overstated: in 1994, pension funds held securities valued in excess of $2 trillion while mutual funds held $800 billion in securities.120 It is essential to a proper understanding of statehood and sovereignty that the model reflect the role played by those in control of these resources.

On one level, portfolio investment may not seem to implicate sovereignty issues at all: a portfolio manager choosing to buy stock on a particular State’s exchange is simply participating in a free market where that State may not appear as an active player.121 If all the process involved was an entity joining the market as a potential seller and another entity accessing that market as a purchaser, there would be little need for discussion. However, as with direct foreign investment, the process entails much more. The role of a State in regulating, promoting and participating in its capital markets cannot be ignored.

The nature of this role and its implications for statehood and sovereignty must be considered in several contexts. First, there is a growing movement that advocates international regulation of the capital market.122 If proponents of this approach prevail, new

118 See INTERNATIONAL FINANCE CORPORATION, EMERGING STOCK MARKETS FACTBOOK 6 (1996) [hereinafter FACTBOOK].

119 Private non-portfolio fund transfers increased only 4% in 1994 as compared to 61% in 1993. See id. at 5.


121 Of course, if the State owns the entity that is selling or purchasing the stock, the State will act as a market participant rather than as a controlling State.

122 See generally ETHAN B. KAPSTEIN, SUPERVISING INTERNATIONAL BANKS: ORIGINS AND IMPLICATIONS OF THE BASEL ACCORD 1-9 (Peter B. Kenen et al. eds., Essays in Int’l Fin. No. 185, 1991) (analyzing the implications of the Basle Accord for the international financial system); Peter E. Millsapugh, Global Securities Trading: The Question of a Watchdog, 26 GEO. WASH. J. INT’L...
actors will be created either as new free-standing regulatory bodies or as new groups within existing entities. This addition of actors will require expansion of the cast of international players recognized as eligible recipients of sovereign “sticks.” Because the new actors fit neatly into the same roles as existing international organizations such as IFIs, this expansion need not radically alter the traditional model. Once the idea that “sticks” can be passed is accepted, the identity of the new actor is not problematic. Because there is no immediate likelihood of the creation of an international regulatory body, a more difficult issue is how States should allocate their sovereign “sticks” in the absence of international regulation. What role does the recipient State play in attracting portfolio investment?

Theoretically, States are free to structure their capital markets as they see fit in a free, full exercise of their sovereign autonomy. However, as the competition for foreign funds increases, market forces move States to create and maintain economic conditions that will entice investors. Just as the need for foreign direct investment prohibits an unfettered exercise of power by the State in drafting regulations, so too does the fierce competition for portfolio funds significantly constrain a State’s ability to design and modify its economic policies. If those controlling portfolio investment view economic policies as “disfavorable,” they will direct that investment elsewhere. These constraints pose serious challenges to a state-centric model for several reasons. First, they have the potential to cause large reallocations of sovereign “sticks”; second, the identity of the other actors involved in the reallocation of power forces recognition of non-state, nontraditional entities; and third, the manner in which the reallocation occurs is such that States may not admit openly that it occurs, permitting the effectuation of hidden shifts.

4.2. Magnitude of Constraints

To appreciate the magnitude of constraints placed upon States seeking portfolio investment, a cursory understanding of the mechanisms and motivations of that investment process is required. Investors engage in portfolio investment because it

L. & ECON. 355 (1992) (reviewing the functioning of the new global marketplace); Perry, supra note 120, at 738-47 (considering the SEC's response to equity market internationalization).
enables diversification, which in turn helps achieve maximum returns. Portfolio investment may take place in several forms, but the most important are investments in debt or in equity. Debt investment typically involves purchases of bonds issued by States. States rely on an international market to meet their borrowing requirements and to finance budget deficits, while purchasers diversify their portfolios by holding a wide spectrum of bonds.

The international bond market is becoming increasingly important from both the issuer and purchaser perspective. Portfolio investment in debt instruments is quite different from the traditional debtor/creditor relationship. Bonds purchased on the open market are usually freely tradable and do not engender the same concerns for purchasers as straight loans do. For example, if a bond purchaser becomes dissatisfied with market conditions for any particular bond, it simply sells that bond, an exit option not readily available to a traditional creditor.

Equity investment in its simplest form involves purchases of securities, which represent an ownership interest in the underlying entity. International equity investment experienced a revival in the 1980s which continues today. Its popularity stems from increased demand for equity by large investors looking to place huge pools of money in the market and from the creation of new sources of equity through privatization.

While a portfolio need not contain international stocks or bonds, international portfolios are now commonplace due to the increasing importance and accessibility of foreign markets.


125 One piece of evidence of the importance of the international bond market is the increase in issuances over the past fifteen years. In 1981, the nominal value of publicly issued bonds was approximately $37 billion U.S. By 1993, that figure had increased to over $160 billion U.S. See id.

126 See id. at 35.

127 See generally FACTBOOK, supra note 118, at 8 (stating that “market trends continued their inexorable course” and that “markets that did not even
These funds are significant. Spurred by technological advances and a relaxation of governmental control over capital flows, portfolio investment funds are enormous and are gaining in comparison to other types of investment.¹²⁸ Huge sums of money are now being directed to capital markets worldwide.

The vast dollar figures involved in portfolio investment through the well-known "power of the purse" give money managers a significant voice on the international stage. As discussed further below, the emergence of such actors is causing a reallocation of some "sticks" of sovereign power. The magnitude of the shift is amplified by an important distinguishing feature of portfolio investment — its liquidity.

The more liquid an investment is, the more readily it can be withdrawn from a State in favor of an alternative investment site. The more liquid an investment is, the greater is the possibility that those controlling the investment will immediately withdraw funds if an unfavorable investment climate (from the investor's perspective) arises. This possibility, coupled with a dependance on portfolio investment, limits the free action of state policy makers. Thus, the more liquid the investment is, the greater the number of "sticks" held by the capital provider becomes.

Of the several investment vehicles discussed, portfolio investment is by far the most liquid. In general, official aid, whether bi- or multilateral, cannot suddenly be withdrawn either because it is given pursuant to a binding agreement or because it would be ill-advised politically to do so. Direct foreign investment is also not quickly withdrawn. When an investment involves significant control, as in the case of direct foreign investment, the investor becomes a stake-holder in the project. If unfavorable conditions arise, it is in the investor's interest to remain in the recipient State and to attempt to remedy the problems. Otherwise, the investor risks pulling out and forfeiting its control and the start-up costs of its investment. Commercial bank loans also pose a relatively low level of risk of withdrawal. The only way creditors recoup their investment is from repay-

¹²⁸ For example, between 1977-81, 67% of Latin America's external financing came from commercial banks. By 1992, this percentage fell to 14%, while portfolio investment grew from 15% in the late 1970s to 40% by the early 1990s. See Moises Naim, Mexico's Larger Story, 1995 FOREIGN POL'Y 112, 122.
ment of the loan. If a loan recipient encounters difficulty in meeting payment obligations, it is likely that the creditor will work to renegotiate loan terms. Renegotiation would be preferable to putting the debtor in a default position where the creditor receives nothing. 129

Portfolio investment managers do not share the concerns of long-term investors or creditors, and do not have similar incentives to keep their capital in any particular State. With on-line data and high technology information monitoring systems readily available, portfolio managers can easily keep abreast of international market conditions. If a manager with funds invested in a State finds a higher rate of return available elsewhere, or if the conditions in the host State look risky for any reason, portfolio managers can and often do quickly remove their funds. With enormous resources at their disposal, and with the ability to move these resources at the push of a button, money managers can be and are extremely demanding when allocating their funds.

Often, portfolio managers will not consider a State as an investment site unless certain economic conditions exist there—conditions which enable the manager to maximize returns. Managers also hold the hammer of fund withdrawal over the heads of state policy makers. 130 The policies affected by the need to compete for investment dollars, including fiscal, monetary and social policies, are central to state function. The ability of managers to indirectly mandate conditions for investment highlights the degree to which a State reallocates some of its sovereign "sticks" in the search for portfolio investment.

In assessing potential investment sites, international portfolio managers look for host States with liberal policies regarding repatriation of investments and earnings coupled with unrestricted, easily available currency exchange. 131 Gains derived from foreign markets are clearly of little use if they can not be brought home readily. Additionally, foreign investors favor States that maintain a deflationary (or at least a non-inflationary) macroeconomic policy. If inflation rises beyond ordinary expectations, the

129 While the debt obligations may be transferable, some creditor retains a stake in the State's well-being.
130 See generally Carrasco & Thomas, supra note 92.
131 See OECD DOCUMENTS, supra note 124, at 35 (noting that in attempting to attract foreign investment "governments deregulated domestic markets and abolished exchange controls").
relative value of foreign investment in that State will decline and investors will shy away.\textsuperscript{132} The need to follow non-inflationary policies may require a State to adopt strategies it otherwise might prefer to avoid in an effort to attract foreign investors. Such policies include maintenance of higher interest rates or reducing social programs and other support to citizens in order to reduce deficit levels.\textsuperscript{133}

Thus, the need for portfolio investment may dictate to a State that it follow economic policies with troubling social consequences, including increased unemployment and other social ills.\textsuperscript{134} The hope, of course, is that these policies will be to the State’s advantage in the long run. Whether or not this is true, it is important to note the reallocation of sovereign “sticks” which has occurred. States have transferred “sticks” not only to non-States, but also to unrecognized actors.

4.3. Mechanics of Reallocation with Regard to Portfolio Investment

The mechanism of passing sovereign “sticks” involved with portfolio investment differs significantly from other fund transfer schemes. With bi- and multilateral fund transfers, the demands of a known actor — usually another State or an entity comprised of States — limit a State’s policy choices. While bargaining power may be constrained in these situations, they fit within the state-centric model because they permit negotiation between state actors. When the funds flow through direct foreign investment, non-States may be involved, but the participants are readily identifiable.

\textsuperscript{132} To oversimplify for the purpose of example: if $100 U.S. are invested in Mexico when the peso is worth $1 U.S., the value of the investment is $100 U.S. If the value of the peso increases due to inflation so that $1 U.S. now buys only half a peso, the overall value of the initial investment falls.

\textsuperscript{133} See Grabel, supra note 18, at 8 (noting that limitations on policy autonomy may “necessitate the pursuit of restrictive macroeconomic and social policy, to the detriment of economically vulnerable groups”).

\textsuperscript{134} See, e.g., Jonathan Friedland, Latin America Resists Reform Backlash, WALL ST. J., Aug. 5, 1996, at A15 (recognizing that portfolio investors force countries to implement policies leading to high unemployment, stagnant salaries, and poverty).
Although market forces limit the ability of a State to place restrictions on direct foreign investors, the recipient State retains some ability to regulate its behavior due to the foreign investors' long-term interests in the State and to their identifiability. If a direct foreign investor becomes unhappy with conditions in the recipient State, it cannot withdraw instantly. Instead, there is a window of time in which the State and the investor can negotiate. Thus, while the State cedes more "sticks" through this investment structure than it does in the bi- and multilateral context, it retains the ability to deal openly and directly with investors in the final instance.

To a large degree, that ability disappears when a State allocates some of its "sticks" to disparate and unrecognized market forces governing portfolio investment. Portfolio managers have no long-term stake in the country and operate behind the scenes. States know of their demands, but have no established avenue in the current international model to directly address these participants. Thus, a State requiring portfolio funds must deal with entities that are not accommodated in the current international model but who are able, through their control over economic resources, to cause a significant passing of "sticks." The ability of this group to stay one step removed from the traditional international structure and to operate outside the state-centric model, has, to date, prevented wide recognition of the centrality of their role. States are then left to shadow-box with these actors. Whether these actors are positive or negative additions, they are additions. Acknowledging this is a step towards understanding the parameter within which States now act.

Portfolio managers are now de facto in possession of some "sticks" of sovereignty. Recipient States cede some degree of autonomy to these managers. A State, of course, could retain its full autonomy by ignoring the demands of portfolio investors and implementing policies contradictory to their wishes. However,

135 There is some suggestion that, at times, money managers do exert direct influence on state policy makers. For example, "[m]utual funds have not only displaced the Bretton Woods institutions as the main providers of money to developing countries, but they are also offering 'advice' to officials of the very countries in which they are often the largest foreign investors." Naim, supra note 128, at 123. If this is true and demonstrable, it would support the notion that these managers should receive recognition on the international stage where they already clearly play an important role.
this approach could have dire economic consequences for the State. If a State depends on portfolio investment for funds (and virtually every State does to varying degrees), the appearance of unfettered state choice in the ability to forego these funds is illusory. It may also be true that the conditions considered essential by portfolio investors dovetail precisely with what the State would seek to achieve absent such demands. That happy circumstance does not erase the power money managers possess. It simply masks the loss of autonomy experienced by the State until the needs of the State and the demands of the investors diverge. It remains true that, through their control over the market for funds, portfolio managers are exerting more and more influence over matters traditionally viewed as solely within the province of States.

Despite the increasing reallocation of sovereign "sticks" caused by the emergence of new actors, the legal community does not yet broadly recognize portfolio managers as meaningful players. The failure of legal scholars to pay attention to these actors may be due, in part, to their non-state status. Non-state actors have historically proved difficult for international legal scholars to include in their framework. This problem is evidenced by the inability of the international legal community to deal effectively with the emergence of multinational corporations as a powerful presence on the international stage. The inability or unwillingness to recognize the power wielded by non-state actors has serious consequences. If their power remains unacknowledged, and hence not accommodated in a legal framework, we may have recurrent economic crises in the world economy. If that sounds dramatic, consider the example of the Mexican Peso Crisis of 1994–95.


One commentator terms the Peso Crisis a "financial earthquake" which revealed the dangerous "fault lines underlying current trends in global
5. **The Mexican Peso Crisis: A Case Study of the “Bundled” Model**

The “Mexican Peso Crisis” of 1994-95 demonstrates clearly both the expanding role of non-state actors and the inability of existing legal structures to address adequately their presence on the international stage. While not all assertions of power by these actors will have negative effects, the Peso Crisis shows how these assertions may severely limit a State’s choice of policies. This limitation has direct consequences for the State in question, as well as broader implications for the global community.

5.1. **The “Crisis”**

The term “Mexican Peso Crisis” refers to the chain of events which began on December 20, 1994, when the Mexican peso was devalued by approximately 15% and then fell over the next few months to a level less than half its pre-devaluation rate. The devaluation of the peso was the culmination of numerous pressures on Mexican financial markets. The country plunged into economic distress, as portfolio investment funds which had enabled Mexico to prop up the peso’s value were quickly pulled out of the country. The situation in Mexico did not stabilize until the United States and other lenders stepped in with an unprecedented assistance package totaling over fifty billion U.S. dollars. However, before this assistance could be made available, other capital markets experienced contagion effects

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138 See IMF 1996 REPORT, supra note 19, at 53.
139 The World Bank estimated that in the weeks following the devaluation, portfolio investments in Mexico fell from $8 billion to less than $1 billion. See Vincent J. Schodolski, *Funds Wired Wallets Cause Shock Waves In, Beyond Emerging Markets* Mexico Crisis Highlights the Hazards of ”Hot Money,” CHI. TRIB., Feb. 26, 1995, at 1.
140 See id.
141 The “contagion effect” is the natural reaction of market participants confronting negative economic trends in one market to ask “if it could happen in Country X, why won’t it also happen in Countries Y or Z?” See IMF 1996 REPORT, supra note 19, at 113 (discussing severe effects of Mexican Peso Crisis on Argentina); see also Vittorio Corbo & Leonardo Hernandez, *Macroeconomic Adjustment to Capital Inflows: Lessons from Recent Latin American and East Asian Experience*, 11 WORLD BANK RES. OBSERVER 61, 63 (1996) (referring to the contagion of the Peso Crisis as the “tequila effect”).
and governments worldwide, particularly the United States, confronted serious legal and economic concerns with regard to the ability and necessity of providing aid.\footnote{142}

5.2. Roots of The Crisis

Ironically, the troubles in Mexico in the mid-1990's belie the old adage "nothing succeeds like success." Following the debt crisis of 1982, when Mexico led a host of Latin American debtors in announcing that it could not service its external debt, Mexican authorities undertook numerous economic reforms to regain legitimacy in the international community. These reforms included a deficit reduction program, wage and price controls, privatization of state enterprises, and the establishment of a "crawling peg" exchange rate which linked the value of the peso to the U.S. dollar.\footnote{143} One result of the combined impact of these measures was a dramatic reduction in the country's inflation rate from 180% in 1987 to 8% in 1994.\footnote{144} In addition, Mexico sought to liberalize its international trade regime and to increase direct foreign investment in the country. A strong signal of Mexico's success in these efforts came with its entry into the GATT and NAFTA.\footnote{145}

The seemingly improved economic climate of favorable inflation rates, strong trade potential and strengthening direct foreign investment, coupled with "dull gains on U.S. stocks . . . and low yields on U.S. bonds,"\footnote{146} encouraged portfolio investor interest. The Mexican capital markets became a popular site for

\footnote{142} See John H. Chun, Note, "Post-Modern" Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?, 64 FORDHAM L. REV. 2647, 2648 (1996) (noting that the dissent in Congress stalled the aid package for Mexico); Russell Dean Covey, Note, Adventures in the Zone of Twilight: Separation of Powers and National Economic Security in the Mexican Bailout, 125 YALE L.J. 1311, 1313 (1996) (mentioning that "a significant number of Senators and Representatives . . . questioned [the] legality" of the aid plan for Mexico); Humphrey, supra note 14, at 200 (noting that some Congressmen opposed the stabilization plan for the Mexican Peso Crisis).

\footnote{143} This type of exchange rate system created a band within which the peso moved in relation to movements in the value of the dollar. See Naim, supra note 128, at 116.

\footnote{144} See Ramon Moreno, Mexico and the Peso, FRSBSF Weekly Letter (Fed. Reserve Bank of San Francisco, Mar. 29, 1995).

\footnote{145} See GATT, supra note 35; NAFTA, supra note 35.

\footnote{146} Petruno, supra note 91, at A26.
international money managers seeking to diversify their portfolios worldwide. Together with the general increase of international capital flows to developing countries, the result was that Mexico received $28 billion U.S. dollars in net portfolio flows in 1993.\textsuperscript{147}

Unfortunately, these external trappings of improved economic health masked several important dangers threatening the Mexican economy. The precise causes of the Peso Crisis are complex and more technical than this Article can easily explain. To state the situation somewhat simplistically, the Mexican government in effect became dependent on the large and growing inflow of portfolio investment. The presence of large amounts of foreign capital enabled the government to artificially inflate the value of the peso and to avoid confronting signals of the serious overvaluation of the currency.

This dependency set up a vicious cycle. Although Mexico relied on foreign investment for its economic survival, it had to follow destructive economic policies in order to attract that investment. These policies consisted of both insuring investors against currency exchange losses on five billion dollars of peso denominated debt instruments if the peso dropped below a prescribed range, and increasing central-bank peso purchases.\textsuperscript{148} So long as the Mexican markets remained an attractive investment site, the policies would be tolerable. Unfortunately, however, their appeal diminished quickly.

Economic policies at home and abroad combined with political upheaval in Mexico to reduce the appeal of Mexican markets to foreign investors. Originally, those economic policies which contributed greatly to the Mexican Peso Crisis were adopted to enhance Mexico's international stature. A particularly problematic policy was the crawling pegged exchange rate. Linking the Mexican peso to the U.S. dollar assured cheap imports and helped keep inflation in check in Mexico.\textsuperscript{149} However, it permitted the peso to appear artificially strong; its value failed to reflect the true

\textsuperscript{147} See Mexico's Economic Situation and U.S. Efforts to Stabilize the Peso: Hearing Before the Senate Comm. on Foreign Relations, 104th Cong. 67 (1995) (statement of Alan Greenspan, Chairman of the Federal Reserve Board).

\textsuperscript{148} See Craig Torres & Dianne Solis, Two Mexican Banks Discuss Combination, WALL ST. J., June 14, 1994, at A10.

\textsuperscript{149} See Magda Kornis, Financial Crisis in Mexico, MEXICO TRADE & L. REP., Feb. 1, 1995.
status of Mexico's domestic purchasing power or its current payments account.\textsuperscript{150}

While these economic policies were initially successful in attracting foreign investment to the Mexican markets, events on the ground began to make Mexico a less attractive prospect. On January 1, 1994, an uprising in Chiapas by the Zapatist National Liberation Army in protest of Mexico's social and political conditions sparked a long-running conflict.\textsuperscript{151} Numerous acts of violence ensued, including the assassinations of presidential candidate Luis Colosio in March and of the Secretary General of the PRI (Mexico's ruling party) in September.\textsuperscript{152} These difficulties cast a pall over the Mexican markets because political instability is a risk factor seriously considered by foreign investors.\textsuperscript{153} As the political situation worsened and investors began expressing concerns, the government took steps to bolster investor confidence by aggressively defending the peso in foreign exchange markets, depleting its supplies of foreign reserves in the process.\textsuperscript{154}

At the same time, the crawling pegged exchange rate system was fundamentally undermining the health of the peso. When inflation rates in the United States and Mexico were comparable, this pegged rate helped stabilize the Mexican currency. However, when the Mexican rate of inflation became higher than that of the United States,\textsuperscript{155} the pegged exchange rate policy prevented the devaluation of the peso which would have otherwise occurred. As

\textsuperscript{150} See id.


\textsuperscript{152} See id.

\textsuperscript{153} See id. (discussing how Mexican political instability caused many investors to "get cold feet" and to move capital out of Mexico); see also Calvin D. Siebert & Mahmood A. Zaidi, \textit{Employment, Trade and Foreign Investment Effects of NAFTA}, 5 MINN. J. GLOBAL TRADE 333, 353 (1996) (noting that the Bank of Mexico's issuance of the dollar-indexed \textit{tesobonos} made foreign investors even more nervous and provided the "final straw that broke the camel's back").

\textsuperscript{154} See Humphrey, \textit{supra} note 14; Naim, \textit{supra} note 128.

\textsuperscript{155} This occurred because, at the time, the United States was vigorously pursuing an anti-inflation strategy. See John M. Berry, \textit{Greenspan Warns Higher Inflation May Be in Offing}, WASH. POST, Dec. 8, 1994, at B13 (reporting that just before the peso crisis, Federal Reserve Chairman Greenspan testified before Congress as to his concern about inflation and warned that interest rates might be raised to fend off inflation).
a result, the peso became increasingly overvalued. The government's decision to raise interest rates on its short term treasury bills exacerbated dangers posed by Mexico's pegged exchange rate system. The same is true of the government's move to increase the issuance of tesobonos, treasury notes indexed to U.S. dollars, as "suggested" by Weston Group, an investment bank representing such institutional investors as Fidelity Investments and Solomon Brothers, among others.

This move away from peso-denominated cetes to tesobonos was an overt effort to retain foreign investment funds. By issuing tesobonos, the Mexican government shifted the risk of currency fluctuations from portfolio investors to the Mexican government because the government based its obligation to pay on the value of the U.S. dollar if the peso declined in value. Only by taking this step to reduce the risk associated with investment in the country could Mexico forestall capital flight it could not afford. Without any direct acknowledgement of what had transpired, Mexico lost its ability to craft its policies freely and allocated some measure of its autonomy to the managers of foreign funds.

156 Although this is by no means intended to be an economic analysis of the crisis, a brief explanation may clarify the basic mechanics of this phenomenon. Suppose in a fixed exchange rate world, $1 U.S. = 2 Mexican pesos, and that the interest rate in each country is 10%. An investor facing these options could purchase either a $1 bond or a 2 peso bond and be indifferent between the choices (setting aside other risk variables). If the interest rate in the U.S. dropped to 5%, while the Mexican rate held constant, the price of the U.S. bond would then increase because the interest rate and the price of bonds have an inverse relationship. Now the $1 U.S. bond which was worth 2 Mexican pesos might cost $2 U.S. to purchase, changing the currency equivalency from 1:2 to 1:1 and overvaluing the Mexican bond because the currency could not adjust to correct the imbalance.


158 See generally Carrasco & Thomas, supra note 92, at 562 (asserting that the need to attract foreign investment "forced the Mexican government to decide whether it should raise interest rates... or devalue the peso"); Naim, supra note 128, at 123 (noting that the "Mexican crisis offers interesting insights into the new role of international money managers and the conditions they impose on the countries in which they become major investors" and that mutual fund managers "exert an unprecedented influence on the behavior of governments").
For a time, this passage of power had no ill effect. The conditions sought by money managers led to some short term success as the continued presence of foreign investment enabled the government to mask true economic conditions. Eventually, however, the combination of economic and political pressures bearing on Mexico caused the house of cards to tumble. As the depletion of reserves became apparent, foreign investors became doubtful of Mexico's ability to maintain the value of the peso, particularly in light of large amounts soon to be due on foreign-held tesobonos. As reserve levels sank to $7 billion in December, 1994, President Zedillo, with no advance warning, unilaterally broadened the band of the crawling pegged exchange rate, causing the devaluation of the peso by 12.7%. One day later, on December 21, the government entirely abandoned the pegged rate and announced that the peso would be allowed to float.

The devaluation of the peso and the return to a free floating exchange rate had severe implications for the overall health of the Mexican economy. However, unlike the international reaction to Mexico's 1982 debt crisis, no unified program of international assistance was rapidly forthcoming. In part, this is attributable to the actors involved in each crisis. When Mexico defaulted on its loans in 1982, governments and international financial institutions worked out the problem in a fairly systematic way due to the nature of the parties involved. The primary creditors were large commercial banks which had long-standing interests in the region giving them incentive to negotiate, rather than simply withdraw their commitments. Home governments, which wanted the loans renegotiated so as to "preserv[e] the ally," brought additional pressure to bear on these banks.

159 See Naim, supra note 128, at 117-18.
161 See Chun, supra note 142, at 2658.
162 See Naim, supra note 128, at 119 (stating that by March 1995, "a quarter of a million Mexicans had joined the ranks of the unemployed").
164 See id. at 321-323.
165 Lichtenstein, supra note 117, at 1774.
Thus, when Mexico sought assistance from its creditors in 1982, it was able to craft a wide-ranging bailout financed by a broad spectrum of the international community “virtually over-night.”

With the Peso Crisis, Mexico faced a quite different situation. Just as the power exercised by portfolio investors contributed to the collapse of the Mexican economy, their presence — and the inability of the international community to address it adequately — slowed or prevented attempts to remedy the problem. The “creditors” who underwrote the overvaluation of the currency were not long-term stakeholders in the Mexican economy, but profit-maximizing globetrotters who could easily move their money to more attractive venues. Whether or not foreign investors did pull vast sums of money out in reaction to the crisis, the knowledge that such action was possible at any time set parameters within which the state had to act. If the Mexican government had imposed foreign exchange controls, which could have prevented quick withdrawal of portfolio investment from the country, it would have severely diminished the appeal of its markets in the long run, and could have created a negative global impact. Because of its dependence on portfolio investment both before and after the crisis, Mexico found itself in a situation where it could not freely exercise sovereign power in selecting policy responses to the crisis. Faced with limited

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166 Id. at 1771.
167 According to the popular press, foreign investors pulled their money out in droves. See, e.g., Petruno, supra note 91, at A26 (“foreign owners of Mexican stocks and bonds rushed to exit”); Schodolski, supra note 139 (stating that finance officials in other countries were “nervously watching the big institutional investors frantically pull their money out of Mexico”). The IMF, however, suggested a contrary view. See IMF 1996 REPORT, supra note 19, at 8 (suggesting domestic investors sparked the exodus in asserting that “much of the peso crisis was due to the speed at which Mexican capital left the country”).
168 See Lichtenstein, supra note 117, at 1775 (noting that the “new rules” of international capital markets would not have tolerated this act of default and that international investors would have shunned Mexico in the future).
169 See George Graham et al., Bitter Legacy of Battle to Bail out Mexico, FIN. TIMES, Feb. 16, 1995, at 4 (quoting Michel Camdessus, Managing Director of the IMF, as stating that if Mexico had utilized foreign exchange controls, it “would have been a true world catastrophe as the pressure on other [states] to follow would have been tremendous”).
170 This result is likely to occur more frequently as countries shift from syndicated bank loans and toward securitized capital investments. The Mexican experience is by no means an anomaly. See Chun, supra note 142, at 2664.
options, Mexico sought international assistance funding.

The international community responded to the crisis with varying degrees of concern. Although the IMF and the Bank for International Settlements ("BIS") quickly pledged $7.8 billion and $5 billion respectively, these amounts were insufficient to address the problem.\(^{171}\) The IMF began the process of structuring additional credit transfers for Mexico, but those wheels turned very slowly.\(^{172}\) The North American Swap Facility ("NASF"), which was created to supplement NAFTA, provided Mexico with short-term funds of approximately $10 billion from the United States and Canada, but that too proved insufficient to combat the problem.\(^{173}\) Other sources did not readily provide multilateral aid. Many of the members of the international community with the resources to help Mexico chose to treat the situation as only a Mexican domestic problem, one for Mexico to resolve on its own.\(^{174}\) It fell to the United States, which treated the crisis as a "global economic security issue with direct impact on the U.S. economy,"\(^{175}\) to structure a rescue package for Mexico.\(^{176}\) This package enabled Mexico to meet its obligations to foreign investors and maintain international confidence in its markets.

\(^{171}\) See Graham, supra note 169, at 4.

\(^{172}\) See id.


\(^{174}\) Countries who faced contagion risks from the Peso Crisis were primarily other developing countries with insufficient funds to provide meaningful assistance. See IMF 1996 REPORT, supra note 19, at 1, 7-10.

\(^{175}\) SASKIA SASSEN, LOSING CONTROL? SOVEREIGNTY IN AN AGE OF GLOBALIZATION 22 (1996).

\(^{176}\) The final aid package proposed for Mexico consisted of a direct loan of approximately $50 billion, of which $20 billion came from the United States, $18 billion from the IMF (including $8 billion already promised to Mexico and an additional $10 billion), $10 billion from the BIS, $1.5 billion from Canada, and $3 billion from commercial banks. Of these amounts, the U.S. and IMF portions were finalized, and the BIS portion was not. See Chun, supra note 142, at 2660-62.
The bailout package announced by the United States consisted of IMF, BIS and U.S. funds. See id. Both the content and the process through which the plan was structured proved extremely controversial. IMF and BIS officials felt that the United States had overstated the BIS's commitment to the package, announcing that the BIS had agreed to provide funds when in fact it had only agreed to consider the proposal. See Graham, supra note 169, at 4. Ultimately, the IMF did formally agree to the plan, but many members were angered that the IMF used its resources to "bail out risk-taking American mutual and pension fund managers," and that the bailout set bad lending precedent. See id. U.S. critics of the bailout also argued against saving the money of Wall Street investors and called for a more inclusive multilateral approach. See id. Despite these criticisms and objections, the bailout did occur and Mexico, for the time being, avoided more serious consequences.

The "successful" resolution of the Mexican crisis does not mean that the general problem of liquidity imbalances has been solved. Indeed, financial luminaries are quick to point out that "Mexico is not the first, and it won't be the last financial crisis aggravated by the increasing amounts of highly mobile [short-term] capital." See Chun, supra note 142, at 2659. On the practical level, it is clear that "[t]he world's financial system has . . . raced ahead of the institutional infrastructure for crisis management." See id. at 2663.

177 See id.
178 See Graham, supra note 169, at 4.
179 See Chun, supra note 142, at 2659.
180 See id.
181 See id. at 2663.
182 The risk taken by the United States in financing the bailout was alleviated in January 1997 when Mexico repaid the final amounts due three years ahead of schedule. See Frank James, Mexico Pays off U.S. Loan Ahead of Schedule, CHI. TRIB., Jan. 16, 1997, at 18.
183 Mark Clayton, World's Economic Structure Shifts, CHRISTIAN SCI. MONITOR, June 28, 1995, at 1 (quoting Paul Volcker, former Chairman of the Federal Reserve Bank); see also Michel Camdessus, Address at the Council of the Americas Conference, in STATE DEP'T BRIEFING, at 5 (May 1995) ("Vastly increased financial flows across national borders have also made countries that participate in international financial markets much more vulnerable to adverse shifts in market sentiments.").
6. RESPONSES TO THE CHANGING REALITY

Not only have changes in the world’s financial system outpaced changes in institutional infrastructure, they have occurred without thoughtful attention from the international legal community. For the most part, international law is still based on a state-centric model. Yet, political and economic realities clearly demonstrate that States are no longer the sole participants in the world financial system. As the events which unfolded in Mexico show, new entities possess and exercise elements of sovereignty. However, recognition of this reallocation of powers, which occurs in innumerable contexts on a daily basis, does not erase the vitality of the State.

The "claim" elements of sovereignty remain constant: Mexico’s independence, personhood, identifiable government and population were not directly challenged by the Peso Crisis. However, the Crisis did directly affect the "exercise" elements of Mexico's sovereignty, most notably in the autonomy category. The fact that portfolio managers directly rendered “advice” (which by all implication was directive rather than educational) to Mexican authorities responsible for setting economic and fiscal policies, makes clear the conveyance of "exercise" elements. If portfolio managers had made their voices heard in less overt ways, some would have argued that Mexico ceded no autonomy but participated of its own volition in a free market. The argument would assume that money managers simply looked at competitive conditions and chose the best alternative. This latter understanding fits neatly within the state-centric model, with States remaining as the dominant players and competing amongst themselves for investment funds. Under this theory, portfolio investment managers do not possess any "exercise" elements of sovereignty. They enter the field after the elements have been exercised by the State and only respond to existing conditions.

185 Although the long-range political future of the country remains uncertain, this unrest is attributable to a number of factors, of which the Peso Crisis is but one. Furthermore, a change in government does not mean that there is no longer an identifiable government.
As attractive as this scenario may be for those who favor the state-centric model, it is premised on a distorted understanding of political, economic and legal realities. The importance of portfolio investment funds to States forces them to compete fiercely for those funds. That competition takes place in a market where terms are dictated by money managers. Even if the competition is viewed as taking place between States, the rules of the game are established by non-state actors. Thus, States do not act freely in that they must convey the “exercise” element of autonomy.

Why should we be concerned about this transfer of autonomy? The passing of the “exercise” element of autonomy which occurs when States participate in international investment markets happens in many other situations as well. Typically, however, the passage occurs through open and deliberate state action, involving actors recognized as significant by the international community. Thus, when a State elects to participate in certain trading regimes, it surrenders some of its autonomy by making that choice.

Further, a State cedes to other States or state groupings whatever “sticks” necessary to effectuate the arrangement. Even where external factors, such as the customary international legal prohibition of state-sponsored genocide, impose the reallocation of “exercise” elements on a State, the passage occurs because other States demand it. Thus, it falls within the traditional international legal framework. Customary international law exists because a sufficient number of States agree that it exists. This places customary law firmly within a state-centric approach.

This model does not accommodate reallocations of “exercise” elements of sovereignty to non-state, nontraditional international actors such as money managers. Because money managers operate outside the traditional state-centric model and because States feel their influence in varying degrees, legal scholars, for the most part, do not address them. However, economists and political

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186 Economically secure countries, which are less reliant on portfolio investment funds, may be less concerned about the increasing influence of money managers, just as they appear to be less concerned about the impact of increased globalization. See Roger Cohen, Global Forces Batter Politics, N.Y. Times, Nov. 17, 1996, § 4 (Magazine), at 4 (stating that “[t]he difference between America and Europe appears to lie in how threatening the changes wrought by the global marketplace are perceived to be” and that in France “a psychosis over lost sovereignty is growing”).

https://scholarship.law.upenn.edu/jil/vol18/iss3/2
scientists are starting to acknowledge the vast influence of money managers. 187

Does the lack of recognition from the legal community matter? Would recognition lead to a “better” model? Would it help prevent another Mexican Peso Crisis? The answers to these questions are not clear. It may be impossible to prevent another international economic crisis along the lines of the Peso Crisis, as international financial affairs could be largely ungovernable. Nevertheless, some proposals aimed at preventing such a recurrence are currently under consideration. A quick survey of these proposals highlights the difficulties inherent in attempting to regulate this area.

In the wake of the Mexican Peso Crisis, several proposals were suggested to respond to future crises of a similar nature. These include, among others, the creation of an emergency financing mechanism or an international bankruptcy agency which would require the international community to intervene when a country faced severe financial problems similar to Mexico’s. 188 This would avoid the need for after-the-fact negotiation of aid. Other proposals call for the creation of an international bondholder’s corporation to act as the equivalent of the Federal Deposit Insurance Corporation for bonds issued by developing countries. A third suggestion is for an agreement between States to submit investment disputes to courts in either the United States or Great Britain, where sophisticated commercial laws exist. 189

These efforts focus primarily on the implementation of structures and the establishment of mechanisms utilizing established international procedures. Each proposal depends on the

187 A pithy example on the domestic front comes from James Carville, who states “[t]he damned bond market . . . [w]ho the hell knew it was so powerful? . . . If I’m ever reincarnated, I want to come back as the bond market. Then everybody will be afraid of me and have to do what I say.” Jerry Goodman, Investing in a Candidate, N.Y. TIMES, Sept. 15, 1996, ¶ 6 (Magazine), at 28. See also International Capital Markets Charting a Steadier Course, IMF SURVEY (International Monetary Fund, Washington D.C.), Sept. 23, 1996, at 297 (noting that a study of international financial markets since the early 1990s “suggests that these markets will continue to become more global and more dominated by institutional investors”) [hereinafter IMF SURVEY].

188 See generally James B. Hurlock, The Way Ahead for Sovereign Debt, INT’L FIN. L. REV., July 1995, at 10, 12 (discussing responses to the problems of sovereign liquidity and debt default, including the proposal that the IMF become a global bankruptcy court).

189 See id.
acquiescence of States, in keeping with a state-centric approach. Additionally, each proposal aims primarily at minimizing the fallout from market transactions and therefore creating some form of a safety net. They focus on cleaning up the aftermath of a crisis, rather than on prevention. Although they deserve careful consideration, these proposals leave at least two important issues unresolved. First, because each focuses on responses to negative situations, none consider whether or how the situation could be prevented from arising in the first instance. A better solution would enable the international community to eliminate the possibility of such crises in the first place. The IMF acknowledges this problem, stating that in the endeavor to avoid future problems "policy challenges remain... whose resolution is essential for the stable evolution of the international financial system." Further, none of the "solutions" address the fundamental changes affecting the traditional model of international law. Each attempts to use traditional international actors to remedy problems caused by new actors, and each fails to explicitly recognize the shifting power dynamics which contribute to the initial problem.

7. CONCLUSION

Would it make a difference if money managers were recognized as central international actors? Recognition alone will only prevent money managers from exercising their power. Instead, some type of control or regulation might be called for. Given the realities of the marketplace, regulation of these actors may prove very difficult. States depend in varying degrees on the funds money managers provide, and many States will resist any regulation which impedes the flow of those funds. States on stronger financial footing may resist regulation on general policy grounds.

The United States and other developed nations cannot decide internally what level of regulation is appropriate for many entities. It is unlikely that regulation on a global level would

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190 IMF SURVEY, supra note 187, at 293.
191 See IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE 3 (1992) ("The debate over 'appropriate' levels of regulation 'has been rerun so many times that to open it up in an audience of regulatory policy makers today is to put them
be welcomed with open arms. Even if regulation were possible, it would be difficult to enforce such rules in any meaningful fashion. Attempts to enforce international regimes have proven formidable.\textsuperscript{192} There is no reason to believe that financial regulations would fare any better.

While these and other problems with potential regulation of money managers and other, similar types of international actors cannot be ignored, they do not diminish the need to grant such actors some recognition on the international stage. Recognition and a reconfiguration of the state-centric model to include these non-state actors would at least change the terms of the dialogue, and might place issues regarding these entities squarely on the international agenda. Consequently, the opportunity to use non-regulatory approaches at modifying behavior, successfully demonstrated by international experience with multinational corporations, could arise. Although regulation of multinational corporations also poses serious problems, over time and after their power was recognized by many States, the attention multinational corporations have received has led to a change in their behavior.\textsuperscript{193} The role of public opinion and attention should not be ignored. Faced with extremely negative publicity about “sweatshop” working conditions, some American corporations voluntarily altered their business practices.\textsuperscript{194} Recognition of the role that money managers play is the first step towards the possibility immediately to sleep.\textsuperscript{195}.

\textsuperscript{192} See generally GATT, supra note 35; NAFTA, supra note 35.


\textsuperscript{194} See Mark L. Clifford, \textit{Commentary: Keep the Heat on Sweatshops}, BUS. WK., Dec. 23, 1996, at 90 (discussing how U.S. corporations such as Nike changed their practices after media reports of sweatshop labor brought the issue to the attention of the public).
of bringing similar pressures to bear.

Further, the reallocation of "exercise" elements of sovereignty to money managers does in fact occur. Recognition of these actors would encourage careful thinking about the role they play. Although states and other entities may not be able to limit the money managers' power of the purse, they could perhaps better accommodate it in their policy decisions. Recognition may be more important as a policy tool than as a control device, as a means rather than an end. That aspect in no way diminishes its importance. If we care about the end, we must take those steps necessary to achieve it.

Therefore, in addition to crafting "solutions" to financial crises, the international community will benefit if it openly confronts the changes being wrought on the international stage. There is no doubt that participants in the international community are capable of reconfiguring the state-centric model. They may partially overcome their reluctance to do so by realizing that this recasting does not require elimination of the state-centric model in its entirety nor minimize the importance of States. "Claim" elements, those certain fixed attributes of state status, would remain constant. Absent territory, personhood, population and an identifiable government, an entity will not be recognized as a State in the international community. The model must be modified, however, to include an understanding that the "exercise" elements traditionally associated with statehood are characteristics which may be reallocated. Most importantly, the model must accommodate new actors, reflecting the fact that "sticks" may be passed to anyone. States or state-groupings are by no means the only eligible recipients.

The once exclusive, inviolable nature of sovereignty has little relevance in an interdependent, technologically connected world. The difficulties that attempts to include non-state actors such as money managers in a new model will encounter do not mean that inclusion should be avoided. Instead, the herculean nature of the task suggests that it should be undertaken immediately. States will undoubtedly resist acknowledgment of non-States as capable of exerting tremendous influence on state relations. However, this influence is already strongly felt and cannot realistically be denied. Recognition of the changing structure of the international community calls for the development of a model of statehood and sovereignty based on a property analogy. Such a model accommo-
dates the divergent sovereign powers States may possess by acknowledging that “exercise” elements of sovereignty may be reallocated. A new model would break down the absolutist definition of sovereignty into a workable concept for today’s realities.