ARTICLES

THE ECONOMIC ANALYSIS OF INTERNATIONAL LAW: TRANSACTION COST ECONOMICS AND THE CONCEPT OF STATE PRACTICE

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[T]he student of law and the student of politics . . . purport to be looking at the same world from the vantage point of important disciplines. It seems unfortunate, indeed destructive, that they should not, at the least, hear each other.¹

PREFACE

Despite their common ancestry, an intellectual schism has developed between international law and political science. This division stems, in part, from what Oran Young calls "the two-cultures problem." Students of international law and political science represent different intellectual communities. They use different modes of reasoning and different forms of discourse in seeking answers to the questions they pose. In essence, the two cultures represent distinct language communities, burdened with all the difficulties of translation and interpretation.

Recently, attempts have been made to forge a link between theories of international relations and international law.

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2 According to Nicholas Onuf and James Taulbee, "[a]s an area of serious study, international law has all but disappeared from the contemporary curricula of political science and international relations ... in the United States." Nicholas G. Onuf & James Larry Taulbee, Bringing Law to Bear on International Relations Theory Courses, 26 PS: POL. SCI. & POL. 249, 249 (1993).

3 For extensive studies on the trends of teaching international law, see, e.g., RICHARD EDWARDS, A SURVEY OF THE TEACHING OF INTERNATIONAL LAW IN POLITICAL SCIENCE DEPARTMENTS (1963) (reporting the results of a survey conducted under the auspices of the American Society of International Law and the American Political Science Association, investigating the methods of teaching international law); JOHN KING GAMBLE, TEACHING INTERNATIONAL LAW IN THE 1990S (1992) (reporting the results of a survey conducted by the American Society of International Law, focusing on how international law is taught to students of law and students of political science); James Larry Taulbee, Images of International Law: What Do Students Learn from International Relations Textbooks?, 15 TEACHING POL. SCI. 74 (1988) (stating that few university departments offer international law).

5 Most scholars use the term "international relations theory." See Kenneth W. Abbott, Modern International Relations Theory: A Prospectus for International Lawyers, 14 YALE J. INT'L L. 335 (1989) (hereinafter Abbott, Modern International Relations Theory); Anne-Marie Slaughter Burley, International Law and International Relations Theory: A Dual Agenda, 87 AM. J. INT'L L. 205 (1993). However, this term is misplaced if not inaccurate. It suggests that there is only one theory of international relations. In fact, there are many different theories that seek to explain international behavior. These theories emphasize either
Scholars have begun to identify a common ground between the two disciplines. For example, both disciplines examine the concept of order in international affairs. Similarly, both are interested in designing mechanisms that facilitate cooperation in an anarchic world. Building upon this common ground, these disciplines have much to contribute to one another. Indeed, this

individual, state, or systemic factors to explain international behavior. See generally JAMES E. DOUGHERTY & ROBERT L. PFALTZGRAFF, JR., CONTENDING THEORIES OF INTERNATIONAL RELATIONS (3d ed. 1990) (presenting contending theories of international relations by drawing insights from traditional and behavioral-scientific fields); KENNETH N. WALTZ, MAN, THE STATE AND WAR (1959) (investigating the contributions of classical political theory to understanding different causes of interstate conflict and defining the conditions under which war can be controlled); Jack S. Levy, The Causes of War: A Review of Theories and Evidence, in 1 BEHAVIOR, SOCIETY, AND NUCLEAR WAR (Philip E. Tetlock et al. eds., 1989) (providing an exhaustive review of international relations theories).

In addition to these seminal works, this interdisciplinary approach has been used by several authors. See, e.g., William B.T. Mock, Game Theory, Signalling, and International Legal Relations, 26 GEO. WASH. J. INT'L L. & ECON. 33 (1992) (applying game theory to examine the role of signalling in international legal relations); Miguel Montañá-Mora, International Law and International Relations Cheek to Cheek: An International Law/International Relations Perspective on the U.S./EC Agricultural Export Subsidies Dispute, 19 N.C. J. INT'L L. & COM. REG. 1 (1993) (asserting that the EC/U.S. agricultural subsidy dispute is best understood by adding insights from international relations theory to existing legal analysis); John K. Setear, An Iterative Perspective on Treaties: A Synthesis of International Relations Theory and International Law, 37 HARV. INT'L L.J. 139 (1996) (appraising institutionalist theory to examine the concept of iteration in the law of treaties); G. Richard Shell, Trade Legism and International Relations Theory: An Analysis of the World Trade Organization, 44 DUKE L.J. 829 (1995) (analyzing three competing normative approaches to World Trade Organization trade legalism by drawing on international relations, economics, and legal theory).

Scholars of both law and political science have suggested the benefits of interdisciplinary research. See Kenneth W. Abbott, Elements of a Joint Discipline, 86 AM. SOC'Y INT'L L. PROC. 167, 168 (1992); Christopher C. Joyner, Crossing the Great Divide: Views of a Political Scientist Wandering in the World of International Law, 81 AM. SOC'Y INT'L L. PROC. 385, 390 (1987); Robert O. Keohane, Compliance with International Commitments: Politics Within a Framework of Law, 86 AM. SOC'Y INT'L L. PROC. 176, 180 (1992);
merger creates a powerful interdisciplinary approach to the study of international cooperation.8

This article seeks to introduce elements from a third discipline to the study of international cooperation — economics.9 The fruitful merger of law and economics and the recent insights


8 This Article presupposes a common background and common goals for law, international relations, and economics. Thus, as noted by John Setear, “I have not chosen this intersection of theories like some Mendelian gardener waiting detachedly to see which intellectual oddities will result from the interbreeding of academic schools of thought.” Correspondence from John Setear, Professor, UCLA School of Law (Apr. 15, 1995).

9 The application of economic theory to the study of law is well-known. See, e.g., ROBIN PAUL MALLOY, LAW AND ECONOMICS (1990) (examining the relationship between law and economics); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (3d ed. 1986) (applying economic theory to a wide range of legal issues); Robert C. Ellickson, Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics, 65 CHI.-KENT L. REV. 23 (1989) (arguing that the law and economics movement has been losing its trajectory within law schools); Jack Hirshleifer, The Expanding Domain of Economics, 75 AM. ECON. REV. 53 (1985) (asserting that economics penetrates all social disciplines and is reciprocally affected by them); Edmund W. Kitch, The Intellectual Foundations of “Law and Economics,” 33 J. LEGAL EDUC. 184 (1983) (identifying and defending the basic contributions law and economics have made to the study of law); Richard A. Posner, The Economic Approach to Law, 53 TEX. L. REV. 757 (1975) (analyzing the economic approach to law); Edward L. Rubin, Commentary, The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions, 109 HARV. L. REV. 1393 (1996) (arguing that law and economics scholarship and outside scholarship (including critical race theory and radical feminist theory) share a common ground, which includes the analysis of institutions).

Moreover, the application of economic theory to international legal issues is increasing. See, e.g., Howard F. Chang, An Economic Analysis of Trade Measures to Protect the Global Environment, 83 GEO. L.J. 2131 (1995) (addressing the role of international trade restrictions in supporting policies to protect global environment); Symposium, Economic Analysis of International Law, 16 INT’L REV. L. & ECON. 1 (1996) (examining a broad variety of economic issues in trade and business transactions).

In addition, the benefits of interdisciplinary work have been recognized in a number of distinct fields. See, e.g., Charles W. Collier, Interdisciplinary Legal Scholarship in Search of a Paradigm, 42 DUKE L.J. 840 (1993) (describing the anomalies of interdisciplinary legal scholarship); Linda C. Reif, Multidisciplinary Perspectives on the Improvement of International Environmental Law and Institutions, 15 MICH. J. INT’L L. 723 (1994) (book review) (reviewing three recent publications on international aspects of environmental protection); Annelise Riles, Representing In-Between: Law, Anthropology, and the Rhetoric of Interdisciplinarity, 1994 U. ILL. L. REV. 597 (considering “how lawyers and nonlawyers discuss the contribution of interdisciplinary scholarship to the law as a means of rethinking the relationship between these two disciplines”).
gained from international law and theories of international relations suggest that the triad of law, international relations, and economics is a natural extension for an interdisciplinary research agenda that examines international cooperation.\(^\text{10}\)

1. INTRODUCTION

For both international legal scholars and political scientists, the problems associated with achieving international cooperation are well-known.\(^\text{11}\) "Whether expressed through the 2 x 2 matrix of the Prisoners’ Dilemma or the logic of collective action, the central issue is the same — rational, egoistic actors will seek to maximize individual utility, even at the cost of the common good."\(^\text{12}\) Two fundamental assumptions underlie most studies of

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\(^{10}\) This article assumes certain benefits can be gained from the rationality assumptions of economics. But see Alexander Rosenberg, Can Economic Theory Explain Everything?, 9 PHIL. & SOC. SCI. 509 (1979) (criticizing claims that economic theory can explain everything in its domain).

\(^{11}\) Cooperation in the context of international affairs is defined as a situation where “actors adjust their behavior to the actual or anticipated preferences of others, through a process of policy coordination.” ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY 51 (1984) [hereinafter KEOHANE, AFTER HEGEMONY].


The Prisoners’ Dilemma is a game theory model that describes how competing interests between two egoistic actors may lead to sub-optimal behavior which inhibits cooperation. See Duncan Snidal, The Game Theory of International Politics, 38 WORLD POL. 25, 25 (1985) (discussing the recent trend of applying game theory to international politics analysis). But cf. R. Harrison Wagner, The Theory of Games and the Problem of International Cooperation, 77 AM. POL. SCI. REV. 330, 344-45 (1983) (arguing the inadequacy of the Prisoners’ Dilemma model as a tool for analyzing international conflicts).

The collective action problem suggests that rational, self-interested individuals will not act to achieve a common group goal unless some form of coercion is present. See, e.g., JAMES S. COLEMAN, INDIVIDUAL INTERESTS AND COLLECTIVE ACTION (1986) (investigating important problems of sociology and of society using a paradigm of national action borrowed from economics);
international cooperation. First, states are the principal actors in international affairs.\textsuperscript{13} Second, the international system is characterized as a decentralized system that lacks a hierarchical enforcement mechanism.\textsuperscript{14} These two factors render cooperation difficult.

Studies of international cooperation examine the problem of developing cooperative behavior among egoistic actors and maintaining such collaboration under conditions of anarchy.\textsuperscript{15}

\textbf{RUSSELL HARDIN}, \textit{Collective Action} (1982) (studying the problem of collective action in social contexts); \textbf{MANCUR OLSON, JR.}, \textit{The Logic of Collective Action} 2 (1965) (explaining that irrational, self-interested individuals will not achieve their common interests unless there is coercion); \textbf{TODD SANDLER}, \textit{Collective Action} (1992) (analyzing the factors that influence whether collective action will follow voluntarily or whether it needs to be fostered by government).


\textsuperscript{14} While most studies of cooperation agree on the existence of an anarchical international system, there is some disagreement as to its consequences. See, e.g., David A. Baldwin, \textit{Neoliberalism, Neorealism, and World Politics}, in \textit{Neorealism and Neoliberalism: The Contemporary Debate} 3 (David A. Baldwin ed., 1993) (examining the diverging points of view on the nature and consequences of anarchy); Helen Milner, \textit{The Assumption of Anarchy in International Relations Theory: A Critique}, 17 \textit{Rev. Int’l Stud.} 67 (1991) (suggesting that “a more fruitful way to understand the international system combines anarchy and interdependence”); Alexander Wendt, \textit{Anarchy Is What States Make of It: The Social Construction of Power Politics}, 46 \textit{Int’l Org.} 391, 410-12 (1992) (arguing that international institutions are capable of shaping state interests).

\textsuperscript{15} A review of the major works on international cooperation attests to the primacy of this fundamental area of study. See \textbf{ROBERT AXELROD}, \textit{The Evolution of Cooperation} 3 (1984) [hereinafter AXELROD, \textit{Evolution}] (asking “[u]nder what conditions will cooperation emerge in a world of egoists without central authority?”); \textbf{KEOHANE}, \textit{After Hegemony}, supra note 11, at 9 (examining “[u]nder what conditions can independent countries cooperate in the world political economy? In particular, can cooperation take place without hegemony and, if so, how?”); Oye, supra note 13, at 1 (asking “[i]f international relations can approximate both a Hobbesian state of nature and a Lockeian civil
These studies suggest that international institutions can increase the likelihood that cooperative behavior will develop among states.\textsuperscript{16} Institutions are defined as “persistent and connected sets of [formal and informal] rules that prescribe behavioral roles, constrain activity, and shape expectations.”\textsuperscript{17} They are not simple, \textit{ad hoc} arrangements concerning discrete transactions, rather, institutions involve long-term relationships between interested actors. Institutionalist theory suggests that “[i]nstitutions matter because they provide a stable environment for mutually beneficial decision-making as they guide and constrain society, why does cooperation emerge in some cases and not in others?”).

\textsuperscript{16} See generally Robert Axelrod & Robert O. Keohane, \textit{Achieving Cooperation Under Anarchy: Strategies and Institutions}, in \textit{COOPERATION UNDER ANARCHY}, supra note 13, at 226, 228 (arguing that a contextual approach to strategy leads to seeing the importance of international institutions, helping to forge necessary links between game-theoretic arguments and theories about international regimes); Robert O. Keohane & Lisa L. Martin, \textit{The Promise of Institutionalist Theory}, 20 \textit{INT’L SEC.} 39 (1995) (affirming the value and relevance of the institutionalist research program in the face of criticisms from other theoretical approaches); Charles Lipson, \textit{International Cooperation in Economic and Security Affairs}, 37 \textit{WORLD POL.} 1, 22 (1984) (asserting that the juxtaposition of states as independent actors and of their choices resulting in interdependent consequences defines the problems of international relations); Arthur A. Stein, \textit{Coordination and Collaboration: Regimes in an Anarchic World}, 36 \textit{INT’L ORG.} 299, 299 (1982) (developing “a conceptualization of regimes as serving to circumscribe national behavior and thus to shape international interactions”). But see Joseph M. Grieco, \textit{Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism}, 42 \textit{INT’L ORG.} 485, 487 (1988) (arguing that “new liberal institutionalism fails to address a major constraint on the willingness of states to cooperate which is generated by international anarchy and which is identified by realism”); John J. Mearsheimer, \textit{The False Promise of International Institutions}, 19 \textit{INT’L SEC.} 5, 7 (1994) (concluding that “institutions have minimal influence on state behavior, and thus hold little promise for promoting stability in the post-Cold War world”).

behavior."\(^{18}\)

A significant limitation to the development and operation of international institutions, however, involves the problem of transaction costs, an issue that has been identified in the literature on the new institutional economics.\(^ {19}\) It is generally recognized that all contractual arrangements are plagued by transaction costs. Briefly stated, transaction costs are the costs of arranging, monitoring, and enforcing a contract.\(^ {20}\) Transaction costs affect the ability of the parties to make exhaustive agreements capable of addressing all possible contingencies that may arise in the course of their relationship. Thus, any contract that calls for future performance will be incomplete.\(^ {21}\) As a result, the parties may face costly adjustments to address unforeseen contingencies. Alternatively, one party may seek to extract quasi-rents from the other party through opportunist behavior during the course of

\(^{18}\) Duncan Snidal, Political Economy and International Institutions, 16 INT'L REV. L. & ECON. 121, 127 (1996) [hereinafter Snidal, Political Economy].

\(^{19}\) New institutional economics is also referred to as the new economics of organization or as transaction cost economics. See generally MALCOLM RUTHERFORD, INSTITUTIONS IN ECONOMICS (1994) (analyzing the old institutional economics, the American institutionalist tradition, the new institutional economics, and the classical economics tradition); James G. March and Johan P. Olsen, The New Institutionalism: Organizational Factors in Political Life, 78 AM. POL. SCI. REV. 734 (1984) (evaluating the effect of institutions on politics and offering a theoretical framework for further study of institutions); Terry M. Moe, The New Economics of Organization, 28 AM. J. POL. SCI. 739 (1984) (exploring how the new institutional economics can further the study of public bureaucracy); Symposium, The New Institutional Economics: Recent Progress; Expanding Frontiers, 149 J. INST. & THEOR. ECON, 1 (1993) (examining the broad application of institutional economics as well as recent developments in the literature).

\(^{20}\) One definition of transaction costs is "the costs of all resources required to transfer property rights from one economic agent to another. They include the costs of making an exchange (e.g., discovering exchange opportunities, negotiating exchange, monitoring, and enforcement), and the costs of maintaining and protecting the institutional structure (e.g., judiciary, police, armed forces)." SVETOZAR PEJOVICH, ECONOMIC ANALYSIS OF INSTITUTIONS AND SYSTEMS 84 (1995).

the contractual relationship.\textsuperscript{22}

This Article suggests that transaction costs affect all contractual arrangements, including the development and operation of international institutions.\textsuperscript{23} Like firms engaged in private contractual relations, states are involved in the negotiation and implementation of contractual arrangements. These arrangements are also subject to transaction costs. As a result, international agreements will be incomplete because states cannot address all possible contingencies that may arise during their contractual relationship. Thus, transaction costs affect the development and operation of international institutions.

Transaction cost economics suggests that governance structures emerge to address the problems raised by transaction costs.\textsuperscript{24} These governance structures vary from the discrete market

\textsuperscript{22} The quasi-rent value of an asset "is the excess of its value over its salvage value, that is, its value in its next best use to another renter. The potentially appropriable specialized portion of the quasi rent is that portion, if any, in excess of its value to the second highest-valuing user." Benjamin Klein et al., \textit{Vertical Integration, Appropriable Rents, and the Competitive Contracting Process}, 21 J.L. & ECON. 297, 298 (1978) [hereinafter Klein et al., \textit{Appropriable Rents}].


transaction to the fully integrated firm. Exogenous governance structures authorize a third party to address any disputes or unforeseen issues that may develop during the course of the contractual arrangement. These structures can take several forms ranging from arbitration to judicial settlement. In contrast, endogenous governance structures address disputes within the context of the contractual relationship. Through this type of structure, the parties resolve their own problems as they arise. By developing a relationship that recognizes the importance of dynamic responses to change, the parties can establish a mutually reinforcing relationship that can resolve disputes as well as new issues.

Exogenous or endogenous governance structures also address transaction costs at the international level. While students of international cooperation rarely look to international law for guidance, a fundamental principle of international law provides the foundation for endogenous governance structures — the concept of state practice. State practice minimizes the problems of transaction costs at the international level and is an important element in the two principal sources of international law: treaty

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25 See id. at 337. Shelanshi and Klein state:

Governance structures can be described along a spectrum. At one end lies the pure, anonymous spot market, which suffices for simple transactions such as basic commodity sales. . . . At the other end of the spectrum . . . lies the fully integrated firm, where trading parties are under unified ownership and control. . . . The movement from market to hierarchy thus entails a trade-off between the high-powered incentives and adaptive properties of the market, and the safeguards and central coordinating properties of the firm.

Id.

26 The terms exogenous and endogenous are generally not used to refer to governance structures in transaction cost economics. However, they are preferable to the more common terms of trilateral and bilateral governance structures because they refer to the source of governance rather than to the number of actors involved. For a related discussion, see Snidal, Political Economy, supra note 18, at 127-29; Duncan Snidal, The Politics of Scope: Endogenous Actors, Heterogeneity and Institutions, 6 J. THEORETICAL POL. 449, 454-58 (1994) [hereinafter Snidal, Politics of Scope]. The terms exogenous and endogenous governance structures are also similar to the formal and informal instruments of active management identified by Chayes and Chayes in their analysis of treaty compliance. See ABRAM CHAYES & ANTONIA HANDLER CHAYES, THE NEW SOVEREIGNTY 201-27 (1995).
law and customary international law. Specifically, state practice allows states to interpret or even modify their original agreements through subsequent practice, thereby diminishing the need to draft extensive agreements at the outset. Additionally, states maintain the flexibility necessary to address new circumstances as they arise while remaining grounded within the context of their original agreement. Alternatively, continuous and long-standing state practice may develop into customary international law that is legally binding on those states that acquiesce in its formation and development. Customary international law allows states to promote cooperation in the absence of formal agreements. It minimizes the problems raised by transaction costs by allowing states to forgo explicit negotiations and to function even in the absence of a formal structure. It is also flexible enough to address new circumstances as they arise. In both treaty law and customary international law, therefore, state practice facilitates the development of governance structures that address the problems raised by transaction costs.

This Article is divided into four sections. Section 2 provides a brief introduction to the study of transaction cost economics. After describing both the causes and consequences of transaction costs, it examines several governance structures designed to reduce the problems raised by these costs. Section 3 applies transaction cost economics to the study of international cooperation. While this approach has traditionally been applied to private business transactions, it applies with equal rigor to international affairs. Specifically, this section examines how international law can facilitate the development of both exogenous and endogenous governance structures. Section 4 then reviews the concept of state practice in customary international law and treaty law. Finally, Section 5 examines how state practice provides the basis for developing endogenous governance structures. These structures address some of the problems raised by transaction costs.

The goals of this Article are twofold. It seeks to demonstrate the benefits of an interdisciplinary approach that merges the conceptual and theoretical framework of law with international relations and economics to examine the problem of international cooperation. More broadly, this Article hopes to reaffirm the

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relevance of international law.

2. TRANSACTION COST ECONOMICS AND THE LIMITATIONS OF CONTRACTUAL ARRANGEMENTS

Ronald Coase pioneered the concept of transaction costs.\(^{28}\) Coase’s groundbreaking work challenges the neoclassical assumptions of complete information and costless exchanges in contractual arrangements.\(^ {29}\) Rather, Coase suggests that costs inure to transactions:

In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on.\(^ {30}\)

These costs have a significant impact on contractual arrangements. Coase indicates that if transaction costs are taken into account, many contractual arrangements would not be made.\(^ {31}\)

To minimize the consequences of transaction costs, Coase suggests that institutions will develop in order to overcome the inherent limitations of market transactions. Specifically, firms will supersede market transactions.\(^ {32}\) Firms greatly reduce the


\(^{32}\) The firm is an integral component of microeconomic theory. See Geoffrey M. Hodgson, *Economics and Institutions* 195-216 (1988);
cost of using price mechanisms, including the costs of negotiating and concluding contracts for the exchanges that take place. 33

The firm, therefore, is seen as an efficient response to the problems raised by transaction costs.

Oliver Williamson subsequently refined the concept of transaction costs. 34 Like Coase, Williamson recognizes the existence of ex ante costs. 35 These include the costs of drafting and negotiating agreements. 36 In addition to these ex ante costs, contractual arrangements also involve ex post costs. Ex post costs include:

(1) the maladaptation costs incurred when transactions drift out of alignment . . . (2) the haggling costs incurred if bilateral efforts are made to correct ex post misalignments, (3) the setup and running costs associated with the governance structures (often not the courts) to which disputes are referred, and (4) the bonding costs of effecting secure commitments. 37

According to Williamson, transaction costs are the costs of negotiating a contract ex ante and monitoring it ex post as opposed to the production costs, which are the costs of enacting the contract. 38


34 See OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 15-32 (1985); see also OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES (1975) (providing a microeconomic analysis of economic organizations, both within and between markets and hierarchies); Oliver E. Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J.L. & ECON. 233 (1979) (describing the importance of transaction costs and analyzing the governance structures of transactions).

35 See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 20 (distinguishing between ex ante and ex post costs).

36 See id.

37 Id. at 21.

38 See R.C.O. Matthews, The Economics of Institutions and the Sources of Growth, 96 ECON. J. 903, 906 (1986); see also Carl Dahlman, The Problem of Externality, 22 J. LEGAL STUDIES 141, 148 (1979) (suggesting that transaction costs include: (1) search and information costs; (2) bargaining and decision costs; and (3) policing and enforcement costs). Dahlman indicates, however, that "this
2.1. The Causes of Transaction Costs

Williamson offers two explanations for the phenomenon of transaction costs: factors pertaining to the individuals who undertake the transaction, and factors specific to the particular transaction.  

The human factors that contribute to the development of transaction costs are bounded rationality and opportunism. While individuals may seek to act as rational actors, they are restrained by their limited capacity to understand and process all the information they receive. According to Williamson, "[t]ransaction cost economics assumes that human agents are subject to bounded rationality, whence behavior is 'intendedly' rational, but only limitedly so." Indeed, bounded rationality is "the cognitive assumption on which transaction cost economics functional taxonomy of different transaction costs is unnecessarily elaborate: functionally, the three classes reduce to a single one — for they all have in common that they represent resource losses due to lack of information."  

See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 44-52. For an excellent summary of Williamson’s theory of transaction costs, see DAVID M. KREPS, A COURSE IN MICROECONOMIC THEORY 743-70 (1990) [hereinafter KREPS, MICROECONOMIC THEORY]. See also ROGER D. BLAIR & DAVID L. KASERMAN, LAW AND ECONOMICS OF VERTICAL INTEGRATION AND CONTROL 18 (1983) (discussing Williamson’s ideas on transaction cost determinants).

See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 44-52. Williamson identified the existence of a third element of human nature — dignity. He indicated, however, that this element needed further development before it could be incorporated into the theory of transaction cost economics. See id. at 44 n.3; see also Tony McGuiness, Markets and Managerial Hierarchies, in THE ECONOMICS OF THE FIRM 42, 44 (R. Clarke & Tony McGuiness eds., 1987) (describing bounded rationality and opportunism).

The notion that parties cannot address all possible contingencies is based upon Herbert Simon’s work on bounded rationality. See HERBERT T. SIMON, RATIONALITY AND ADMINISTRATIVE DECISION MAKING, IN MODELS OF MAN 196, 198-206 (1957) (noting that the human mind does not have the capacity to solve complex problems in the manner required for objectively rational behavior); see also PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 126-40 (1992) (describing bounded rationality); David M. Kreps & Robert Wilson, Reputation and Imperfect Information, 27 J. ECON. THEORY 253 (1982) (examining the influence of imperfect (or incomplete) information on the development of reputation).

WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 30 (citations omitted).
relied.\textsuperscript{43} Specifically, bounded rationality makes comprehensive contracting infeasible.

Alternatively, parties to a transaction may resort to opportunistic behavior in order to realize individual gains.\textsuperscript{44} Such action may take several forms, ranging from the withholding of relevant information to the intentional transmission of incorrect information.\textsuperscript{45} For example, "[o]ne party might strategically withhold information that would increase the total gains from contracting (the 'size of the pie') in order to increase her private share of the gains from contracting (her 'share of the pie')."\textsuperscript{46}

In addition to human factors, transaction costs arise as a result of factors unique to particular transactions. Specifically, transactions differ with respect to asset specificity, uncertainty, and frequency.\textsuperscript{47} Asset specificity refers to the extent to which the value of an asset depends upon the continuation of a specific relationship.\textsuperscript{48} Asset specificity creates the possibility of appropriate quasi-rents which, in turn, raises the possibility of opportunistic behavior. Uncertainty refers to the inability to predict the outcome of future events.\textsuperscript{49} It is caused by both

\textsuperscript{43} Id. at 45.

\textsuperscript{44} See id. at 47; see also Juliet P. Kostritsky, Bargaining With Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations, 44 HASTINGS L.J. 621, 642-43 (1993) (arguing that opportunism "often explains why [contracting parties] dispense with formal, bargained-for contracts").


\textsuperscript{47} See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 52.

\textsuperscript{48} See Oliver E. Williamson, Credible Commitments: Using Hostages to Support Exchange, 73 AM. ECON. REV. 519, 526 (1983) (stating that there are several forms of asset specificity: site specificity; physical asset specificity; human asset specificity; and dedicated asset specificity).

\textsuperscript{49} See, e.g., Anthony D'Amato, Legal Uncertainty, 71 CAL. L. REV. 1, 2 (1983) (defining legal uncertainty as "the situation that obtains when the rule that is relevant to a given act or transaction is said by informed attorneys to have an expected official outcome at or near the 0.5 level of predictability"); Alex Y. Seita, Uncertainty and Contract Law, 46 U. PITT. L. REV. 75, 77-84
environmental conditions and behavioral conduct. Uncertainty of future events and the resulting need for adaptive governance structures constitute inevitable components of all contractual arrangements. As noted by Friedrich Hayek, "the economic problem of society is mainly one of adaptation to changes in particular circumstances of time and place." \textsuperscript{50} Frequency refers to the extent to which a particular transaction is repeated. As the frequency of a particular transaction increases, transaction costs will increase concomitantly. The impact of each of these factors on the development of transaction costs varies due to their interaction effects.\textsuperscript{51}

Thus, transaction costs economics identifies a significant limitation to the development and operation of contractual arrangements. Because of transaction costs, complex contracts are invariably incomplete and many are maladaptive. As a result, two consequences emerge. First, the contracting parties may face costly adjustments in addressing unforeseen contingencies.\textsuperscript{52} Second, one party may seek to extract quasi-rents from the other party through opportunistic behavior.\textsuperscript{53} Indeed, if transaction costs are sufficiently high, parties may decide to forgo the agreement altogether.

2.2. Remedies for Transaction Costs

Williamson suggests that identifying mechanisms that can effectively respond to unforeseen contingencies may solve the problem of incomplete contracts. "Instrumental gap filling thus is an important part of contract execution. Whether it is done easily and effectively or, instead, reaching successive agreements on

\textsuperscript{50} Friedrich Hayek, The Use of Knowledge in Society, 35 AM. ECON. REV. 519 (1945).

\textsuperscript{51} See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 60.

\textsuperscript{52} See id. at 178 (stating that "[m]any contingencies are unforeseen (and even unforeseeable), and the adaptations to those contingencies that have been recognized for which adjustments have been agreed to are often mistaken").

\textsuperscript{53} See Paul L. Joskow, Vertical Integration and Long-Term Contracts: The Case of Coal-Burning Electric Generating Plants, 1 J.L. ECON. & ORG. 33, 37 (1985) ("When contingencies arise that are not fully and unambiguously covered by formal contractual provisions, one or both parties to the transaction may have incentives to 'behave badly' by taking actions that increase the costs or reduce the revenues that will be obtained by the other party.").
adaptations and their implementation is costly makes a huge difference in evaluating the efficacy of contracts." The organizational imperative that emerges is: "Organize transactions so as to economize on bounded rationality while simultaneously safeguarding them against the hazards of opportunism."

More broadly, Williamson posits that efficiency guides the development of economic institutions: "Transaction cost economics maintains that there are rational economic reasons for organizing some transactions one way and other transactions another." As transaction costs increase, transactions accordingly become more complex and integrated. This transition explains the variation in transactional forms, which range from discrete and simple contracts to more complex contractual arrangements. Transaction cost economics maintains that this is a result of underlying differences in the characteristics of transactions.

Williamson identifies four types of governance structures that regulate contractual arrangements: market, exogenous, endogenous, and unified. Market governance structures regulate the most simple and discrete forms of contractual arrangements.

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54 WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 178.
55 Id. at 32.
57 See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 68. In contrast, Alchian and Demsetz explain the existence of the firm by focusing on the costs of monitoring productivity. See Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 AM. ECON. REV. 777, 781-85 (1972).
58 See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 72-78; see also KREPS, MICROECONOMIC THEORY, supra note 39, at 750-51 (discussing Williamson's classifications of governance structures). Williamson actually uses the terms "trilateral" and "bilateral" to describe exogenous and endogenous governance structures. As discussed supra, however, "exogenous" and "endogenous" are preferable because they refer to the source of governance rather than the number of actors involved. See supra note 26.
59 "A truly discrete exchange transaction would be entirely separate not only from all other present relations but from all past and future relations as well." Ian R. Macneil, Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law, 72 NW. U. L. REV.
In market governance structures, the specific identity of the parties is of negligible importance; substantive content is determined by reference to formal terms of the contract; and legal rules apply. Market alternatives are mainly what protect each party against opportunism by his opposite. Litigation is strictly for settling claims; concentrated efforts to sustain the relation are not made, because the relation is not independently valued.60

Market governance structures emphasize the discrete nature of the transaction and enhance presentation.61

As a contract becomes more complex and the arrangement extends beyond a discrete relationship, new problems arise which the market governance structure cannot handle.62 These contracts typically involve long-term arrangements or significant uncertainty. As a result, more complex governance structures

854, 856 (1978) [hereinafter Macneil, Adjustment].

60 WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 74. Similarly, Macneil notes that “[g]enerally speaking, a serious conflict, even quite a minor one such as an objection to a harmlessly late tender of the delivery of goods, terminates the discrete contract as a live one and leaves nothing but a conflict over money damages to be settled by a lawsuit.” Macneil, Adjustment, supra note 59, at 877.

61 According to Macneil,

[p]resentation is a way of looking at things in which a person perceives the effect of the future on the present. It is a recognition that the course of the future is so unalterably bound by present conditions that the future has been brought effectively into the present so that it may be dealt with just as if it were in fact the present. Thus, the presentation of a transaction involves restricting its expected future effects to those defined in the present, i.e., at the inception of the transaction.

Macneil, Adjustment, supra note 59, at 863.

62 Macneil identifies several elements where discrete transactions differ from complex contractual relations. These include: “(1) commencement, duration and termination; (2) measurement and specificity; (3) planning; (4) sharing vs. dividing benefits and burdens; (5) interdependence, future cooperation, and solidarity; (6) personal relations among, and numbers of, participants; and (7) power.” Ian R. Macneil, Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a “Rich Classificatory Apparatus,” 75 NW. U. L. REV. 1018, 1025 (1981).
emerge in response to increasing transaction costs. Long-term contracts have two common characteristics: (1) the existence of gaps in their planning, and (2) the presence of a range of techniques to create flexibility in lieu of leaving gaps. According to Macneil, long-term contracts are typically regulated by either of two governance structures: "(1) an explicitly stated contractual guarantee legally enforced by the government or some other outside institution [exogenous governance], or (2) an implicit contractual guarantee enforced by the market mechanism of withdrawing future business if opportunistic behavior occurs [endogenous governance]."

Exogenous governance structures refer disputes to a third party for adjudication. The third party takes the place of contract provisions in determining the damages for a breach or the adaptations that will be made in various circumstances. The third party can take many forms including an independent expert, an arbitration panel, or a judicial proceeding.

In contrast, endogenous governance structures resolve disputes within the parameters of the contractual arrangement. Third party involvement is not found in endogenous governance structures. Rather, the parties rely on each other for problem solving. The relationship underlying the endogenous governance structure has been compared to the iterated Prisoners' Dilemma, where the parties agree to cooperate with each other, forgoing short-term gains in the interest of long-term cooperation.

One way of understanding endogenous governance structures is through relational contract theory, which was developed by legal scholars to explain how complex contracts address uncertainties and resolve disputes. Fundamentally, relational contract

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63 See Macneil, Adjustment, supra note 59, at 865.
64 Klein et al., Appropriable Rents, supra note 22, at 303.
65 See KREPS, MICROECONOMIC THEORY, supra note 39, at 750.
66 See Macneil, Adjustment, supra note 59, at 866, for a discussion of the role of the architect under the form contracts of the American Institute of Architects as an example of direct third-party determination of performance.
67 See KREPS, MICROECONOMIC THEORY, supra note 39, at 751.
theory recognizes that elements of certain contracts cannot easily be reduced to specific obligations ex ante. Obstacles include the inability to identify future conditions and the inability to adequately characterize complex adaptations, even when contingencies can be identified in advance. In these cases, relational contract theory suggests that parties attempt to address uncertainties and resolve disputes within the parameters of their ongoing relationship. Relational contract theory views the contractual relationship as dynamic, in contrast to classical contract law which views it as static.

The fundamental insight of relational contract theory is that most private exchange occurs within ongoing relationships between parties, rather than the discrete transactional environment assumed in classical and neoclassical contractual theory. In relational contracts, discrete practices, like breach and litigation, have been replaced by adjustment within social and political processes largely separate from the positive legal institutions of the state. Finally, if transaction costs are severe, unified governance

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70 For a theoretic analysis of cooperation in long-term contracts, see Scott, Conflict, supra note 68, at 2005.

71 Macneil also notes that the relational contract theory is different from the model described by neoclassical contract law:

In the neoclassical system, the reference point for those questions about the change tends to be the original agreement. In a truly relational approach the reference point is the entire relation as it had developed at the time of the change in question (and in many instances, as it has developed since the change). This may or may not include an "original agreement," and if it does, may or may not result in great deference being given it.

Macneil, Adjustment, supra note 59, at 890.

structures begin to emerge. In a unified governance structure, market transactions give way to the firm's internal transfers. “In particular, when it is too costly for one party to specify a long list of the particular rights it desires over another party’s assets, then it may be optimal for the first party to purchase all rights except those specifically mentioned in the contract.”

The concept of vertical integration is most closely associated with the unified governance structure. Vertical integration occurs when a party places its assets under the control of another party. It involves “the elimination of contractual or market exchanges, and the substitution of internal exchanges within the boundaries of the firm.” By replacing market transfers with internal transfers, vertical integration minimizes transaction costs.

In summary, transaction cost economics identifies the existence

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73 Williamson, however, notes that “[t]he contention that transaction cost economizing is the main factor responsible for decisions to integrate does not preclude that there are other factors, several of which sometimes operate simultaneously.” WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 103.

74 According to Coase, [o]utside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs a production. It is clear that these are alternative methods of co-ordinating production.


of transaction costs in contractual arrangements and evaluates their impact. It suggests that contractual arrangements are typically incomplete because of transaction costs. As a result, the parties may face costly adjustments to address unforeseen contingencies. Alternatively, one party may seek to extract quasi-rents from other parties through opportunistic behavior. Transaction cost economics also suggests that the presence and intensity of transaction costs explain the variation in the governance structure of contractual arrangements.

3. TRANSACTION COST ECONOMICS AND INTERNATIONAL COOPERATION

The principles of transaction cost economics apply with equal rigor at the international level. "Virtually any relation, economic or otherwise, that takes the form of or can be described as a contracting problem can be evaluated to advantage in transaction cost terms." Like firms engaged in private contractual relations, states are involved in the negotiation and implementation of contractual arrangements. These arrangements are also subject to transaction costs. States cannot make exhaustive agreements that address every contingency that may arise in the course of their relationship. These negotiations would take many years, and the cost of such negotiations would be prohibitive. States also lack the information necessary to consider adequately all potential risk factors and developments.

The consequences of transaction costs on international institutions are twofold. First, states may face costly adjustments

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78 For examples of how political science scholars have consistently applied economic theory to the study of international relations, see KEOHANE, AFTER HEGEMONY, supra note 11, at 27-29; KENNETH WALTZ, THE THEORY OF INTERNATIONAL POLITICS 89-93 (1979); Duncan Snidal, The Game Theory of International Politics, 38 WORLD POL. 25, 31 (1985).

79 WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 387.


to address unforeseen contingencies. Second, states may seek to extract quasi-rents from other states through opportunistic behavior. Thus, the development and operation of international institutions may be affected by the presence of transaction costs. While states may be interested in developing institutions that promote cooperation, transaction costs may affect the development and operation of these institutions.

As already mentioned, transaction cost economics suggests that four governance structures develop in response to transaction costs: market, exogenous, endogenous, and unified governance. The discrete nature of market governance structures precludes their application to international agreements. Unlike domestic contractual arrangements where the specific identity of the parties may be insignificant, there are few, if any, international transactions where identities are of negligible importance. From security arrangements to economic accords, the identity of member states is an integral component of each agreement.

Similarly, the unified governance structure is inapplicable to most international agreements which, by their nature, apply between sovereign states. States fiercely protect their sovereignty and are hesitant to cede control to another state. Thus, governance structures at the international level typically involve either

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82 See WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 72-78. Friedrich Kratochwil suggested a comparable approach when he examined regimes and transaction costs. See Friedrich Kratochwil, Contract and Regimes: Do Issue Specificity and Variations of Formality Matter?, in REGIME THEORY AND INTERNATIONAL RELATIONS 73 (Volker Rittberger ed., 1995). Kratochwil distinguished five forms of contracts: the spot contract, the spot contract with sequential performance, the simple incomplete contract, the complex long-term contract, and a contract imposing obligations concerning an ongoing relationship. He suggested that regimes come closest to long-term incomplete contracts. See id. at 76.

83 Several forms of unified governance structures, however, have been suggested in international affairs. See GRENVILLE CLARK & LOUIS B. SOHN, WORLD PEACE THROUGH WORLD LAW (3d ed. 1966); INIS L. CLAUDE, JR., POWER AND INTERNATIONAL RELATIONS 255-71 (1962); KARL W. DEUTSCH ET AL., POLITICAL COMMUNITY AND THE NORTH ATLANTIC AREA (1957). Empires may also be viewed as a form of unified governance structure. See, e.g., MICHAEL W. DOYLE, EMPIRES 12 (1986) (arguing that an empire is “a system of interaction between two political entities, one of which, the dominant metropole exerts political control over the internal and external policy — the effective sovereignty — of the other, the subordinate periphery”); JACK SNYDER, MYTHS OF EMPIRE (1991) (providing domestic explanations for the rise and fall of empires).
exogenous or endogenous arrangements. This section examines how these two mechanisms function at the international level.

3.1. Exogenous Governance Structures

Exogenous governance structures address the problems raised by transaction costs by authorizing a third party to address any disputes or unforeseen developments that may arise in the course of the relationship. The third party acts as an independent actor with no interest in the substantive matter of the parties’ relationship. Exogenous structures can take several forms, including arbitration and judicial settlement.  

Exogenous governance structures apply the basic rules of the game to the myriad of unanticipated contingencies and disputes that may arise in the relationship. The inherent flexibility of these structures is one of their more powerful attributes. These structures can administer the rules developed by the parties, monitor adherence to these rules, and publicize transgressions. In order to succeed, the parties must recognize the binding nature of the decisions made by exogenous structures.

3.1.1. The European Union

The European Union’s (“EU”) legal system is illustrative of an exogenous governance structure in international affairs. Since

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84 For a detailed analysis of international dispute settlement, see J.G. MERRILLS, INTERNATIONAL DISPUTE SETTLEMENT (2d ed. 1991); DISPUTE SETTLEMENT IN PUBLIC INTERNATIONAL LAW (Karin Oellers-Frahm & Norbert Wühler eds., 1984).

85 Exogenous governance structures have been identified in a wide variety of settings throughout history. For an example of exogenous structures in medieval trade, see Avner Greif et al., Coordination, Commitment, and Enforcement: The Case of the Merchant Guild, 102 J. POL. ECON. 745 (1994); Paul Milgrom et al., The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs, 2 ECON. AND POL. 1 (March 1990).


87 For an analysis of different aspects of the EU legal system, see generally GORDON SLYNN, INTRODUCING A EUROPEAN LEGAL ORDER (1992) (describing several facets of the EU legal system); G. Federico Mancini, The Making of a Constitution for Europe, 26 COMMON Mkt. L. REV. 595, 595 (1989) (arguing that the European Community is a “peculiar form of international
its inception in 1957, the EU's legal system has played a decisive role in the development of European integration.\textsuperscript{88} The system consists of the national courts of member states, the Court of First Instance, and the European Court of Justice.\textsuperscript{89} If disputes arise in the interpretation of EU law, national courts are authorized to adjudicate the matter.\textsuperscript{90} In their analysis, national courts must recognize the supremacy of European law over inconsistent national law.\textsuperscript{91} Alternatively, if the matter involves disputes between member states or an EU institution (i.e., the European Commission, the European Parliament, or the Council of Ministers), the European Court of Justice adjudicates such matters.\textsuperscript{92} In either case, the European Court of Justice acts as the final arbiter of matters pertaining to European law.\textsuperscript{93}

The EU legal system functions as an exogenous governance structure for two reasons. First, members of the EU recognize the primacy of European law over national law. Second, the EU judiciary is empowered to adjudicate any matters pertaining to the EU. Thus, the EU legal system acts as an \textit{ex ante} safeguard to \textit{ex

组织[with a] . . unique institutional structure and . . unprecedented law-making and judicial powers"; J.H.H. Weiler, \textit{Journey to an Unknown Destination: A Retrospective and Prospective of the European Court of Justice in the Arena of Political Integration}, 31 J. COMMON MKT. STUD. 417, 419 (1993) ("Under the doctrinal perspective the political institutions of the Community (Commission, Council, Parliament) the governments of the Member States (and other actors within Member States), transnational interests and organizations constitute each, and together, \textit{objects of the Court's jurisprudence}"); J.H.H. Weiler, \textit{The Transformation of Europe}, 100 YALE L.J. 2403 (1991) [hereinafter Weiler, Transformation] (examining the development of the relationship between the EU and member states and the role of the EU legal structure).

\textsuperscript{88} For a general description of the European Union, see NEILL NUGENT, \textit{THE GOVERNMENT AND POLITICS OF THE EUROPEAN COMMUNITY} (1989); Weiler, \textit{Transformation}, supra note 87, at 2403.

\textsuperscript{89} See NUGENT, supra note 88, at 229-32. The Single European Act of 1986 authorized The Court of First Instance to assist the European Court of Justice in handling its case load. See \textit{id.} at 162.

\textsuperscript{90} See T.C. HARTLEY, \textit{THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW} 86 (2d ed. 1988); SLYNN, supra note 87, at 9.

\textsuperscript{91} The notion of supremacy was first enunciated by the European Court of Justice in Case 6/64, Costa v. ENEL 1964 ECR 585. See Eric Stein, \textit{Lawyers, Judges and the Making of a Transnational Constitution}, 75 AM. J. INT'L L. 1, 10-11 (1981).

\textsuperscript{92} See SLYNN, supra note 87, at 9.

\textsuperscript{93} See NUGENT, supra note 88, at 220-28.
post opportunism.94

In *International Cooperation and Institutional Choice*, Geoffrey Garrett examines the role of the European Community’s (“EC”) legal system in the development of the EC’s internal market as embodied in the 1987 Single European Act.95 According to Garrett, the decision to complete the European internal market by 1992 “may represent the most ambitious instance of multilateral cooperation since the construction of the post-World War II international order.”96 Garrett argues that the EC legal system played an important role in the successful implementation of the internal market. Specifically, the EC legal system mitigated the monitoring and incomplete contracting problems facing member states.97

As a preliminary matter, Garrett identifies the implications of transaction costs on international agreements. He states that conventional analyses of cooperation assume that community

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94 Ress, *supra* note 80, at 298-300 (“[T]he primacy of European Community law and the idea of the direct applicability of EEC Treaty provisions and secondary EEC law may be considered as first steps against ex-post opportunism.”).


members will agree on a comprehensive set of rules to govern all future interactions *ex ante*, and that compliance with and transgressions of these rules will be obvious. Garrett recognized, however, that both assumptions are often unwarranted.

One significant problem faced by EC states in monitoring compliance with EC obligations is the requirement that each participant know a great deal about the past behavior of the others for cooperation to evolve. The existence of multiple actors decreases the probability that states will know enough about the past behavior of other actors to make informed strategic choices. Garrett indicates that such uncertainty could inhibit the emergence of cooperation in the European Community: "Given the multitude and complexity of interactions in the EC ... it is a practical impossibility for all governments to know precisely whether actors have transgressed common agreements in the past." Since rule violations could not be effectively identified, there would be significant incentives to transgress such rules.

An additional impediment facing EC members is the problem of incomplete contracting. Exhaustive agreements that anticipate disputes in advance are costly, if not impossible. While EC members recognized the benefits of agreeing *ex ante* on the set of rules to govern every possible contingency, such action was infeasible.

Garrett suggests that the EC legal system resolved these two fundamental problems. First, the EC legal system established a monitoring system to ensure compliance with EC legislation. The legal system was authorized to adjudicate matters pertaining to the European Community, and both public and private parties were authorized to bring lawsuits to enforce EC legislation. According to Garrett, a legal system that regulates the behavior of participants and identifies transgressions of agreed upon rules contributes to the force of cooperative agreements.

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98 See Garrett, *Cooperation*, supra note 95, at 557.
99 See *id.* at 539.
100 *Id.* at 557.
101 See *id.*
102 See *id.* Garrett recognized that, [i]nstitutions that monitor the behavior of parties to a cooperative agreement and identify their transgressions are likely to be vital to the retaliatory and reputational processes that undergird the logic of the iterated prisoners' dilemma. In the context of the EC, therefore, one
of the European Community recognized the limitations of purely legislative efforts to address every possible future contingency. Rather than attempting to do this, they made agreements that only sketched the broad "rules of the game." The EC legal system, including the courts of member states and the European Court of Justice, then applied and adapted these rules to specific cases. Accordingly, Garrett indicates that "[t]he EC legal system provides a mechanism through which the types of general agreements about the rules of the game supplied by the EC treaties and internal market directives can be applied to the myriad interactions that constitute the EC economy." Through this process, the EU legal system acts as an exogenous governance structure to minimize the problems raised by transaction costs at the international level.

3.2. Endogenous Governance Structure

In contrast to exogenous governance structures, endogenous structures allow states to address the problems raised by transaction costs within the context of their relationship. Unlike exogenous structures, endogenous structures do not rely upon a third party or other outside mechanism to resolve disputes. Rather, disputes are resolved by the parties within the course of their relationship.

The concept of endogenous governance structures is consistent

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Id. at 540-41 (citation omitted).

103 Id. at 557.

104 See id.

105 Id. at 558. In their analysis of legal integration in the European Community, Mattli and Slaughter agree that "the member states of the European Community, like parties to any international bargain, would prefer a functioning court to resolve disputes, fill in missing contract terms, and hold parties to their word. Such preferences keep courts in business the world over, domestically and internationally." Mattli & Slaughter, A Reply, supra note 97, at 184. They disagree, however, on the judicial decision-making process and the nature of state interests that the European Court of Justice takes into account. See id.

with transaction cost economics, which recognizes the advantages of informal structures over more formal and structured mechanisms for dispute settlement.\textsuperscript{107} Indeed, endogenous governance is "based on empirical evidence and growing sentiment among legal scholars and practitioners that legal centralism places far too much emphasis on formal written contracts and their effective adjudication in courts of law."\textsuperscript{108} Rather, transaction cost economics focuses "on 'private ordering' and the concept of 'contract as framework.'"\textsuperscript{109} Unlike formal adjudication, informal governance structures are not confrontational in nature. By emphasizing the relationship, they encourage cooperation rather than conflict. Informal structures are also more flexible than the adjudicatory process. They offer a quicker solution than more formalized dispute settlement mechanisms can provide.

\textsuperscript{107} The concept of endogenous governance structures is also consistent with the concept of tacit bargaining, which recognizes the advantages of informal practice over formal negotiations. See GEORGE W. DOWNS & DAVID M. ROCKE, TACIT BARGAINING, ARMS RACES, AND ARMS CONTROL (1990). As Downs and Rocke state:

[t]acit bargaining takes place whenever a state attempts to influence the policy choices of another state through behavior, rather than by relying on formal or informal diplomatic exchanges. The process is tacit because actions, rather than rhetoric, constitute the critical medium of communication. It is bargaining and not coercion because the actions are aimed at influencing an outcome that can only be achieved through some measure of joint voluntary behavior.

\textit{Id.} at 3.

Tacit bargaining has several advantages over more formal behavior. For example, formal negotiations are often lengthy and complex. In addition, formal negotiations have difficulty coping with constantly evolving environments. In particular, formal negotiations cannot handle technological innovations as well as tacit bargaining. On the other hand, "[t]acit bargaining is flexible enough to permit the kind of dynamic adjustments that are necessary to cope with changes in technology and leadership." \textit{Id.} at 14.

Tacit bargaining, however, also faces certain limitations. The actions of tacit bargaining are potentially more costly than the talk of formal negotiations. In addition, "[t]acit bargaining by its very nature changes the status quo and, when unsuccessful, produces a situation that is less desirable from the standpoint of one or both parties." \textit{Id.} at 15 (emphasis omitted).

Endogenous governance structures are also consistent with common pool resource management described by Ostrom. See OSTROM, supra note 12, at 15-21, 88-102.

\textsuperscript{108} Yarbrough & Yarbrough, Institutions, supra note 23, at 255. In addition, "formal structures represent only one part of the network or web of interactions that comprise political and economic behavior." \textit{Id.} at 257.

\textsuperscript{109} \textit{Id.} at 255 (citation omitted).
The concept of endogenous governance structures is also consistent with relational contract theory. In these types of contracts, "discrete practices, like breach and litigation, have been replaced by adjustment within social and political processes largely separate from the positive legal institutions of the state." Gidon Gottlieb criticizes the approach of traditional legal theory which suggests that sustained relationships require exogenous pressure to ensure compliance, stating, "[t]his point of view is incomplete and fails to explain how the rules function as rules for the entities that are engaged in sustained and durable relationships." In Understanding Dynamic Obligations, Edwin Smith examines the development of endogenous governance structures in the realm of arms control. Specifically, Smith examines the development of arms control agreements between the United States and the former Soviet Union that established dynamic obligations between the parties. These agreements were structured to create evolving commitments and to allow consensual changes in the obligations imposed in order to fulfill the object of the treaty in uncertain or unpredictable conditions. They forgo the use of exogenous structures to resolve disputes or address unforeseen contingencies. Rather, these agreements facilitate the ability of the parties to address unforeseen contingencies and resolve disputes as they arise.

According to Smith, international cooperation is difficult to achieve because states face both the collective action problem and uncertainty. The collective action problem reduces the likelihood of international cooperation because states will seek to maximize individual welfare even at the expense of joint gains. Specifically, the collective action problem suggests that rational, self-interested actors will not contribute to cooperative action if they are able to reap the benefits of cooperation without contributing to its development. In addition, parties to international

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110 Palzer, supra note 72, at 730 (citation omitted).
111 Gottlieb, supra note 68, at 574.
112 Smith, supra note 6.
113 See id. at 1560.
114 See id. at 1559.
115 See id.
116 See OLSON, supra note 12, at 14-16.
agreements face numerous uncertainties in drafting their agreements.\textsuperscript{117} First, economic and technological conditions are likely to change as the agreement evolves. Although states may predict gains from cooperation, "they cannot evaluate the character of those gains because of uncertainty about the course of economics or technology."\textsuperscript{118} Second, states may lack important information relative to the agreement.\textsuperscript{119} Third, states may be uncertain as to the level of risk they face.\textsuperscript{120} Fourth, while states may recognize the advantages of cooperation, they may be uncertain regarding how to coordinate their efforts.\textsuperscript{121} In each of these situations, uncertainty complicates the problem of coordinating collective action in response to shared risks.\textsuperscript{122}

Smith suggests that "[f]ormal agreements that create dynamic obligations provide one mechanism for coping with the combination of uncertainty and collective action problems."\textsuperscript{123} These agreements are structured to create evolving commitments and provide for consensual changes in the obligations imposed in order to satisfy the purpose of the treaty in uncertain conditions.\textsuperscript{124} Specifically, "[d]ynamic obligations arise under agreements that allow the parties to mutually adjust commitments while maintaining a shared perception of reciprocal responsibility."\textsuperscript{125} The formal nature of the agreement increases the binding character of the commitment.\textsuperscript{126} The dynamic nature of the agreement encourages cooperation, even after the original terms of the agreement prove to be inadequate.\textsuperscript{127}

In developing the concept of dynamic obligations, Smith refers to analogous arrangements in the fields of domestic contract law and international relations: relational contract theory and the

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\textsuperscript{117} See Smith, supra note 6, at 1557-559.
\textsuperscript{118} Id. at 1557.
\textsuperscript{119} See id. at 1558.
\textsuperscript{120} See id.
\textsuperscript{121} See id. at 1559.
\textsuperscript{122} See id.
\textsuperscript{123} Id. at 1560.
\textsuperscript{124} See id. at 1557.
\textsuperscript{125} Id.
\textsuperscript{126} See id. at 1560, 1574.
\textsuperscript{127} See id. at 1560.
\end{small}
theory of international regimes. Relational contract theory emphasizes the importance of the underlying relationship in the contractual setting and suggests that parties will seek to resolve disputes informally rather than through the legal process. Smith suggests that “theories of domestic law developed to distinguish long-term, interactive relational contracts from contracts that involve a discrete transaction contribute to the analysis of treaties that create dynamic obligations.” Similarly, the theory of international regimes describes how regularized patterns of state behavior can facilitate cooperation among egoistic actors in a decentralized international system. Regimes are defined as “principles, norms, rules and decision-making procedures around which actor expectations converge . . . .” They increase the likelihood of cooperation by generating predictable patterns of behavior. According to Smith, regimes provide a foundation for the development of dynamic obligations at the international level. When regimes develop “treaties generating dynamic obligations may provide the most appropriate formalized statements that can be constructed, because they allow the development of custom, usage and practice.” Through the formal and informal network developed by international regimes, the development of dynamic relations is facilitated.

After developing the concept of dynamic obligations, Smith then applies it to examine several arms control agreements, such as the agreements resulting from the SALT/START process.

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128 See id. at 1583-95.
129 See id. at 1587-88.
130 Smith, supra note 6, at 1590.
131 See generally INTERNATIONAL REGIMES (Stephen D. Krasner ed., 1983) (containing several essays which describe the concept of international regimes from different theoretical views); Robert O. Keohane, The Demand for International Regimes, 36 INT’L ORG. 325 (1982) (analyzing regime theory through a rational choice analysis).
133 Specifically, regimes facilitate the development of international agreements and, therefore, international cooperation by “raising the anticipated costs of violating others’ property rights, by altering transaction costs through the clustering of issues, and by providing reliable information to members.” KEOHANE, AFTER HEGEMONY, supra note 11, at 97.
134 Smith, supra note 6, at 1593.
135 See id. at 1598.
The SALT/START arms control agreements did not rely upon an independent legal system or some form of third-party dispute settlement. Rather, the dynamic structure of these arms control agreements replaced the need for exogenous structures.

The success of the SALT/START process can be attributed to its dynamic character. The parties shared a common understanding of the purpose of their relationship and its related agreements. In addition, the parties developed specific verification mechanisms to increase their confidence in the agreements. For example, the Anti-Ballistic Missile Treaty established the Standing Consultative Commission ("SCC") to "promote the objectives and implementation of . . . this Treaty." Its purpose was to facilitate the exchange of information between the parties and address any disputes that arise. Similarly, the Intermediate-Range Nuclear Forces Treaty established the Special Verification Commission ("SVC") to "promote the objectives and implementation of the provisions of this Treaty." Its purpose was to "resolve questions relating to compliance with the obligations

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136 Id. at 1598.

The regime was based on principles and norms that included a shared understanding of the need to stabilize strategic parity, the recognition of the existence of mutual deterrence, the awareness of the likelihood that unilateral measures would lead to decreased security at greater cost, and the acceptance of need for a balance between offense and defense.

Id.; see also Condoleezza Rice, SALT and the Search for a Security Regime, in U.S.-SOVIET SECURITY COOPERATION 293 (Alexander L. George et al. eds., 1988) (examining the SALT/START process in light of regime theory).


assumed; and ... agree upon such measures as may be necessary to improve the viability and effectiveness of this Treaty."\textsuperscript{140} According to Smith, the SALT/START institutional structures replaced third-party dispute resolution for arms control agreements.\textsuperscript{141} Interestingly, Williamson viewed the Standing Consultative Commission as an example of an endogenous governance structure: \textsuperscript{142}

The SCC is not an independent third party, and it has no authority with respect to enforcement; rather, it is a forum in which the two parties can meet to work out ambiguities stemming from the implementation of arms control treaties. Plainly the SCC is an instrument of private ordering, there being no legal forum to which the parties would be willing to present their concerns and contest differences.\textsuperscript{143}

Smith's analysis of dynamic obligations describes how endogenous governance structures address the problems of transaction costs. Unlike formal legal commitments that have difficulty responding to the uncertainty that is inherent in international affairs, dynamic obligations establish networks of related and mutually reinforcing commitments that allow for flexibility and durability in the international sphere.\textsuperscript{144} Indeed, in an area as sensitive as nuclear arms control, states would be particularly hesitant to recognize the decisions of an exogenous

\textsuperscript{140} Id. at art. XIII, para. 1, a-b.
\textsuperscript{141} See Smith, supra note 6, at 1601.
\textsuperscript{142} See Oliver Williamson, The Firm as a Nexus of Treaties: An Introduction, in THE FIRM AS A NEXUS OF TREATIES 4 (Masahiko Aoki et al. eds., 1990). In this edited volume, several scholars, including Williamson, questioned whether the firm should continue to be viewed as a nexus of contracts. They viewed this perception as unduly rigid. It suggested a legal centralism to contractual relations that did not really exist and also emphasized the role of legal sanctions over private ordering. These scholars suggested replacing the term “nexus of contract” with “nexus of treaty”: “The substitution of the term treaty for contract brings private ordering forcefully to the fore.” Id. But see Yarbrough & Yarbrough, International Contracting, supra note 23, at 242 (calling contracts legally enforceable agreements).
\textsuperscript{143} Williamson, The Firm as a Nexus of Treaties: An Introduction, supra note 142, at 4 (citation omitted).
\textsuperscript{144} See Smith, supra note 6, at 1605-06.
institution. As Smith notes, "parties to arms control agreements will not rely upon dispute resolution by neutral tribunals."

3.3. Summary

Both exogenous and endogenous governance structures address the problems raised by transaction costs. However, the development of exogenous structures at the international level suffers from several limitations. First, an exogenous structure requires states to cede certain levels of sovereignty to a third party. In a decentralized international system states are reluctant to take such action. The Prisoners’ Dilemma reveals how the structural constraints of a decentralized system can lead states to fear the consequences of defection by other states. As a result, states will be reluctant to enter into agreements which require the transfer of sovereignty or limit their freedom of action. Second, an exogenous governance structure requires a formal and sophisticated mechanism to function effectively. Effective management of such a complex and tightly coupled system, however, is often difficult to achieve. Third, if a neutral third party issues a ruling, it may still require the offending party take action to correct its own behavior. Even those treaties that afford an "independent third party or organ (arbitration or court) to settle disputes, by rendering a binding interpretation of a disputed treaty clause of provisions, are not always able to yield a conclusive

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145 Id. at 1551.
solution."\textsuperscript{149} Thus, the determination of legal liability does not automatically resolve disputes. Fourth, exogenous responses may give rise to retaliation by the punished state. Accordingly, states must consider the costs of such retaliation.\textsuperscript{150} For these reasons, it has been suggested that treaties should be drafted in a way that allows for self-implementation without the need for control measures such as subsequent enforcement.\textsuperscript{151} Endogenous governance structures do not suffer from these limitations. Unlike exogenous structures, endogenous structures do not rely upon a third party. Rather, they encourage parties to resolve disputes and address unforeseen contingencies within the course of their relationship. This method is consistent with transaction cost economics, which recognizes the importance of informal institutions in resolving problems of transaction costs.\textsuperscript{152} Informal institutions are preferable to formal legal structures, which may be incomplete and misleading due to a lack of effective enforcement of rules assumed by the formal approach.\textsuperscript{153} Indeed, Williamson recognized the need for such specialized governance structures within treaties:

The limits of legal centralism being so transparent for treaties — since the parties may refuse a legal forum and/or ignore legal sanctions — there is a clear need from the outset for the parties to craft specialized governance structures within which to embed a treaty.\textsuperscript{154}

\textsuperscript{149} Ress, \textit{supra} note 80, at 293.

\textsuperscript{150} See CHAYES & CHAYES, \textit{supra} note 26, at 105; AXELROD, \textit{EVOLUTION}, \textit{supra} note 15, at 183. Abram Chayes and Antonia Chayes add that "in bilateral relationships like arms control and trade, the risk of setting off 'a long echo of alternating retaliations' will often dwarf the consequences of overlooking what are arguably relatively minor or 'technical' violations." CHAYES & CHAYES, \textit{supra} note 26, at 105 (footnote omitted).

\textsuperscript{151} See Williamson, \textit{The Firm as a Nexus of Treaties: An Introduction}, \textit{supra} note 142, at 4.

\textsuperscript{152} See \textit{id.} at 164-66; see also Joskow, \textit{supra} note 53, at 39 (stating that transaction cost economics recognizes "that there is a strong incentive to structure contracts to minimize reliance on the legal system (which is costly and confronts grave difficulties in distinguishing promised behavior from 'bad behavior')").

\textsuperscript{153} See Yarbrough & Yarbrough, \textit{Institutions}, \textit{supra} note 23, at 257.

\textsuperscript{154} Williamson, \textit{The Firm as a Nexus of Treaties: An Introduction}, \textit{supra} note 142, at 4.

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While exogenous governance structures can play a role in mitigating the problems raised by transaction costs, endogenous structures are the focus of this article.

4. STATE PRACTICE IN INTERNATIONAL LAW

A fundamental principle of international law facilitates the development of endogenous governance structures — the concept of state practice. The concept of state practice is found in the two principal sources of international law: customary international law and treaty law.155

4.1. Customary International Law

According to international law, continuous and long-standing state practice may develop into customary international law and be considered legally binding on those states that acquiesce in its formation and development.156

Article 38(1)(b) of the Statute of the International Court of

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155 In addition to customary international law and treaty law, there are several other sources of international law. Article 38 of the Statute of the International Court of Justice provides:

1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

   (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
   (b) international custom, as evidence of a general practice accepted as law;
   (c) the general principles of law recognized by civilized nations;
   (d) subject to the provision of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

2. This provision shall not prejudice the power of the Court to decide a case ex aequo et bono, if the parties agree thereto.


156 See generally IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 4-11 (4th ed. 1990) (discussing the elements and effects of custom); BRIERLY, supra note 27, at 59-62 (detailing the ubiquitous role of custom); Josef L. Kunz, The Nature of Customary International Law, 47 AM. J. INT’L L. 662-69 (1953) (examining early attempts in the literature to address the problems inherent to acknowledging customary international law).
Justice defines international custom as "evidence of a general practice accepted as law." According to the Restatement (Third) of the Foreign Relations Law of the United States ("Restatement"), "[c]ustomary international law results from a general and consistent practice of states followed by them from a sense of legal obligation." The basis of customary international law, therefore, is the notion "that states in and by their international practice may implicitly consent to the creation and application of international legal rules." Customary international law can arise in three separate contexts: it can develop to create new international law, supersede prior customary law, or supersede prior treaty law.

The sources of customary international law are found in state practice. The numerous sources of custom include: diplomat-
ic correspondence, policy statements, press releases, the opinions of legal advisers, official manuals on legal questions, executive decisions and practices, orders to naval forces, international and national judicial decisions, treaty provisions, and other international obligations.\textsuperscript{162} The Restatement notes that the practice of states may include diplomatic acts and instructions, public measures, other governmental acts, and official statements of policy, whether such acts and statements are independent or undertaken in cooperation with other states.\textsuperscript{163} In addition to these traditional sources, omission and silence may be considered relevant in the development of customary international law. State inaction may imply ratification through acquiescence.\textsuperscript{164} The decisions of both the Permanent Court of International Justice ("PCIJ") and the International Court of Justice ("ICJ") suggest that the failure of a state to take certain action may be deemed relevant in determining the status of customary international law.\textsuperscript{165}

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\textbf{Norwegian Fisheries} case, Judge Read of the ICJ stated:

"Customary international law is the generalization of the Practice of States. This cannot be established by citing cases where coastal States have made extensive claims, but have not maintained their claims by the actual assertion of sovereignty over trespassing foreign ships... The only convincing evidence of State practice is to be found in seizures, where the coastal State asserts its sovereignty over trespassing ships."

Anglo-Norwegian Fisheries (U.K. v. Nor.), 1951 I.C.J. 116, 191 (Dec. 18); see also \textit{MARK E. VILLIGER, CUSTOMARY INTERNATIONAL LAW AND TREATIES}, 4-9 (1985) (explaining that verbal expressions alone are insufficient to forge state practice). Despite these assertions attesting to the primacy of physical acts over other demonstrative actions, this view remains the minority position.

\textsuperscript{162} See \textit{BROWNIE}, \textit{supra} note 156, at 5. The ICJ has noted that the form of the protest is not decisive and that "the sole relevant question is whether the language employed in any given declaration does reveal a clear intention." Temple of Preah Vihear (Cambodia v. Thail.), 1961 I.C.J. 17, 32 (May 26).


\textsuperscript{165} In the \textit{Lotus} case, the PCIJ examined whether Turkey could exercise criminal jurisdiction to prosecute a French citizen for acts committed on the
There are two principal elements to customary international law. First, state practice must be consistent. Second, state practice must develop out of a sense of legal obligation.

4.1.1. Consistency of State Practice

Consistency of state practice is essential for the development of customary international law. The emphasis on consistency is based on the notion that customary international law depends upon its regular observance in practice.\(^{166}\)

The ICJ examined the relevance of consistency in the development of customary international law in the *Asylum* case.\(^{167}\) In this case, a Peruvian political leader sought and received political asylum in the Colombian Embassy in Lima, Peru. Peru, however, refused to recognize his classification as a political refugee by the Colombian government. After diplomatic negotiations failed to resolve the crisis, the matter was referred to the ICJ.\(^{168}\)

In proceedings before the ICJ, Colombia argued that, as the state granting asylum, it "[w]as competent to qualify the nature of the offense by a unilateral decision binding on Peru."\(^{169}\) Colombia based this assertion on several international agreements and on customary international law.\(^{170}\) Specifically, it invoked "American international law in general," arguing the existence of a

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\(^{166}\) The duration, frequency, uniformity, and generality of a practice provide evidence of consistency. See BROWNLIE, *supra* note 156, at 5-6.

\(^{167}\) Asylum (Colom. v. Peru), 1950 I.C.J. 266 (Nov. 20).

\(^{168}\) See *id*.

\(^{169}\) *Id.* at 274.

\(^{170}\) Colombia referred to the 1928 Havana Convention on Asylum and the 1933 Montevideo Convention on Political Asylum. See *id.* at 275, 276.
regional custom peculiar to Latin-American states.¹⁷¹

In its analysis, the ICJ noted that a party that relies on a custom must prove: (1) that it is established in such a manner that it has become binding on the other party, and (2) that the rule is in accordance with a constant and uniform usage practiced by the states in question.¹⁷² After examining state practice in the realm of diplomatic asylum, the ICJ refused to acknowledge that the Colombian position had developed into a customary rule of international law. According to the ICJ:

The facts brought to the knowledge of the Court disclose so much uncertainty and contradiction, so much fluctuation and discrepancy in the exercise of diplomatic asylum and in the official views expressed on various occasions, there has been so much inconsistency in the rapid succession of conventions on asylum ratified by some States and rejected by others, and the practice has been so much influenced by considerations of political expediency in the various cases, that it is not possible to discern in all this any constant and uniform usage, accepted as law, with regard to the alleged rule of unilateral and definitive qualification of the offence.¹⁷³

Thus, the ICJ concluded that the Colombian government failed to prove the existence of a customary rule of international law.

In addition, the ICJ indicated that even if a customary rule of international law had developed, Peru could not be bound by such a rule:

But even if it could be supposed that such a custom existed between certain Latin-American States only, it could not be invoked against Peru which, far from having by its attitude adhered to it, has, on the contrary, repudiated it by refraining from ratifying the Montevideo Conventions of 1933 and 1939, which were the first to include a rule

¹⁷¹ Id. at 276.
¹⁷² See id. at 276-77.
¹⁷³ Id. at 277.
concerning the qualification of the offence in matters of diplomatic asylum.\textsuperscript{174}

Thus, the ICJ ruled that "Colombia, as the State granting asylum, is not competent to qualify the offence by a unilateral and definitive decision, binding on Peru."\textsuperscript{175} This analysis suggests that the development of customary international law may be successfully challenged by states that continuously object to its formation.\textsuperscript{176} When the acts of some states encounter protests from other states, these acts and protests often cancel each other out.\textsuperscript{177}

Lassa Oppenheim defines protest as "a formal communication from one State to another that it objects to an act performed, or contemplated, by the latter."\textsuperscript{178} I.C. MacGibbon provides a more elaborate definition which describes a protest as:

[A] formal objection by which the protesting State makes it known that it does not recognize the legality of the acts against which the protest is directed, that it does not acquiesce in the situation which such acts have created or which they threaten to create, and that it has no intention

\textsuperscript{174} See \textit{id.} at 278. The ICJ acknowledged that a special custom can develop among a small group of states. See \textit{id.}

Whereas general customary law applies to all states, special custom applies to a limited group of states. Examples of special custom include nongeneralizable topics such as title to territorial areas or rules expressly limited to countries of a certain region. See generally D'AMATO, \textit{CONCEPT OF CUSTOM}, supra note 161, at 234-36 (comparing general and special customary law); Anthony A. D'Amato, \textit{The Concept of Special Custom in International Law}, 63 Am. J. Int'l L. 211 (1969) (explaining World Court decisions in relation to the differences between general and special customary law).

\textsuperscript{175} 1950 I.C.J. at 278.


D'Amato has argued that the persistent objector rule only applies in the case of special custom. See D'AMATO, \textit{CONCEPT OF CUSTOM}, supra note 161 at 233-62.

\textsuperscript{177} See AKEHURST, supra note 161, at 28.

of abandoning its own rights in the premises.\textsuperscript{179}

Thus, a protest serves three purposes: to challenge the development of customary international law, to enable a state to escape from being bound by the development of an emerging norm of international law, and to provide a state with the opportunity to promote the acceptance of its own viewpoints as to the proper status of the law.\textsuperscript{180}

The ICJ has acknowledged the use of protest by a state to successfully challenge the development of customary international law. In the \textit{Anglo-Norwegian Fisheries} case,\textsuperscript{181} the Norwegian government promulgated a decree delimiting the Norwegian fisheries zone. The zone reserved fishing rights exclusively for Norwegian nationals. Numerous incidents occurred in which British trawlers were detained for fishing in the self-proclaimed Norwegian zone. After diplomatic negotiations failed to resolve the matter, it was referred to the ICJ.

In these proceedings, the United Kingdom argued that the lines of delimitation of the Norwegian fisheries zone were not drawn in accordance with the applicable rules of international law. Specifically, customary international law provided that the length of any straight lines drawn to determine maritime boundaries must not exceed ten sea miles. In response, the Norwegian government argued that its own system of delimitation conformed with the requirements of international law.\textsuperscript{182}

In its analysis, the ICJ noted that the adoption of the ten-mile rule was not uniform. Although certain states included the rule in their national law and in their treaties, and although arbitral decisions applied it, other states adopted a different limit.\textsuperscript{183} Thus, the ten-mile rule had not become a rule of customary international law. Moreover, the ICJ indicated that "[i]n any event the ten-mile rule would appear to be inapplicable as against Norway inasmuch as she has always opposed any attempt to apply


\textsuperscript{181} \textit{Anglo-Norwegian Fisheries} (U.K. v. Nor.), 1951 I.C.J. 116 (Dec. 18).

\textsuperscript{182} See id. at 126.

\textsuperscript{183} See id. at 131.
it to the Norwegian coast. Thus, the ICJ held that Norway's decree delimiting the fisheries zone did not contradict international law.

4.1.2. Opinio Juris

In addition to the consistency of state practice, the development of customary international law requires that states follow the practice out of a sense of legal obligation (opinio juris). The concept of opinio juris provides a qualitative element to the development of customary international law. As noted in the Restatement, "a practice that is generally followed but which states feel legally free to disregard does not contribute to customary law." Thus, for a state to be bound by the development of a customary norm of international law, it must knowingly and willingly accept the developing norm.

The PCIJ first enunciated the doctrine of opinio juris in the Lotus case. In the Lotus case, a French mail steamer collided with a Turkish collier, killing eight Turkish citizens. The French officer responsible for keeping watch on the French steamer was tried and convicted for negligence by a Turkish court. France immediately protested, arguing that Turkey had no authority to prosecute the French officer. It challenged Turkey's action as a violation of international law. Subsequently, the French and Turkish governments agreed to submit their dispute to the PCIJ.

The PCIJ examined "whether there are any rules of international law which may have been violated by the prosecution in

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184 Id.
185 See id. at 143.
187 RESTATEMENT, supra note 158, § 102 cmt. c.
188 Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 9, at 4 (Sept. 7).
189 See id. at 10-12. The French officer was sentenced to 80 days imprisonment and a fine. See id. at 11.
190 See id. at 11-12.
pursuance of Turkish law of Lieutenant Demons.”

In these proceedings, France argued that a customary rule of international law had developed regarding criminal prosecution over acts committed aboard vessels on the high seas. Since states had abstained from exercising jurisdiction over such criminal acts, France argued that this practice had developed into a customary norm prohibiting the exercise of jurisdiction. The PCIJ found such evidence of state action insufficient:

Even if the rarity of the judicial decisions to be found among the reported cases were sufficient to prove in point of fact the circumstance alleged by the Agent for the French Government, it would merely show that States had often, in practice, abstained from instituting criminal proceedings, and not that they recognized themselves as being obliged to do so; for only if such abstention were based on their being conscious of having a duty to abstain would it be possible to speak of an international custom.

The ICJ reiterated the doctrine of opinio juris in the North Sea Continental Shelf cases. In these cases, a dispute arose among Germany, Denmark, and the Netherlands regarding the boundaries of their respective areas of the continental shelf in the North Sea. Denmark and the Netherlands argued that the principle of

191 Id. at 18.
192 See id. at 21-22.
193 Id. at 28.
194 North Sea Continental Shelf (F.R.G. v. Den./Neth.), 1969 I.C.J. 4 (Feb. 20). Similarly, in the Case Concerning Military and Paramilitary Activities in and Against Nicaragua, the ICJ noted that:

[For a new customary rule to be formed, not only must the acts concerned ‘amount to a settled practice,’ but they must be accompanied by the opinio juris sive necessitatis. Either the States taking such action or other States in a position to react to it, must have behaved so that their conduct is ‘evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e., the existence of a subjective element, is implicit in the very notion of the opinio juris sive necessitatis.’]

equidistance for the purpose of maritime boundary delimitation, as codified in the 1958 Geneva Convention on the Continental Shelf, was a customary rule of international law and, therefore, applied to Germany.\textsuperscript{195} In contrast, Germany argued that the equidistance method was not a rule of customary international law. Rather, Germany stated that it “should have a ‘just and equitable share’ of the available continental shelf, in proportion to the length of its coastline or sea-frontage.”\textsuperscript{196}

The ICJ examined whether the equidistance principle for the delimitation of the continental shelf was applicable to Germany. First, it noted that Germany had never ratified the 1958 Convention and, therefore, was not bound by its provisions. Similarly, the ICJ concluded that Germany had not subsequently manifested its acceptance of the equidistance delimitation principle. The ICJ then examined whether the equidistance principle had become a rule of customary international law, binding on all states. To this end, it examined state practice:

The essential point in this connection — and it seems necessary to stress it — is that even if these instances of action by non-parties to the Convention were much more numerous than they in fact are, they would not, even in the aggregate, suffice in themselves to constitute the \textit{opinio juris}; — for in order to achieve this result, two conditions must be fulfilled. Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e. the existence of a subjective element, is implicit in the very notion of the \textit{opinio juris sive}

\textsuperscript{195} The position of Denmark and the Netherlands was:

\textit{[T]he use of this method is not in the nature of a merely conventional obligation, but is, or must now be regarded as involving, a rule that is part of the corpus, of general international law; — and, like other rules of general or customary international law, is binding on the Federal Republic of Germany automatically and independently of any specific assent, direct or indirect given by the latter.}

\textsuperscript{196} \textit{Id.} at 21.
necessitatis.\textsuperscript{197}

In other words, states must feel that they are conforming to a legal obligation. Indeed,

[...]he frequency, or even habitual character of the acts is not in itself enough. There are many international acts, e.g. in the field of ceremonial and protocol, which are performed almost invariably, but which are motivated only by considerations of courtesy, convenience, or tradition, and not by any sense of legal duty.”\textsuperscript{198}

Applying this principle to the facts of the case, the ICJ determined that the use of the equidistance principle for the delimitation of the continental shelf had not developed into a rule of customary international law.\textsuperscript{199} Thus, the use of the equidistance delimitation principle was not obligatory.

4.1.3. Summary

In summary, state practice plays an integral role in the development of customary international law. Indeed, the concept of state practice in the development of customary international law is consistent with the positivist theory of international law — states create international law and, therefore, can only be bound by their consent.\textsuperscript{200}

\textsuperscript{197} Id. at 45.
\textsuperscript{198} Id.
\textsuperscript{199} See id. at 46.
\textsuperscript{200} See, e.g., FRANCIS ANTHONY BOYLE, WORLD POLITICS AND INTERNATIONAL LAW 18-19 (1985) (discussing turn-of-the-century international legal positivist theories); JULIUS STONE, LEGAL CONTROLS OF INTERNATIONAL CONFLICT 12-13 (1954) (discussing Hugo Grotius' notions of international law); Roberto Ago, Positive Law and International Law, 51 AM. J. INT'L L. 691, 719 (1957) (describing the development of positive international law); Roberto Ago, Positivism, in 7 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 385 (1984) (defining positivism); L. Oppenheim, The Science of International Law: Its Task and Method, 2 AM. J. INT'L L. 313, 332-33 (1908) (distinguishing international law, which must be consented to, and municipal law, which can be imposed from above).

This position is by no means uncontroverted. Several scholars have questioned the role of state consent in the development of customary international law. See, e.g., I.M. Lobo de Souza, The Role of State Consent in the
4.2. International Treaties

Along with customary international law, international treaties are considered a principal source of international law.\(^{201}\) Treaties can both codify existing customary international law and create new sources of international law.\(^{202}\) Similar to its role in the development of customary international law, state practice plays an important role in defining international treaties.

According to Lord McNair, it is well-settled that when there is a doubt as to the meaning of a provision or an expression contained in a treaty, the relevant conduct of the contracting parties after the conclusion of the treaty (sometimes called "practical construction") has a high probative value as to the intention of the parties at the time of its conclusion. This is both good sense and good law.\(^{203}\)

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\(^{202}\) See RESTATEMENT, supra note 158, § 102(3) ("International agreements create law for the states parties thereto and may lead to the creation of customary international law when such agreements are intended for adherence by states generally and are in fact widely accepted.").


A review of international legal practice attests to the importance attached to state practice in the interpretation of treaties.204

For example, in the 1911 Chamizal arbitration case, the United States and Mexico disputed the title of the Chamizal tract, a territory bordering the two countries.205 In 1848 and 1853, the United States and Mexico signed agreements designating the middle of the Rio Grande as the legal boundary between the two countries.206 Subsequent changes in the course of the Rio Grande, however, altered the territory of each country and placed the ownership of the Chamizal tract in dispute.207 The Mexican government argued that the treaties had established a fixed and invariable boundary that could not be altered by the alluvial process.208 In contrast, the United States argued that the international boundary followed the course of the river; thus, the Rio Grande should continue to function as the border.209 Unable to resolve the matter through diplomatic channels, the parties referred the case to the International Boundary Commission.210

204 Other legal scholars have reiterated this principle. For example, Fitzmaurice indicated that:

[It] is difficult to deny that the meaning of a treaty, or some part of it . . . may undergo a process of change or development in the course of time. Where this occurs, it is the practice of the parties in relation to the treaty that effects, and indeed is, that change or development. . . . For what is here in question is not so much the meaning of an existing text, as a revision of it, but a revision brought about by practice or conduct, rather than effected by and recorded in writing.


205 See The Chamizal Arbitration between the United States and Mexico, 5 AM. J. INT’L L. 782, 783, 786 (1911) [hereinafter Chamizal].


207 See Chamizal, supra note 205, at 791.

208 See id.

209 See id.

210 The parties referred the case to the International Boundary Commission on two occasions. On the first occasion, the two members of the Commission were unable to agree on a decision. As a result, the United States and Mexico agreed to enlarge the Commission to include a third Commissioner. It was mutually decided that a Canadian jurist would be the third Commissioner. The decision of the Commission could be rendered unanimously or by majority
The Commission examined the language of the 1848 and 1853 agreements as well as the subsequent course of conduct of the United States and Mexico to determine whether the parties intended the Rio Grande to serve as a fixed line boundary.\textsuperscript{211} It concluded that:

On the whole, it appears impossible to come to any other conclusion that the two nations have, by their subsequent treaties and their consistent course of action in connection with all cases arising thereunder, put such an authoritative interpretation upon the language of the Treaties of 1848 and 1853 as to preclude them from now contending that the fluvial portion of the boundary created by those treaties is a fixed boundary.\textsuperscript{212}

Thus, the Commission held that the United States was entitled to sovereignty over that portion of the disputed area that had been altered by the alluvial process and that Mexico was entitled to sovereignty over the remaining area.\textsuperscript{213}

The influential 1935 Harvard Draft Convention on the Law of Treaties also recognized the role of state practice in the interpretation of treaty provisions.\textsuperscript{214} Article 19(a) of the Convention provides that "[a] treaty is to be interpreted in the light of the general purpose which it is intended to serve."\textsuperscript{215} It then lists several elements which should be considered in connec-

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\textsuperscript{211} See id. at 791-92.
\textsuperscript{212} See id. at 805.
\textsuperscript{213} See id. at 812. Following the Commission's ruling, the United States announced it would not accept the award as binding because it had not been granted sovereignty over the entire disputed area. Indeed, the dispute was not resolved until a 1963 agreement between the United States and Mexico in which the disputed area was divided between the two countries. See Treaty to Resolve Pending Boundary Differences and Maintain the Rio Grande and Colorado River as the International Boundary Between the United States and Mexico, Nov. 23, 1970, U.S.-Mex., 23 U.S.T. 371; Convention for the Solution to the Chamizal Problem, Aug. 29, 1963, U.S.-Mex., 15 U.S.T. 21, 505 U.N.T.S 185.
\textsuperscript{215} Id. at 937.
tion with the purpose of the treaty. These include "[t]he historical background of the treaty, travaux preparatoires, the circumstances of the parties at the time the treaty was entered into, the change in these circumstances sought to be effected, [and] the subsequent conduct of the parties in applying the provisions of the treaty." The commentary attached to Article 19 provides:

In interpreting a treaty, the conduct or action of the parties thereto cannot be ignored. If all the parties to a treaty execute it, or permit its execution, in a particular manner, that fact may reasonably be taken into account as indicative of the real intention of the parties or of the purpose which the instrument was designed to serve.

Both the PCIJ and the ICJ have consistently held that subsequent state practice maintains probative value as to the meaning and understanding of treaty provisions. The PCIJ

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216 See id.
217 Id.
218 Id. at 966.
219 The U.S. Supreme Court also looks to state practice to clarify treaty provisions. See, e.g., Pigeon River Improvement v. Charles W. Cox, Ltd., 291 U.S. 138, 158-60 (1934); Terrace v. Thompson, 263 U.S. 197, 222-23 (1923). In Factor v. Laubenheimer, the Court stated that "[i]n ascertaining the meaning of a treaty, we may look beyond its written words to the negotiations and diplomatic correspondence of the contracting parties relating to the subject-matter, and to their practical construction of it." Factor v. Laubenheimer, 290 U.S. 276, 294-95 (1933).

The use of subsequent practice to clarify or interpret agreements is also found in domestic contract law. See, e.g., Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 435-36 (S.D. Fla. 1975); Margolin v. Franklin, 270 N.E.2d 140, 143 (Ill. App. Ct. 1971). For example, Section 2-208 of the Uniform Commercial Code provides:

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.
(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both
referred to state practice on several occasions.\textsuperscript{220} For example, in the \textit{Competence of the International Labour Organization} case, the League of Nations requested an advisory opinion from the PCIJ on the competence of the International Labour Organization to regulate agricultural labor.\textsuperscript{221} The PCIJ noted that the International Labour Organization was established by Part XIII of the Treaty of Versailles, which applied to agricultural labor.\textsuperscript{222} It recognized, however, that if there was any ambiguity in the Treaty of Versailles, "the Court might, for the purpose of arriving at the true meaning, consider the action which has been taken under the Treaty."\textsuperscript{223} The PCIJ held that the parties repeated dealings with the subject of agriculture during the intervening period of the Treaty's signing and the raising of the debate favored the inclusion of agriculture.\textsuperscript{224} Thus, the PCIJ concluded that the competence of the International Labor Organization extends to international regulation of agricultural labor.\textsuperscript{225}

The ICJ has also referred to state practice in interpreting treaty provisions. In the \textit{Legal Consequences of South Africa in Namibia} case, the United Nations Security Council requested an advisory opinion by the ICJ on the legal consequences for states regarding the continued presence of South Africa in Namibia in light of U.N. Security Council Resolution 276.\textsuperscript{226} South Africa chal-

course of dealing and usage of trade (Section 1-205).
(5) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

U.C.C. \S\ 2-208 (1972). The official comment to Section 2-208 provides that "[t]he parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was." \textit{Id.} cmt. 1.


\textsuperscript{222} \textit{See id.} at 23-25.

\textsuperscript{223} \textit{Id.} at 39.

\textsuperscript{224} \textit{See id.} at 39-41.

\textsuperscript{225} \textit{See id.} at 43.

lenged the validity of this request on the grounds that it had been adopted despite the abstention of two permanent members of the Security Council.\textsuperscript{227} Specifically, South Africa argued that the request violated Article 27 of the U.N. Charter which required concurring votes by all the permanent members of the Security Council.\textsuperscript{228} Without the concurring votes of the absent members, South Africa argued the ICJ was not competent to deliver an opinion. The ICJ reasoned, however, that the members of the Security Council had always treated an abstention by a permanent member as the equivalent of a concurring vote.\textsuperscript{229} The ICJ

U.N. Security Council Resolution 276 was adopted on January 30, 1970. It declared, \textit{inter alia}, "that the continued presence of the South African authorities in Namibia is illegal and that consequently all acts taken by the Government of South Africa on behalf of or concerning Namibia after the termination of the Mandate are illegal and invalid." VII UNITED NATIONS RESOLUTIONS, SERIES II, SECURITY COUNCIL, 49-50 (Dusan Djonovich ed., 1990) [hereinafter RESOLUTIONS].


\textsuperscript{228} See Consequences, 1971 I.C.J. at 22. Article 27 of the U.N. Charter provides:

1. Each member of the Security Council shall have one vote.
2. Decisions of the Security Council on procedural matters shall be made by an affirmative vote of nine members.
3. Decisions of the Security Council on all other matters shall be made by an affirmative vote of nine members including the concurring votes of the permanent members; provided that, in decision under Chapter VI, and under paragraph 3 of Article 52, a party to a dispute shall abstain from voting.

U.N. CHARTER art. 27.

\textsuperscript{229} The ICJ stated:

\textit{[T]he proceedings of the Security Council extending over a long period supply abundant evidence that presidential rulings and the positions taken by members of the Council, in particular its permanent members, have consistently and uniformly interpreted the practice of voluntary abstention by a permanent member as not constituting a bar to the adoption of resolutions. By abstaining, a member does not signify its objection to the approval of what is being proposed; in order to prevent the adoption of a resolution requiring unanimity of the permanent members, a permanent member has only to cast a negative vote. This procedure followed by the Security Council, which has continued unchanged after the amendment in 1965 of Article 27 of the Charter, has been generally accepted by Members of the United Nations and evidences a general practice of that Organization.}

1971 I.C.J. at 22.
therefore concluded that the Security Council resolution requesting an advisory opinion had been adopted appropriately.  

The use of state practice to interpret treaty provisions was codified by the Vienna Convention on the Law of Treaties which entered into force in 1980. Article 31(1) of the Vienna Convention requires the parties to interpret the treaty in good faith, giving the ordinary meaning to the terms of the treaty in their context and in light of the treaty’s object and purpose. Article 31(2) states that:

the context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument

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230 See id. at 27; see also South West Africa (Eth. v. S. Afr.; Liber. v. S. Afr.) 1966 I.C.J. 4 (July 18); Certain Expenses of the United Nations 1962 I.C.J. 151 (July 20); Corfu Channel (U.K. v. Albania) 1949 I.C.J. 4 (Apr. 9). In the Corfu Channel case, the ICJ alluded to the use of state practice in guiding treaty interpretation. See 1949 I.C.J. at 25. In the Certain Expenses of the United Nations case, Judge Fitzmaurice stated that “practice must be a very relevant factor . . . . The interpretation in fact given to an international instrument by the parties to it, as a matter of settled practice, is good presumptive (and may in certain cases be virtually conclusive) evidence of what the correct legal interpretation is.” Certain Expenses of the United Nations, 1962 I.C.J. at 201. In the South West Africa cases, the ICJ noted the importance of state practice in interpreting treaties. See South West Africa, 1966 I.C.J. at 135-36 (stating “[t]he interpretations placed on instruments by the parties to them, though not conclusive as to their meaning, have considerable probative value when they contain recognition by a party of its own obligations under an instrument”).


232 See Vienna Convention, supra note 231, art. 31, 8 I.L.M. at 691-92.
related to the treaty.\textsuperscript{233}

Article 31(3) of the Vienna Convention provides that, together with the context of the treaty, there shall be taken into account:

(a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
(c) Any relevant rules of international law applicable in the relations between the parties.\textsuperscript{234}

Finally, Article 32 of the Vienna Convention provides that "recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion . . . when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure, or (b) leads to a result which is manifestly absurd or unreasonable."\textsuperscript{235}

According to the International Law Commission ("ILC"), which prepared the Draft Articles on the Law of Treaties, the importance of subsequent practice in the interpretation of a treaty is obvious since it illustrates the parties' understanding of the meaning of the treaty.\textsuperscript{236} In its commentary of Article 31(3)(b) of the Vienna Convention, the ILC stated:

The value of subsequent practice varies according as it shows the common understanding of the parties as to the meaning of the terms. The Commission considered that subsequent practice establishing the understanding of the parties regarding the interpretation of a treaty should be included in paragraph 3 as an authentic means of interpre-

\textsuperscript{233} Id.
\textsuperscript{234} Id.
\textsuperscript{235} Id. art. 32, 8 I.L.M. at 692.
tation alongside interpretative agreements.\textsuperscript{237}

Under the provisions of the Vienna Convention, therefore, state practice is considered relevant for the interpretation of treaty provisions.\textsuperscript{238}

The preceding analysis indicates that state practice can be used to interpret international agreements. It also raises an interesting question: can state practice actually modify an international agreement?

In the 1963 \textit{Air Transport Services Agreement Arbitration}, the United States and France disagreed as to the interpretation of the 1946 Air Transport Services Agreement.\textsuperscript{239} The principal issue

\textsuperscript{237} \textit{Id.} at 42.

\textsuperscript{238} The concept of state practice is referred to in several other provisions of the Vienna Convention. For example, Article 45 provides that:

A State may no longer invoke a ground for invalidating, terminating, withdrawing from or suspending the operation of a treaty under articles 46 to 50 or articles 60 and 62 if, after becoming aware of the facts:

(a) It shall have expressly agreed that the treaty is valid or remains in force or continues in operation, as the case may be; or

(b) It must by reason of its conduct be considered as having acquiesced in the validity of the treaty or in its maintenance in force or in operation, as the case may be.

Vienna Convention, \textit{supra} note 231, art. 45, 8 I.L.M. at 697. According to the International Law Commission, "[t]he foundation of the principle that a party is not permitted to benefit from its own inconsistencies is essentially good faith and fair dealing (\textit{allegans contraria non audiendus est})." Documents, \textit{supra} note 236, at 59. With reference to paragraph (b), the International Law Commission indicated that a "State is not permitted to take up a legal position which is in contradiction with the position which its own previous conduct must have led the other parties to suppose that it had taken up with respect to the validity, maintenance in force or maintenance in operation of the treaty." \textit{Id.} At the Conference, several states introduced proposals to delete paragraph (b). However, these proposals were defeated. \textit{See United Nations Conference on the Law of Treaties, U.N. GAOR, 1st Sess., at 390-402 (1969)} [hereinafter \textit{United Nations Conference on the Law of Treaties, First Session}].

Similarly, Article 8 of the Vienna Convention provides that "[a]n act relating to the conclusion of a treaty performed by a person who cannot be considered under article 7 as authorized to represent a State for that purpose is without legal effect unless afterwards confirmed by that State." Vienna Convention, \textit{supra} note 231, art. 8, 8 I.L.M. at 683; \textit{see also} Documents, \textit{supra} note 236, at 13-14 (stating commentary by the International Law Commission on Draft Article 8).

\textsuperscript{239} \textit{See} \textit{Air Transport Services Agreement Arbitration} (United States v. France) 38 I.L.R. 182, 186 (1963). The United States and France have been
was whether a U.S. air carrier, Pan American Airways, could route international aviation services through Paris in flights between the United States and Turkey and Iran. France argued that the Agreement did not provide for such rights. In interpreting the Agreement, the arbitral tribunal noted the importance of the conduct of the parties subsequent to the conclusion of the Agreement. Indeed, the practice and subsequent conduct of the parties could be used as a supplementary means of interpretation:

This method may be susceptible of either confirming or contradicting, and even possibly of correcting, the conclusions furnished by the interpretations based on an examination of the text and the preparatory work, for the purposes of determining the common intention of the Parties when they concluded the Agreement.

In addition, the tribunal determined that the conduct of the parties from the time when the first differences of opinion arose was particularly relevant, since it may be useful for interpreting the Agreement, and provide a source of subsequent modification. Specifically, the Tribunal decided that conduct would play a decisive role in cases where:

express or implied consent has been given to a certain claim or the exercise of a certain activity, or cases where an attitude — whether it can rightly or not be described as a form of tacit consent — certainly has the same effects on

involved in several other disputes concerning air transportation. See Lori Fisler Damrosch, Retaliation or Arbitration — Or Both? The 1978 United States-France Aviation Dispute, 74 AM. J. INT'L L. 785 (1980) (describing the arbitration of a different dispute between Pan Am airways and France).

240 See 38 I.L.R. at 187.
241 See id. at 219.
242 See id. at 245.
243 Id. at 245-46.
244 See id. at 249 ("This course of conduct may, in fact, be taken into account not merely as a means useful for interpreting the Agreement, but also as . . . a possible source of subsequent modification, arising out of certain actions or certain attitudes, having a bearing on the juridical situation of the parties and on the rights that each of them could properly claim.")
the resulting juridical situation between the Parties as consent properly speaking would have. The Tribunal is referring in particular to assumptions such as the following: the interested party has not, in fact, raised an objection that it may have had the possibility of raising, or it has abandoned, or not renewed at a time when the opportunity occurred, the objection that it raised at the outset; or while objecting in principle, it has in fact consented to the continuance of the action in respect of which it has expressed the objection; or again, it has given implied consent, resulting from the consent expressed in connection with a situation related to the subject-matter of the dispute.\textsuperscript{245}

Applying these principles of interpretation, the arbitral tribunal concluded that the 1963 Air Transport Agreement did not authorize U.S. air carriers to route international aviation services through Paris in flights between the United States and Turkey and Iran.\textsuperscript{246} The language of the Agreement did not indicate an intention to authorize such services.\textsuperscript{247} However, the tribunal determined that subsequent agreements, as well as the conduct of the parties, had modified the original Agreement. These modifications granted U.S. air carriers the right to provide aviation services through the disputed routes.\textsuperscript{248}

In the Draft Articles on the Law of Treaties, the ILC submitted an article which recognized the modification of treaties through subsequent practice. The draft article provided that, "[a] treaty may be modified by subsequent practice in the application of the treaty establishing the agreement of the parties to modify

\textsuperscript{245} Id. at 249-50.
\textsuperscript{246} See id. at 256-58.
\textsuperscript{247} See id.
\textsuperscript{248} See id. The Tribunal, however, ruled against the United States on one issue and concluded that "a United States airline has not the right to carry traffic which is embarked in Paris and disembarked at Istanbul, Ankara or other points in Turkey, or embarked at Istanbul, Ankara or other points in Turkey and disembarked at Paris." Id. at 257; see also Temple of Preah Vihear (Cambodia v. Thail.), 1961 I.C.J. 17, 34 (May 26) (using subsequent conduct as a tool in interpreting the validity of a jurisdictional agreement signed by Thailand).
its provisions."

In its commentary, the ILC indicated that "[t]his article covers cases where the parties by common consent in fact apply the treaty in a manner which its provisions do not envisage." The ILC noted that subsequent practice in the application of a treaty,

is authoritative evidence as to its interpretation when the practice is consistent, and establishes understanding regarding the meaning of the provisions of the treaty. Equally, a consistent practice, establishing the common consent of the parties to the application of the treaty in a manner different from that laid down in certain of its provisions, may have the effect of modifying the treaty.

The ILC cited the Air Transport Services Agreement Arbitration with approval.

During the Conference on the Law of Treaties, however, the draft article was deleted. Several countries expressed the concern that uncertainty might result from such a provision. Countries also expressed concerns about the domestic ramifications of the provision. Some delegates considered the pro-

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249 Documents, supra note 236, at 55.
250 Id.
251 Id.
252 See id. at 55-56.
254 For example, the Vietnamese representative said that "[t]o allow for the possibility of modifying the treaty by subsequent practice would open the door to all kinds of interpretations, in the course of which the treaty might lose much of its substance." Id. at 208. Similarly, the French representative argued that "if States were given the impression that any flexible attitude towards the application of a treaty was tantamount to agreement to modify the treaty, they would tend in the future to become much more circumspect and rigid in their attitudes." Id. at 208.
255 For example, the French representative indicated that the adoption of the article might raise serious constitutional problems for many States: the principle of formal parallelism required that modifications of a treaty at the domestic level should follow the same procedure as the original text. If the manner in which the responsible officials applied the treaty was in itself capable of leading to modifica-
posed article unnecessary.\footnote{See id. at 211-14. According to the Iraqi representative:} In contrast, other countries argued that the draft article simply reflected the inherent flexibility of international law and was consistent with customary practice.\footnote{Id. at 211. Similarly, the Italian representative stated:}

In response to the comments made by the state representatives, Sir Humphrey Waldock, the Special Rapporteur on the law of treaties for the International Law Commission, indicated that the draft article,

tion, that requirement of parallelism could hardly be met.


\footnote{For example, the Israeli representative Shabtai Rosenne noted that while "he would not go so far as to say that the rule in question did not exist in international law," he thought it was already covered by other articles of the treaty. See United Nations Conference on the Law of Treaties, First Session, \textit{supra} note 238, at 213.}
was based on the principle that a State which had taken up a position on a point of law, particularly in the interpretation of treaties, and allowed another State to act in accordance with that understanding of the legal position, could not go back on its representation of the legal position and declare the act performed illegal.258

According to Waldock, the draft article would serve to codify existing practice.259 Waldock indicated that although Article 3 of the Vienna Convention, which refers to international agreements not in written terms,260 could be used to support the use of state practice to modify treaties, the ILC thought it wiser to deal with the question in a separate article.261 Finally, Waldock argued that the use of state practice to modify treaties had never before raised any constitutional problems. Indeed, “[i]f the application of a treaty provision conflicted with national law, the representative of the Ministry of Foreign Affairs of the country concerned would object and request that the treaty be amended.”262

Despite the deletion of this draft article, the Vienna Convention recognizes the right of parties to amend or modify international agreements. Articles 39 through 41 address the amendment

258 Id. at 214.
259 See id. at 215.
260 Article 3 of the Vienna Convention provides:
The fact that the present Convention does not apply to international agreements concluded between States and other subjects of international law or between such other subjects of international law, or to international agreements not in written form, shall not affect:

(a) The legal force of such agreements;
(b) The application to them of any of the rules set forth in the present Convention to which they would be subject under international law independently of the Convention;
(c) The application of the Convention to the relations of States as between themselves under international agreements to which other subjects of international law are also parties.

Vienna Convention, supra note 231, art. 3, 8 I.L.M. at 694.
262 Id. at 214-15.
and modification of treaties.\textsuperscript{263} Nothing in these sections precludes parties from using state practice to modify or amend an international agreement. Indeed, the ILC recognized that “in some cases treaties, especially those in simplified form, were varied by informal procedures and even by oral agreement of ministers.”\textsuperscript{264} According to Waldock, such informal procedures between states remained valid.\textsuperscript{265}

In summary, state practice is relevant in both the interpretation and modification of international agreements.

5. AN INTERDISCIPLINARY MERGER: THE ECONOMIC ANALYSIS OF INTERNATIONAL LAW

This section suggests that the concept of state practice facilitates the development of endogenous governance structures that address the problems raised by transaction costs.

5.1. State Practice and Treaty Law

State practice reduces the transaction costs associated with the development and operation of treaties in three ways. First, state practice relieves parties of the burden of trying to address every possible contingency that may arise in the course of the relationship in the initial agreement. Rather, the agreement can act as a guide, establishing the broad parameters of the relationship and setting forth basic rules. The parties’ subsequent conduct fills in the gaps. This provides states with the flexibility necessary to address new or changing circumstances while their actions remain grounded within the context of the original agreement.

Second, state practice can be used to interpret the original agreement if subsequent ambiguities arise. This feature is both legitimate and practical. State practice requires the mutual assent of each party in order to be binding. In addition, the parties

\textsuperscript{263} Article 39 provides that “[a] treaty may be amended by agreement between the parties.” Vienna Convention, \textit{supra} note 231, art. 39, 8 I.L.M. at 694. Article 40 governs the amendment of multilateral treaties by all the parties to the treaty. \textit{See id.} art. 40, 8 I.L.M. at 694-95. Article 41 governs the modification of multilateral treaties between certain parties. \textit{See id.} art. 41, 8 I.L.M. at 695.

\textsuperscript{264} United Nations Conference on the Law of Treaties, First Session, \textit{supra} note 238, at 204.

\textsuperscript{265} \textit{See id.} In support of this statement, Waldock cited Article 3 of the Vienna Convention. \textit{See id.}
themselves are the most capable of understanding the nature and scope of their relationship. Indeed, state practice "represents the common-sense practical interpretation of the treaty under the varied contingencies of its ongoing operation."267

Third, state practice can be used to modify the original agreement. This allows parties to address new circumstances without resorting to more formal and time-consuming mechanisms. As noted in the deliberations of the Vienna Convention, such practice is perhaps the most reliable and efficient method for affirming legal certainty between states.268 Resorting to state practice is less costly than resorting to more formal arrangements. State practice also reduces the likelihood that a state can unilaterally take advantage of new circumstances because state practice requires the mutual assent of all states involved.

Despite the broad benefits of state practice, some scholars have questioned whether international law is capable of addressing the dynamic nature of international affairs. In his article, Understanding Dynamic Obligations, Edwin Smith criticizes traditional doctrinal approaches to international agreements. According to Smith, prior to the twentieth century, few international agreements established dynamic relationships between states.269 Rather, most international agreements "served principally as static frameworks resulting from efforts to avoid intolerable international conflicts."270

As a result, international legal doctrine also began to view such agreements as static. Traditional doctrines protect the fixed expectations of the parties and do not adequately respond to changing circumstances such as new technology or

266 According to Gerald McGinley, state practice represents the ongoing pragmatic understanding of those individuals who have functioned under and within the treaty's terms. If this is so, one might ask, wherein lies the evidentiary value of such practice? The answer seems to be that those actually engaged in working under the treaty are likely to have more knowledge and experience about the realities of the functioning of the treaty than either those who prepared it or those who have dealt with it from a distance or for a limited period of time.


267 Id.

268 See supra note 257.

269 See Smith, supra note 6, at 1575.

270 Id. at 1576.
acquired information. According to Smith, "[t]he changing nature of international agreements limits the utility of traditional treaty doctrines."  

Smith criticizes the Vienna Convention on the Law of Treaties as being exceedingly static and incapable of accommodating dynamic obligations. He argues that provisions concerning the interpretation of treaties emphasize the text of the agreement as the principal indicator of the intent of the parties. Other evidence of state intent is relegated to a secondary role. By focusing on the text, the Vienna Convention provides a technique for measuring state intent that is "archaic and unduly rigid." The characteristics of "these traditional rules provide little guidance for parties seeking to comply with agreements that create dynamic obligations." However, Smith does acknowledge the strengths of the Vienna Convention:  

In essence, the Vienna Convention provides traffic-control rules for formal treaty relationships, allowing parties to determine their own goals while setting parameters for the manner in which each party uses the treaty relationships to achieve those goals. However, traditional procedural rules applicable to the obligations of formal international agreements cannot address the substantive problems involved in preserving agreements that generate dynamic obligations.

Smith's analysis of international law and the Vienna Convention both underemphasizes the benefits of state practice and overemphasizes the limitations of textual interpretation. By recognizing the primacy of the text, the Vienna Convention provides a foundation for the parties' relationship. Although the

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271 See id. at 1577.
272 Id. at 1575.
273 See id. at 1578-83.
274 See id. at 1578.
275 See id.
276 Id. at 1579 (quoting Kearney & Dalton, The Treaty on Treaties, supra note 231, at 570).
277 Id. at 1580.
278 Id. at 1582.
relationship may evolve and expand beyond its original parameters, the original text provides a common reference point and a stable foundation for subsequent practice. By recognizing the importance of state practice, however, the Vienna Convention provides a mechanism through which the parties can adapt their agreement as the relationship develops.

Indeed, the importance of stability and flexibility in contractual arrangements is well-documented. In modern economic structures, there is a constant clash “between the need for stability and the need to respond to change.” 279 Interestingly, this analysis is consistent with Smith’s depiction of dynamic agreements as “agreements that allow the parties to mutually adjust commitments while maintaining a shared perception of reciprocal responsibility.” 280 According to Smith:

Formal binding agreements can be most helpful if they contain provisions that allow the evolution of obligations and give greater assurances to the parties of the continued viability of the relationship. With sufficient flexibility, formal agreements assist in the establishment of evolving relationships between states, which can facilitate a variety of mutually beneficial adaptive responses to technological, political and economic changes. 281

Other scholars, such as Hans Morgenthau, are even more critical of treaty law. According to Morgenthau, a primary criticism of international law is that it lacks precision and, therefore, binding force:

In order to find a common basis on which all those different national interests can meet in harmony, rules of international law embodied in general treaties must often be vague and ambiguous, allowing all the signatories to read the recognition of their own national interests into the legal text agreed upon. 282

279 Macneil, Adjustmen, supra note 59, at 854.
280 Smith, supra note 6, at 1557.
281 Id.
282 MORGENTHAU, supra note 146, at 299-300.
Morgenthau’s criticism, however, suffers several defects. First, most international agreements are, in fact, quite explicit. Second, Morgenthau fails to recognize the primary reason for entering international agreements — to establish stable expectations and to reduce uncertainty. If treaty interpretation was entirely subjective, treaties could not perform this task of promoting stability and reducing uncertainty since states could read their own national interests into any legal text. Thus, states are limited from engaging in such extreme forms of self-serving behavior because of their interest in promoting stability and reducing uncertainty. Third, there may be certain advantages to leaving some treaty provisions ambiguous. As Morgenthau recognizes, treaties are often drafted in ambiguous language in order “to obtain the approval of all subjects of the law.”283 Such ambiguities, however, can be resolved by subsequent state practice. States gain the short-term advantages of wide spread treaty acceptance and the long-term advantages of binding agreements.284

5.2. State Practice and Customary International Law

Unlike treaty law, customary international law is not based upon formal written agreements. Rather, customary international law develops as the result of uniform and consistent state practice followed out of a sense of legal obligation.

Customary international law allows states to establish binding relationships without resorting to the formalism of the treaty process. Instead of formal and time-consuming negotiations, customary international law recognizes the role of state practice in establishing the relationship between the states. By recognizing that their consistent practice may give rise to a binding rule of international law, states are encouraged to establish long-term relationships. This customary practice, in turn, promotes regular patterns of behavior. Customary practice also clarifies state expectations about their respective entitlements, further stabilizing

283 Id. at 299.

284 It should be recognized, however, that ambiguities in international agreements may give rise to problems. See William J. Aceves, Ambiguities in Plurilingual Treaties: A Case Study of Article 22 of the 1982 Law of the Sea Convention, 27 OCEAN DEV. & INT’L L. 187 (1996) [hereinafter Aceves, Ambiguities].

https://scholarship.law.upenn.edu/jil/vol17/iss4/1
the relationship between states. As the relationship between the states advances, it naturally responds to unforeseen contingencies. As state practice develops into customary international law, it becomes binding upon those states that have acquiesced in its formation and development. Yet, customary international law also recognizes that state practice can change. Indeed, state practice can give rise to a new rule of customary international law. It can also modify treaty obligations. Thus, customary international law allows states to reap the benefits of a formal relationship without the limitations imposed by a formal agreement.

The importance of custom has been well-documented in several contexts. Custom has been referred to as “a set of


286 See supra Section 4.1.


288 See supra Section 4.2.

behavioral dispositions inherited from the past." Custom establishes expectations regarding certain behavior. In turn, these expectations can guide economic transactions without the need for costly safeguards. Through this process, custom may contribute to economic efficiency.

The importance of custom has also been identified in the literature on path dependence. Path dependence identifies the influence of inertia, a process which forms and guides institutional development: "Once a development path is set on a particular course, the network externalities, the learning process of organizations, and the historically derived subjective modeling of the issues reinforce the course." As Douglas North points out, path dependence means that history matters. The role of path dependence is particularly significant in the legal setting, where legal precedent influences subsequent legal decisions and state actions. For example, the development of the common law

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290 Schlicht, supra note 289, at 178.
291 See id. at 180 ("The importance of custom stems from the fact that it creates entitlements and preferences which shape economic transactions . . . . In this way, custom may render many economic transactions possible without a need to rely on elaborate and costly safeguards.").
293 NORTH, supra note 292, at 99.
294 The genealogical method of analysis shares similar elements. This approach was acknowledged by Nietzsche who noted that:

The cause of the origin of a thing and its eventual utility, its actual employment and place in a system of purposes, lie worlds apart; whatever exists, having somehow come into being, is again and again reinterpreted to new ends . . . and the entire history of a "thing," an organ, a custom can in this way be a continuous sign-chain of ever new interpretations and adaptations whose causes do not even have to be related to one another but, on the contrary, in some cases succeed and alternate with one another in a purely chance fashion.

FRIEDRICH NIETZSCHE, ON THE GENEALOGY OF MORALS 77 (Walter Kaufmann & R.J. Hollingdale trans., 1989); see also Michel Foucault, Nietzsche, Genealogy, History, in THE FOUCAULT READER 76 (Paul Rabinow ed., 1984) (discussing the relationship between genealogy and the three modalities of history Nietzsche recognized). For an application of the genealogical method
represents a form of institutional change. The common law is based on precedent, providing both continuity and predictability that are critical to reducing uncertainty among contracting parties. As North states, “[p]ast decisions become embedded in the structure of law, which changes marginally as new cases arise involving new, or at least in terms of past cases unforeseen, issues; when decided these become, in turn, a part of the legal framework.”

Robert Keohane alluded to the role of custom in his analysis of conventions, or informal institutions. In contrast to formal organizations or regimes, Keohane defined conventions as “informal institutions, with implicit rules and understandings, that shape the expectations of actors. They enable actors to under-


295 NORTH, supra note 292, at 96-97; see also 1 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY 115-18 (1973) (discussing how judicial decisions are predictable as a result of reliance on precedent); Victor P. Goldberg, Institutional Change and the Quasi-Invisible Hand, 17 J.L. & ECON. 461, 482 (1974) (arguing that institutional choice takes place under great ignorance of existing institutions); Ronald A. Heiner, Imperfect Decisions and the Law: On the Evolution of Legal Precedent and Rules, 15 J. LEGAL STUD. 227 (1986) (arguing that costly and imperfect information are responsible for major procedures that have evolved in the law).

296 See Robert Keohane, Neoliberal Institutionalism: A Perspective on World Politics, in INTERNATIONAL INSTITUTIONS AND STATE POWER 4 (1989). According to Keohane, there are three forms of institutions: (1) formal inter-governmental or cross-national non-governmental organizations; (2) international regimes; and (3) conventions. Id. at 3-4. Indeed, Michael Byers recognized the similarity between Keohane’s definition of conventions and customary international law.

Keohane’s definition of conventions is similar to, and would seem to encompass, the process of customary international law. Like many customary rules, Keohane’s conventions are ‘temporally and logically prior to regimes or formal international organizations’ and ‘[n] the absence of conventions, it would be difficult for states to negotiate with one another or even to understand the meaning of each other’s actions.’ Unlike customary rules, however, Keohane’s conventions do not appear to be legally binding. Conventions, like regimes and organizations, are voluntary constructs of states. However, unlike the explicit rules involved in regimes and organizations, conventions are not ‘contractual’ in nature. Therefore, non-conformity with conventions merely imposes efficiency costs and does not constitute a breach of legal obligations.

Byers, supra note 287, at 133 (quoting Keohane (citation omitted)).
stand one another and, without explicit rules, to coordinate their behavior."297 Keohane argued that "[c]onventions are not only pervasive in world politics but also temporally and logically prior to regimes or formal international organizations. In the absence of conventions, it would be difficult for states to negotiate with one another or even to understand the meaning of each other's actions."298 The importance of custom, therefore, resides in its ability to shape the expectations of actors and constrain behavior in the absence of explicit rules.299

5.3. Summary

International institutions play an important role in establishing cooperation among states, even in a decentralized world. However, the development and operation of institutions may be affected by transaction costs. Therefore, institutions must develop exogenous or endogenous governance structures to alleviate the problems raised by transaction costs.

This Article suggests that state practice facilitates the development of endogenous governance structures, thereby reducing the problems raised by transaction costs and increasing the likelihood of cooperation. The Vienna Convention on the Law of Treaties provides that state practice is relevant for interpreting and modifying treaty provisions. State practice reduces the problems raised by transaction costs by allowing states to interpret and even modify their original agreement through subsequent practice.

297 Keohane, Neoliberal Institutionalism: A Perspective on World Politics, supra note 296, at 4.

298 Id. However, Keohane suggests that conventions cannot address severe Prisoner's Dilemma situations. Keohane states that "[c]onventions are especially appropriate for situations of coordination, where it is to everyone's interest to behave in a particular way as long as others also do so. More specific contractual solutions . . . are necessary to deal with prisoners' dilemma problems of major significance." Id.

299 See JACK KNIGHT, INSTITUTIONS AND SOCIAL CONFLICT (1992). According to Knight,

[s]ocial institutions are sets of rules that structure social interactions in particular ways. These rules (1) provide information about how people are expected to act in particular situations, (2) can be recognized by those who are members of the relevant group as the rules to which others conform in these situations, and (3) structure the strategic choices of actors in such a way as to produce equilibrium outcomes.

Id. at 54.
This reduces the need to draft extensive agreements at the outset. It also provides states with the flexibility to address new circumstances while remaining grounded within the context of their original agreement. Furthermore, state practice that is continuous and long-standing may develop into customary international law and be considered legally binding on those states that acquiesce in its formation and development. Customary international law allows states to promote cooperation in the absence of formal agreements. It minimizes the problems raised by transaction costs by allowing states to forego explicit negotiations and to function even in the absence of a formal structure. It is also flexible enough to address new circumstances as they arise. In both treaty law and customary international law, therefore, state practice facilitates the development of endogenous governance structures that address the problems raised by transaction costs.

This Article also suggests that transaction costs will have a significant impact on whether states choose treaty law or customary international law in the development of international institutions. As indicated by Williamson, "[t]ransaction cost economics maintains that there are rational economic reasons for organizing some transactions one way and other transactions another." Treaty law promotes cooperation by establishing formal agreements. These agreements serve several purposes. They highlight the importance of the relationship by publicizing

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300 This conclusion is consistent with the notion that costs may affect legal form. As costs increase, some forms of law may be more efficient than others. See generally Colin S. Diver, The Optimal Precision of Administrative Rules, 93 YALE L.J. 65 (1983) (fashioning a standard for administrative rule-making in order to deal with dissatisfaction over the precision of administrative rules); Isaac Ehrlich & Richard Posner, An Economic Analysis of Legal Rulemaking, 3 J. LEGAL STUD. 257 (1974) (examining the degree of precision with which a legal command is expressed as a determinant of the efficiency of the legal process); Louis Kaplow, Rules Versus Standards: An Economic Analysis, 42 DUKE L.J. 557 (1992) (offering an economic analysis of the extent to which legal comments should be promulgated as rules or standards); Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685 (1976) (discussing differences between rigid highly administrable rules and equitable standards in solving legal problems); Carol M. Rose, Crystals and Mud in Property Law, 40 STAN. L. REV. 577 (1988) (stating that rigid rules depend on shared social understanding and facilitate social interactions).

301 WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, supra note 34, at 52.
the respective rights and obligations of member states. They raise the costs of noncompliance. They promote efficiency by identifying and allocating property rights. Above all, they minimize uncertainty and promote stable expectations by setting forth rights and obligations in precise language.

Customary international law also promotes cooperation, but it does so in the absence of formal agreements. Whereas treaties require an extensive process leading to formal codification, customary international law does not. Rather, customary international law develops among states that acquiesce in its formation and development. If the transaction costs associated with the negotiation of treaty law are high, states may prefer customary international law because it allows states to forego expensive and time-consuming negotiations. Likewise, if the transaction costs associated with the codification of treaty law are high, states may also prefer customary international law because it does not require a formal agreement. Finally, if the transaction costs associated with the maintenance of treaty law are high, states may prefer customary international law because it functions even in the absence of a formal structure. In short, each form of international law serves a unique purpose. As transaction cost economics suggests, efficiency will guide the development of international institutions.

A final caveat should be noted. This Article has emphasized how state practice can reduce the problems raised by transaction costs in the development and maintenance of international institutions. There are, however, some limitations to the use of state practice. Perhaps the most significant limitation is uncertain-

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303 This conclusion is consistent with the notion that law and legal systems must ultimately serve the interests of the actors that function in their ambit. For an analysis of how legal systems are reactive to the interests of such actors, see Daniel A. Farber & Philip P. Frickey, Symposium, Foreword: Positive Political Theory in the Nineties, 80 GEO. L.J. 457 (1992); John A. Ferejohn & Barry R. Weingast, A Positive Theory of Statutory Interpretation, 12 INT’L REV. L. & ECON. 263 (1992); Mathew D. Modzburg et al., Positive and Normative Models of Procedural Rights: An Integrative Approach to Administrative Procedures, 6 J.L. ECON. & ORG. 307 (special issue, 1990).
ty. As noted by Friedrich Kratochwil, "[t]he main advantage of 'nailing things down' with explicitly stated norms is that norms allow one to separate the disagreements on a particular issue from the rest of the ongoing social interactions."\footnote{Kratochwil, supra note 82, at 91.} Indeed, this can raise significant problems when states seek to use state practice to clarify ambiguities.\footnote{See Aceves, Ambiguities, supra note 284.} Another concern is the possibility that state practice will be resorted to out of short-term expediency rather than long-term interests:

Because of this, great care must be taken to ensure that a particular practice is not crystallized into rule of law to the detriment of the larger principles and purposes of the instrument. Such a use of the practice would stultify a treaty as readily as would a rigid adherence to text without regard to the practical realities of the treaty's operations.\footnote{McGinley, supra note 266, at 230.}

Finally, state practice, like all law, is subject to interpretation and, therefore, is susceptible to the vagaries of interpretation.\footnote{See CHAYES & CHAYES, supra note 26, at 10-13.}

6. CONCLUSION

This Article demonstrates the benefits of an interdisciplinary approach to the study of international cooperation. By merging the disciplines of law, international relations, and economics, this study provides new insights into the function of international law and, specifically, the concept of state practice.

More broadly, this Article has sought to move beyond the reflectivist approach that has guided most studies of international legal scholarship.\footnote{For a description of reflectivist and rationalistic approaches, see Keohane, International Institutions: Two Approaches, supra note 17, at 382.} By examining the function of international law, this study seeks to instill a rationalistic foundation to international legal scholarship.\footnote{See generally THOMAS C. SCHELLING, MICROMOTIVES AND MACROBEHAVIOR 13 (1978) (exploring "the relation between the behavior characteristics of the individuals who comprise some social aggregate, and the}
tic elements which underlie international law, this study seeks to provide a significant contribution to the scientific study of international cooperation. Finally, by revealing the influence of law on state behavior, this Article hopes to reaffirm the relevance of international law.