
The Design of International Agreements

Andrew T. Guzman*

Abstract

States entering into international agreements have at their disposal several tools to enhance the strength and credibility of their commitments, including the ability to make the agreement a formal treaty rather than soft law, provide for mandatory dispute resolution procedures, and establish monitoring mechanisms. Each of these strategies – referred to as ‘design elements’ – increases the costs associated with the violation of an agreement and, therefore, the probability of compliance. Yet even a passing familiarity with international agreements makes it clear that states routinely fail to include these design elements in their agreements. This article explains why rational states sometimes prefer to draft their agreements in such a way as to make them less credible and, therefore, more easily violated. In contrast to domestic law, where contractual violations are sanctioned through zero-sum payments from the breaching party to the breached-against party, sanctions for violations of international agreements are not zero-sum. To the extent that sanctions exist, they almost always represent a net loss to the parties. For example, a reputational loss felt by the violating party yields little or no offsetting benefit to its counter-party. When entering into an agreement, then, the parties take into account the possibility of a violation and recognize that if it takes place, the net loss to the parties will be larger if credibility-enhancing measures are in place. In other words, the design elements offer a benefit in the form of greater compliance, but do so by increasing the cost to the parties in the event of a violation. When deciding which design elements to include, the parties must then balance the benefits of increased compliance against the costs triggered in the event of a violation.

* Professor of Law, Boalt Hall School of Law, University of California at Berkeley. Email: guzman@law.berkeley.edu. I owe thanks to Stephen Choi, Jeff Atik, Allen Ferrell, Ryan Goodman, Oona Hathaway, Larry Helfer, Louis Kaplow, Kal Raustiala, Steven Shavell, Beth Simmons, Joel Trachtman, Fred Tung, and participants at faculty seminars at Harvard Law School, Loyola Law School, Temple University’s James E. Beasley School of Law, the University of Toronto School of Law, UCLA Law School, and Yale Law School, for helpful comments and discussions. Special thanks go to Daniel Frederick and Nicholas James. Jennie Wang and Rachel Anderson provided excellent research assistance.

1 Introduction

States enter into international agreements all the time, and these agreements vary widely along several dimensions.¹ Some are formal treaties, while others fall short of that classification, being labelled instead ‘soft law’;² some include dispute resolution procedures while others do not;³ and some provide for sophisticated monitoring mechanisms that are absent from other agreements.⁴ When states draft their agreements they often make choices – like the choice of soft law or the decision to omit provisions for dispute resolution or monitoring – that serve to weaken the force and credibility of their commitments.⁵ This behaviour is puzzling. International law is routinely criticized for being too weak and failing to offer effective enforcement mechanisms. If this is indeed a problem, one would expect states to seek out ways to enhance the strength and credibility of their commitments. After all, states enter into international agreements as a way of exchanging promises about future conduct. These agreements have value only if the promises exchanged serve to bind the parties. The agreements are, therefore, more valuable if they can bind the parties more effectively. If international law is weak, we should expect states to do everything in their power to increase the strength, credibility and ‘compliance pull’ of their agreements.

In the domestic context, for example, the parties to a contract typically want their written agreements to be enforceable. This enforceability allows them to rely on one another’s promises and enter into a more profitable exchange.⁶ States cannot write enforceable promises in the same way as private parties, but one would expect them to use the tools at their disposal to make their agreements more, rather than less,

¹ This article offers an explanation for some, but not all, of the diversity that exists in international agreements. Some of the other sources of diversity within agreements are discussed in the Autumn 2001 symposium issue of *International Organization*. See Koremenos, Lipson, and Snidal, ‘The Rational Design of International Institutions’, 55 *Int Org* (2001) 761; Koremenos, Lipson, and Snidal, ‘Rational Design: Looking Back to Move Forward’, 55 *Int Org* (2001) 1051.

² E.g., the North American Free Trade Agreement (NAFTA) is the product of a formal treaty while the Basle Accord is not a treaty. See Basle Committee on Banking Supervision, ‘International Convergence of Capital Measurement and Capital Standards’ (July 1998), available at <http://www.bis.org/publ/bcbs04a.htm>; see generally, Lee, ‘The Basle Accords as Soft Law: Strengthening International Banking Supervision’, 39 *Va J Int’l L* (1998) 1; Oatley and Nabors, ‘Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord’, 52 *Int Org* (1998), 1, at 35–54.

³ E.g., bilateral investment treaties (BITs) typically include dispute resolution procedures, as does the WTO, whereas the Geneva Convention Relative to the Treatment of Prisoners of War does not. See, e.g., Treaty Concerning the Reciprocal Encouragement and Protection of Investment, 14 Nov. 1991, U.S.-Arg., arts. II-V, S. Treaty Doc. No. 103-2, at 3–6 (1993); Geneva Convention Relative to the Treatment of Prisoners of War, 75 UNTS (1949) 135.

⁴ E.g., the International Covenant on Civil and Political Rights (ICCPR) provides for the submission of reports by the parties when so requested by the Human Rights Committee (‘the Committee’), and the Committee is authorized to review and comment on these reports: see ICCPR, 999 UNTS (1966) 171 (1966), art. 40(1)(b), (4); see also Raustiala, ‘Police Patrols, Fire Alarms & the Review of Treaty Commitments’, mimeo, at 2 (2003) (on file with author).

⁵ A soft law agreement reduces the credibility of the commitment relative to a treaty because it represents a lower level of commitment. Omitting dispute resolution and monitoring procedures has a similar effect because these procedures serve to identify and publicize violations.

⁶ This is a simple insight from contracts. It is discussed in detail in Section 2.

credible. Yet states do not do so. They routinely fail to draft agreements to maximize the credibility of their promises. They frequently enter into soft law agreements; most agreements, including treaties, do not include mandatory dispute resolution provisions;⁷ and mechanisms for monitoring and review are often weak or non-existent.⁸ Neither legal nor political science scholars have a theory to explain why states are so hesitant to use these credibility-enhancing strategies.⁹

The central claim of this article is that state resistance to such strategies is the product of tension between two objectives pursued by states when they enter into an agreement.¹⁰ The first is the desire to make the agreement credible and binding. This is analogous to the desire on the part of private parties to make their agreements enforceable. The design elements of hard law, dispute resolution, and monitoring all promote this goal.¹¹ The observation that each of these design elements promotes credibility and compliance yet is often not incorporated in an agreement is at the heart of the puzzle addressed in this paper.

The second part of the explanation is related to the sanctions triggered by the violation of an international agreement. In the domestic context, a contractual breach is normally punished through monetary damages paid by the breaching party to the breached-against party. This is a zero-sum transfer in the sense that what is lost by

⁷ See Guzman, 'The Cost of Credibility: Explaining Resistance to Interstate Dispute Resolution Mechanisms', 31 *J Legal Stud* (2002) 303. Domestic contracts do not normally include dispute resolutions provisions either, but, unlike international agreements, they can rely on the background legal system for enforcement. International contracts provide a better example of private parties seeking to ensure the credibility of their agreements. These contracts typically include a choice of law clause and frequently an arbitration clause, which identifies the law that is to govern the dispute and the forum in which a dispute will be resolved.

⁸ See Raustiala, *supra* note 4. Domestic contracts do not always provide for monitoring, but they tend to do so where monitoring is most important. E.g., secured creditors will normally include monitoring provisions of some sort in their credit agreements when the amount involved is large enough to justify the costs of monitoring.

⁹ See, e.g., Raustiala, 'Form and Substance in International Agreements', mimeo (2002) (stating that international lawyers 'have produced few theories of why states chose to use or avoid legality') (on file with author); Guzman, *supra* note 7, at 307 ('The reluctance of states to include binding dispute resolution clauses in their agreements has received limited attention from international law scholars.'). But see Sykes, 'Protectionism as a "Safeguard": A Positive Analysis of the GATT "Escape Clause" with Normative Speculations', 58 *U Chicago L Rev* (1991) 255 (offering a public choice explanation of the escape clause provisions contained in Art. XIX of GATT).

¹⁰ As this sentence makes clear, this article embraces an institutionalist view. It is worth noting that there is considerable debate about the proper way to model state behaviour, and institutionalism is only one of the possible choices, with the other common ones being realism and constructivism. The merits and demerits of these approaches have been exhaustively catalogued, debated, and discussed elsewhere, and it serves no purpose to revisit that debate here. For discussions of these approaches, see Abbott, 'Modern International Relations Theory: A Prospectus for International Lawyers', 14 *Yale J Int'l L* (1989) 335 (institutionalism); Koh, 'Why Do Nations Obey International Law?', 106 *Yale LJ* (1997) 2599 (constructivism); Koh, 'Transnational Legal Process', 75 *Nebraska L Rev* (1996) 181 (constructivism); M.E. Brown, S.M. Lynn-Jones, and S.E. Miller (eds.), *The Perils of Anarchy: Contemporary Realism and International Security* (1995) (realism).

¹¹ Throughout this article the term 'design elements' will be used to describe the credibility enhancing devices that represent the focus of the article – hard law, dispute resolution, and monitoring.

one party is gained by the other.¹² When agreements between states are violated, however, the associated sanctions do not have this zero-sum character.¹³

When a state violates an international commitment it suffers, to the extent that it faces any sanction, a loss of reputation in the eyes of other states, perhaps combined with some form of direct sanction.¹⁴ These sanctions represent a loss to the state that has violated its obligation, but do not provide an offsetting gain to the party to whom the obligation was owed. The sanction, therefore, is a net loss to the parties – one party faces a cost that is not recovered by the other.¹⁵

When the parties enter into an agreement, they recognize the potential for this future loss and the fact that credibility-enhancing design elements serve to increase this net loss in the event of a violation. The desire to increase the credibility of commitments, then, is tempered by a desire to avoid this loss. It is the tension between these competing goals of credibility and loss avoidance that explains the fact that states use the design elements discussed in this article – hard law, dispute resolution, monitoring – in some but not all international agreements.

The article proceeds as follows. Section 2 describes in detail why the failure of states to design their agreements in such a way as to maximize the credibility of their commitments is a puzzle, especially in light of what we know about the exchange of promises in the domestic setting.¹⁶ Section 3 explains how the desire for greater credibility and compliance interacts with the fear of losses generated in the event of a violation. Section 4 presents the predictions yielded by the theory regarding the use of credibility-enhancing devices. Section 5 explores some of the implications of the theory, including predictions about when credibility-enhancing devices are most likely. Section 6 concludes.

2 The Puzzling Diversity of International Commitments

When states enter into an international agreement, they have complete control over what is and is not included. Among the decisions that must be made are: the choice between hard and soft law; the decision to include or exclude dispute resolution provisions; and the decision to include or exclude monitoring, reporting and verification

¹² There are, of course, transaction costs, including lawyers' fees, but these are put to one side. In many cases these fees will be modest, and perhaps even zero, because most disputes are settled prior to trial, and some are settled before lawyers are even hired.

¹³ See *infra* note 33.

¹⁴ See Guzman, 'A Compliance-Based Theory of International Law', 90 *Calif L Rev* (2002) 1823.

¹⁵ States could, of course, provide for money damages in their agreements. In fact, they almost never do so. The reason for state resistance to money damages is itself something of a puzzle and this article does not attempt to explain this fact. It may be that money payments are not considered an effective deterrent, or that the political costs associated with either paying money damages or accepting them in compensation for a violation are significant. Alternatively, there may be a sense among states that money damages would be ignored too easily. Whatever the reason, this article simply recognizes this fact and assumes that money damages are not available. For a more detailed discussion of this issue, see Section 5B.

¹⁶ Along the way, Section 2 considers existing explanations for the resistance to credibility-enhancing devices in international agreements, including some that rely on domestic political forces.

provisions.¹⁷ This section explains why we would expect states to use these design elements to increase the credibility and effectiveness of international agreements, and shows that the failure of states to use them more often should be puzzling to international law scholars. It also reviews and evaluates existing arguments advanced to explain why these elements are so rarely used. Some of these arguments have merit and the explanation advanced here is intended as a complement to these claims, not a substitute. Other arguments advanced in the literature, however, have little to recommend them and should be dismissed.

The first design element of interest to this article is the soft law/hard law divide,¹⁸ which will be referred to as the choice of 'form'.¹⁹ When states enter into an agreement, they have the option of adopting either form.²⁰ If they evidence an intent to be 'bound', the agreement is labelled a treaty, and if they do not demonstrate such an intent, it is labelled 'non-binding,' or soft law.²¹ Though the precise place of soft law within the framework of international law is uncertain, it is clear that traditional

¹⁷ The choice regarding dispute resolution and monitoring is, of course, not a binary one. There are a wide variety of ways each of these design elements could be incorporated. The article frequently speaks of a choice to include or exclude such elements, but this should be recognized as a shorthand for the actual choice that includes not only whether or not to include the design elements, but how strong to make them.

¹⁸ There is no single agreed-upon definition of soft law. One approach is to identify what soft law is not. It is not 'hard law', by which is meant treaties or custom, nor is it a purely political understanding without a legal component. Rather, soft law is what lies between these two alternatives. See Abbott and Snidal, 'Hard and Soft Law in International Governance', 54 *Int Org* (2000) 421, at 422. For more about 'soft law,' see Wellens and Borchardt, 'Soft Law in European Community Law', 14 *ELRev* (1989) 267; Handl *et al.*, 'A Hard Look at Soft Law', 82 *Am Soc Int'l L Proc* (1988) 371; Gruchalla-Wesierski, 'A Framework for Understanding "Soft Law"', 30 *McGill LJ* (1984) 37. The term 'soft law' is used herein to denote law that falls short of the classical definition of international law. See Raustiala, *supra* note 9 (describing the term soft law). This is a common usage of the term, but it is not the only one. Some use the term to describe rules that meet the classical definition but are imprecise or weak. See Weil, 'Toward Relative Normativity in International Law', 77 *Am J Int'l L* (1983) 413, at 414 n.7 ('It would seem better to reserve the term "soft law" for rules that are imprecise and not really compelling, since sublegal obligations are neither "soft law" nor "hard law": They are simply not law at all.'). Dupuy, 'Soft Law and the International Law of the Environment', 12 *Mich J Int'l L* (1991) 420; O'Connell, 'The Role of Soft Law in a Global Order', in D. Shelton (ed.), *Commitment and Compliance: The Role of Non-binding Norms in the International Legal System* (2000), at 100, 109–110; Chinkin, 'The Challenge of Soft Law: Development and Change in International Law', 38 *ICLQ* (1989) 850.

¹⁹ In other writing I have commented on the conceptual problems that soft law presents for international legal scholars. See Guzman, *supra* note 14, at 1878–1883.

²⁰ See A. Aust, *Modern Treaty Law and Practice* (2000).

²¹ The terms 'binding' and 'non-binding' are sometimes used as synonyms for hard and soft law respectively but these terms are somewhat misleading because binding commitments – meaning treaties – often do not include enforcement mechanisms of any kind, let alone the sort of coercive enforcement mechanisms that we are used to in domestic law. Non-binding agreements, on the other hand, are commonly thought to affect the behaviour of states, and do so in part because they impose some sort of obligation on the signatories. We cannot, therefore, distinguish these two categories of commitment based on whether there is a sanction for non-compliance or whether state behaviour is affected. If non-binding agreements affect behaviour, a failure to comply must entail some consequences. On the other hand, it is clear that violation of a binding agreement imposes only limited costs on states. The most that can be said about the distinction between binding and non-binding agreements, then, is that a violation of the former will, all else being equal, impose greater costs on the violating state than violation of the latter.

international law scholarship considers soft law less 'law' than the 'hard law' of treaties and, for that matter, custom.²² By this it is meant that soft law is less obligatory than hard law and, presumably, has less impact on behaviour.²³ This article accepts as given the conclusion that, all else being equal, soft law impacts state behaviour less than do treaties in the sense that a given set of substantive obligations is more likely to affect behaviour if it takes the form of a formal treaty.²⁴

But soft law is not the only design element that can affect the 'compliance-pull' of an agreement. States also choose whether or not to adopt formal dispute resolution processes.²⁵ These can range from a framework for consultation to a formal system of binding adjudication.²⁶ Though some high-profile agreements, such as the WTO²⁷ and the Law of the Sea Convention,²⁸ include mandatory dispute resolution mechanisms,

²² Van Dijk, 'Normative Force and Effectiveness of International Norms', 30 *FRG YB Int'l L* (1987) 9, at 20. Perhaps the most traditional position views agreements other than treaties as nothing more than evidence of custom. See Dupuy, *supra* note 18, at 432. Under another view, soft law 'tends to blur the line between the law and the non-law, be that because merely aspirational norms are accorded legal status, albeit of a secondary nature; be that because the intended effect of its usage may be to undermine the status of established legal norms': Handl, *supra* note 18, at 371.

²³ One additional clarification is needed here. Some commentators use a definition of soft law that encompasses formal treaties whose substantive obligations are weak. Thus, e.g., a formal treaty that has no clear requirements, but instead consists of a set of goals, aspirations, or promises to pursue certain general objectives, would be considered 'soft' under this taxonomy. See Baxter, 'International Law in "Her Infinite Variety"', 29 *ICLQ* (1980) 549, at 554; Chinkin, *supra* note 18, at 851. It is certainly true that the impact of an agreement is affected by both its form (binding versus non-binding) and its substantive provisions. That is, a formal treaty can certainly have its impact reduced if the substance of the agreement is watered down. Furthermore, one could talk in general terms about a treaty being 'strong' or 'weak' based on how much pressure it puts on states to change their behaviour, and this would depend on both the form and substance of the agreement. All that said, it remains useful to distinguish between the impact of a choice of form and the impact of a change in the substance of a treaty. For this reason, this article will retain the terms 'binding' and 'non-binding', as well as hard and soft law, to refer to the formal legal status of an obligation. Treaties will be referred to as binding or hard; other agreements as non-binding or soft. This is done to clarify the discussion and demonstrate the fact that many binding agreements impact on state behaviour less than some non-binding agreements.

²⁴ This is assumed to be true even if the treaty has no monitoring, dispute resolution provisions or other enforcement mechanisms. Thus, it is the treaty form itself that increases the commitment, the costs of violation, and the likelihood of compliance.

²⁵ At various points this article will refer to the decision to include or exclude dispute resolution provisions. In fact, states face a range of options with regard to dispute resolution rather than a binary choice. When the article refers to this choice, then, it should be taken to mean a choice among the full variety of possible strategies, ranging from little or no system to deal with dispute to a very structured and formal mandatory process.

²⁶ An example of the former can be found in the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), 12 *ILM* (1973) 1085, which provides for negotiations between disputing parties and which allows for arbitration of disputes, but only with the consent of both parties. See *ibid.*, at Art. XVIII. An example of the latter can be seen in bilateral investment treaties (BITs). See, e.g., Treaty Concerning the Reciprocal Encouragement and Protection of Investment, 14 Nov. 1991, U.S.-Arg., arts. II-V, S. Treaty Doc. No. 103-2, at 3–6 (1993), 31 *ILM* (1992) 124, at 129–132; Vandeveld, 'U.S. Bilateral Investment Treaties: The Second Wave', 14 *Mich J Int'l L* (1993) 621.

²⁷ See Understanding on Rules and Procedures Governing the Settlement of Disputes (Annex 2 to the Agreement Establishing the World Trade Organization), 15 Apr. 1994, reprinted in 33 *ILM* (12994) 1226.

²⁸ See United Nations Convention on Law of the Sea, 10 Dec. 1982, Art. 76, UN A/Conf.62/122, 21 *ILM* (1982) 1261.

most agreements do not provide procedures of that sort.²⁹ The conventional view of dispute resolution, and the one adopted in this article, assumes that it increases the incentive toward compliance because it provides a mechanism to identify violations and may provide for some formal sanction.³⁰ The third design element that increases credibility is the use of monitoring procedures. There are, of course, a wide range of ways to monitor compliance, ranging from self-reporting or occasional and informal statements of state conduct to formal inspections of state behaviour and compliance by neutral observers.³¹

A *International Agreements as Contracts*

International agreements are, at root, an exchange of promises among states. This is true whether they are full-blown treaties or merely statements of intent; whether they require wholesale changes to domestic practices or merely reflect existing behaviour; and whether or not they include provisions for enforcement. Because our understanding of promises made at the international level is quite poor, there is much to be gained by looking to other areas of law where we have a better set of theoretical and conceptual tools with which to work. In particular, scholarship on the law of contracts offers a sophisticated understanding of promises made in the domestic context. It is, therefore, helpful to think of international agreements as a form of contract and bring to bear on the study of those agreements some of the insights from the contracts literature. Of course, there are important differences between promises exchanged by states and those exchanged by private parties. In fact, this article points to one such difference to help explain why states often enter into agreements that are less binding than one might expect. Nevertheless, analogy to contracts is useful because it offers a good starting point for the study of international agreements.

Consider one of the most basic ideas from contract theory, the Coase theorem.³² In the absence of transaction costs, the parties will negotiate an efficient contract, meaning one that generates the maximum possible joint surplus.³³ The terms of the contract will then provide for some distribution of that surplus. In a contract between a buyer and a seller, for example, the seller will offer higher and higher quality up to the point where the buyer's willingness to pay for higher quality is less than the cost of further quality increases. The ultimate sale will include a price adjustment to reflect

²⁹ See Guzman, *supra* note 7, at 304.

³⁰ Dispute resolution may provide an additional benefit, in that it serves to reduce the use of costly sanctions, especially when there has been no violation, because a finding that there has been no violation can prevent the unjustified use of such sanctions.

³¹ See, e.g., *supra* note 4. Kal Raustiala categorizes the different monitoring systems as either strong or weak. His category of strong systems include 'police patrols', by which he means investigation and evaluation of behaviour by a central authority, and 'fire alarms', by which he means a determination by a central authority based on self-reporting or claims by other parties. See Raustiala, *supra* note 4.

³² Coase, 'The Problem of Social Cost', 3 *JL & Econ* (1960) 1.

³³ In discussions of international institutions the effort to maximize the total joint surplus of the parties to an agreement is sometimes referred to as 'rational design'. See Koremenos, Lipson, and Snidal, *supra* note 1, at 781.

this higher quality, though precisely how the gains generated by the contract are divided will vary based on the market power of the parties. Notice that this interaction generates the optimal quality level – higher quality would not be worth the cost, lower quality would reduce the total benefit enjoyed by the parties by more than the cost savings.

This simple theory of negotiation is well established in the contracts literature, but how does it affect the way in which we view inter-state agreements? Before proceeding, we must make some assumptions about state behaviour. This article assumes that states are rational beings; that they act in their own self-interest, at least as that interest is defined by the political leaders of the state; and that states are aware of the impact of their actions on the behaviour of other states. These represent standard assumptions about state conduct, but our understanding of state behaviour remains sufficiently contested that it is worthwhile to identify them explicitly.³⁴ The assumptions imply that when states enter into international agreements they will, like domestic parties entering into a contract, seek to maximize the joint benefits to the parties.³⁵

With the above assumptions in mind, imagine two (or more) states engaged in negotiation over some set of issues. For example, Mexico and the United States might be concerned about a set of environmental issues that affect both states. The states may have different priorities and different goals, and each may pursue its own interests without regard for the interests of the other. Whatever agreement they ultimately reach, however, our assumption that they will reach an efficient agreement ensures that there is no alternative agreement that could make both parties better off. Suppose, for instance, that the United States prefers tougher environmental standards than does Mexico. If those standards are sufficiently important to the US, it will get the standards it wants in exchange for some other concession – perhaps better treatment for illegal immigrants within the United States. Alternatively, if the cost to Mexico of higher standards is greater than what the US is willing to pay, lower standards will prevail in the agreement because the compensation demanded by Mexico for its acceptance of higher standards would exceed the willingness to pay of the United States. The parties will increase the level of agreed-upon standards as long as

³⁴ The assumptions made here are conventional institutionalist ones. See Abbott, 'Modern International Relations Theory: A Prospectus for International Lawyers', 14 *Yale J Int'l L* (1989) 335; R. O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (1984), at 27; Raustiala and Slaughter, 'International Law, International Relations and Compliance', in W. Carlsnaes *et al.* (eds.), *Handbook of International Relations* (2002).

³⁵ Note that these assumptions about state behaviour are consistent with both a public interest model of governance, in which states pursue the welfare of their citizens, and an alternative public choice model, in which governmental leaders pursue their own private goals: see Guzman, 'Choice of Law: New Foundations', 90 *Georgetown LJ* (2002) 883, at 900 (discussing how public choice issues can be handled in an international law context). The most able scholar using public choice analysis in the international context is Alan Sykes. See Schwartz and Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization', 31 *J Legal Stud* (2002) 179; Schwartz and Sykes, 'Toward a Positive Theory of the Most Favored Nation Obligation and its Exceptions in the WTO/GATT System', 16 *Int'l Rev L & Econ* (1996) 27; Sykes, 'Protectionism as a "Safeguard": A Positive Analysis of the GATT "Escape Clause" with Normative Speculations', 58 *U Chi L Rev* (1991) 255.

the US is willing to pay more than Mexico demands – leading them to an agreement that maximizes their joint welfare. No other agreement could, when combined with some transfer payment, make both parties better off.

The domestic contract law story ends at this point – it is assumed that, having reached an agreement that maximizes joint welfare, the parties will enter into a binding legal contract.³⁶ The contract would reflect the efficient bargain; disputes between the parties would typically be resolved by the domestic court system or, perhaps, some form of mandatory private arbitration; and monitoring would be provided for, up to the point where the marginal benefit of additional monitoring is outweighed by its marginal costs. Entering into such a contract encourages both sides to uphold their end of the agreement, permits greater reliance by each party, and allows the parties to achieve the joint gains that motivated the contract in the first place.³⁷

A glance at international agreements reveals that they appear inconsistent with the above description.³⁸ Specifically, agreements among states frequently do not make use of familiar and accessible mechanisms to increase the credibility of commitments. States often enter into soft law agreements rather than treaties, typically fail to provide for any dispute resolution procedures,³⁹ and frequently require little or no monitoring or verification of performance.⁴⁰

³⁶ Domestic parties do occasionally enter into agreements that are not binding. E.g., in the course of the negotiation of a loan, two parties may sign a 'letter of intent' which lays out the terms of the ultimate agreement but is not itself legally enforceable. Agreements of this sort are often, though probably not always, intended to help the parties make sure that they have a common expectation about ongoing negotiations. In any event, and whatever their purpose, it is clear that such agreements are atypical of domestic law agreements, and private contracting normally takes the form described in the text.

³⁷ See text accompanying note 44.

³⁸ Variance in the use of credibility-enhancing devices is almost certainly related in part to the subject matter of the agreement. E.g., it is conventional wisdom that dispute resolution is more common in trade and human rights than in, e.g., arms agreements: see, e.g., Smith, 'The Politics of Dispute Settlement Design: Explaining Legalism in Regional Trade Pacts', 54 *Int Org* (2000) 137. Similarly, it is said that monitoring is more common in the environmental context: see, e.g., E. B. Weiss and H. K. Jacobson, *Engaging Countries: Strengthening Compliance with International Environmental Accord* (2000), at 91. This article does not attempt to evaluate these empirical claims or to test the theory against them in a formal way. Section 4, however, discusses when the theory predicts that credibility-enhancing devices are most likely and offers some comments suggesting how well these predictions accord with what we observe. More formal testing of the theory is left for future work.

³⁹ And they almost never provide for dispute resolution procedures that attempt to impose something analogous to expectation damages.

⁴⁰ To illustrate the basic difference between what analogy to domestic contracting suggests and what we observe in the international context, consider how odd it would seem to see sophisticated business parties enter into negotiations, expend significant resources, produce a complex agreement, and then intentionally make that agreement non-binding and unenforceable. Similarly, one would be surprised to see an agreement that is legally binding, but that declares itself unenforceable before any court or tribunal. Indeed, the use of agreements that are intentionally not adjudicable before any body is so alien to conventional contract law that it is hard even to know what it means for a contract to be legally binding if there is no enforcement: see Uniform Commercial Code § 1–201(3, 11) (defining 'Contract' and 'Agreement'). Finally, a lawyer who negotiated a complex, long-term agreement and then failed to provide for the use of available and cost-effective monitoring procedures would be criticized for an error of judgement. Not only do all of these things happen in the world of inter-state agreements, they represent standard operating procedure.

Before proceeding further, it is important to recognize that all the design elements discussed in this article are related.⁴¹ Each of them alters the extent to which an agreement provides an incentive for states to comply. Signing a treaty rather than soft law, including mandatory dispute resolution, and choosing to put monitoring procedures in place, all increase the impact of an agreement on state behaviour. Furthermore, it is possible to trade the compliance benefits of one of these elements off against those of another. For example, a treaty that has stringent monitoring and reporting obligations but no dispute resolution procedures might have the same impact on behaviour as an agreement with limited monitoring and reporting but a mandatory dispute resolution procedure.⁴²

That there is a trade-off among these elements, however, does not explain state behaviour because from a contracting perspective, one would expect states to use each of the elements to increase the credibility of their commitments.⁴³ Like the parties to a domestic contract, states wish to maximize the joint benefits from an agreement. Consistent with that desire, the parties will adopt enforcement techniques that ensure performance unless the total joint cost of performance is greater than the total joint benefit. Specifically, they want to provide an incentive to perform, even if it turns out that performance is costly to one of the parties, as long as performance yields net benefits to the parties taken together. In domestic contracts, of course, the law attempts to provide a system of damages and other remedies that leads to efficient results. It is for this reason that expectation damages represent the standard remedy for contract violation – they encourage efficient breach.⁴⁴

The standard enforcement tools of international law are, of course, a great deal weaker than those present in domestic systems. In particular, states cannot rely on a system of coercive enforcement to ensure an efficient level of damages.⁴⁵ The enforcement

⁴¹ I am not the first to make this observation. In a recent draft article, Kal Raustiala has observed that the choice of form (i.e., treaty v. soft law) can be traded off against the substance of an agreement: see Raustiala, *supra* note 9, at 34.

⁴² See Kaplow, 'The Value of Accuracy in Adjudication: An Economic Analysis', 23 *J Legal Stud* (1994) 307, at 352–354 (explaining the relationship between increased accuracy and costly sanctions in the domestic context).

⁴³ As already discussed, see *supra* the text accompanying notes 35–37: contract theory tells us that states should increase the level of commitment up to the point at which the costs of violation are equal to the benefits thereof. If some combination of design elements generated excessive commitment states would provide for some lower level of commitment. In the international arena, however, it is hard to believe that any combination in the design elements can generate optimal, let alone excessive, incentives to comply.

⁴⁴ See R. A. Posner, *Economic Analysis of the Law* (4th edn., 1992), at 117–126; Barton, 'The Economic Basis of Damages for Breach of Contract', 1 *J Legal Stud* (1972) 277, at 283–289; Shavell, 'Damage Measures for Breach of Contract', 11 *Bell J Econ* (1980) 466. But see Friedmann, 'The Efficient Breach Fallacy', 18 *J Legal Stud* (1989) 1 (challenging the claim that expectation damages yield an efficient outcome). In domestic law there are other efficiency goals – specifically efficient insurance and efficient precaution – that may lead one to favour less than expectation damages. These objectives, however, have less applicability to inter-state agreements and, in any case, the level of damages provided by the background rules of international law seems too low even if these other goals are taken into account.

⁴⁵ See, e.g., Damrosch, 'Enforcing International Law Through Non-Forcible Measures', 269 *Recueil des Cours* (1997) 19 ('A fundamental (and frequent) criticism of international law is the weakness of mechanisms for enforcement.'): Falk, 'The Adequacy of Contemporary Theories of International Law – Gaps in Legal Thinking', 50 *Va L Rev* (1964) 231, at 249 (1964) ('Among the most serious deficiencies in

mechanisms are sufficiently weak that, as far as I am aware, no commentator argues that enforcement measures in international law are sufficient to secure optimal levels of compliance.⁴⁶

Given the weakness of the international enforcement system, one might expect that international agreements would include mechanisms intended to increase the likelihood of compliance. In fact, such mechanisms are not routinely included in agreements, and sanctions are normally not provided for. Where sanctions are provided, they are often not severe, and often only prospective.⁴⁷ Simply put, in many agreements, the tangible sanctions for a failure to comply with international law are very weak. Though there may also be a reputational sanction,⁴⁸ there is no reason to think that reputation is sufficient to provide for an efficient level of breach between states. Reputational sanctions are limited in magnitude and can be unpredictable, and even a total loss of reputation may not be enough to deter a violation of international law.⁴⁹ Reputational sanctions are also likely to under-deter breach because the actions of the parties may not be observable to third parties. In the absence of a disinterested adjudicator, the breached-against party cannot credibly demonstrate that the other party was at fault.

Before proceeding it is worth pausing to address a potential objection. It might be said that a rule of customary international law imposes on a violating state the obligation to 'make full reparation for the injury caused by the internationally wrongful act'.⁵⁰ If one has sufficient belief in the power of customary international law, one might ask if states rely on this background rule and therefore do not find it necessary to provide for damages in their agreements. Analogizing to the domestic sphere, the argument would be that private parties relying on the default remedies of contract law may not feel it necessary to include a liquidated damage clause of other contractual language governing damages.

A realistic appraisal of both the power of customary international law and the status of this particular rule, however, makes it clear that this claim is implausible. First,

international law is the frequent absence of an assured procedure for the identification of a violation.');

Franck, 'Legitimacy in the International System', 82 *Am J Int'l L* (1988) 705, at 705 (observing '[t]he surprising thing about international law is that nations ever obey its strictures' because 'the international system is organized in a voluntarist fashion, supported by so little coercive authority').

⁴⁶ But see Damrosch, 'Enforcing International Law Through Non-forcible Measures', 269 *Recueil des Cours* (1997) 19–22 (arguing that there are more sanctions for violation of international law than is generally recognized).

⁴⁷ See, e.g., the WTO Dispute Settlement Understanding, Art. 22(4) ('The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.').

⁴⁸ See R. O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (1984), at 105–108; R. Axelrod, *The Evolution of Cooperation* (1984); Guzman, *supra* note 14.

⁴⁹ See Downs and Jones, 'Reputation, Compliance, and International Law', 31 *J Legal Stud* (2002) 95 (discussing reputation as it affects international law).

⁵⁰ See Draft Articles on Responsibility of States for Internationally Wrongful Acts, adopted by the International Law Commission at its 53rd session (Sept. 2001), Supp. No. 10 (A/56/10), chap. IV.E.1, at www.un.org/law/ilc/convents.htm (this site also contains the authoritative commentaries).

it does not seem to be the case that there exists a rule requiring reparation in the event of a violation of international law. The determination of what is and what is not customary international law is, of course, contentious, and it is beyond the scope of this article to attempt a comprehensive analysis of the question in this context.⁵¹ It is enough to note that we do not witness a consistent pattern of reparations being paid between states when international obligations are violated.

Furthermore, even if this is, indeed, a rule of customary international law, it is only relevant when states have chosen to enter into a hard law agreement and include a dispute resolution mechanism. The hard law form is necessary because the rule only binds states in the event of a violation of a treaty. States, therefore, could only consider the reparations obligation relevant in instances in which they select the hard law form. If anything this deepens the puzzle addressed in the article since a customary international law requiring reparation would make hard law even more powerful and effective relative to soft law.

Similarly, if this obligation were thought to be both effective and desirable we would expect more, rather than less, use of dispute resolution since the obligation to make reparation requires some authority to determine whether or not there has been a violation. And where states have determined that they do not want to provide for dispute resolution we would expect to see them routinely opting out of this obligation to make reparations. This is so because whatever concerns states about dispute resolution (for instance, fear of losing a case, fear of being perceived to be in violation of the law) should concern them about the reparation obligation. For example, a state making a reparation payment is also admitting guilt, so if states avoid dispute resolution because they do not want to be declared to have violated international law one would also expect them to avoid the reparations obligation.

Even if one were to accept, contrary to the practice of states, the claim that there exists a customary international law rule requiring the payment of reparation in response to a violation of international law, this rule could only serve as a substitute for credibility enhancing devices if it is equally effective. Again, this is not the place for a complete discussion of the problems with customary international law, but it is clear that it is at best a weak force acting on states. As such, it is hard to believe that it offers a substitute to the credibility-enhancing devices discussed herein.

Finally, even if one believes that a rule of customary law exists, and that it is effective, the compensation it calls for is often quite modest. For example, a state that violates international law 'is under an obligation to give satisfaction for the injury caused by that act insofar as it cannot be made good by restitution or compensation. Satisfaction may consist in an acknowledgement of the breach, an expression of regret, a formal apology or another appropriate modality.'⁵² This form of 'reparation' hardly seems sufficient to explain why states avoid the credibility-enhancing devices discussed in this article.

⁵¹ See Goldsmith and Posner, 'A Theory of Customary International Law', 66 *U Chicago L Rev* (1999) 1113; Swaine, 'Rational Custom', 52 *Duke LJ* (2002) 559.

⁵² Draft Articles, Art. 37.

B Existing Explanations

1 Explanations for the Presence of Soft Law⁵³

This article is not the first to ask why states use soft law, and there are a number of existing explanations for why states enter into soft law agreements.⁵⁴ The two most salient – flexibility and domestic issues – are presented below. The flexibility argument is largely unconvincing but the claims about domestic politics are surely an important part of the explanation for soft law.

2 Flexibility

The basic flexibility argument is that '[s]oft legalization allows states to adapt their commitments to their particular situations rather than trying to accommodate divergent national circumstances within a single text. This provides for flexibility in implementation'.⁵⁵ In simple terms, states choose soft law because it is less binding on them and, therefore, gives them greater flexibility.⁵⁶ This flexibility is said to be desirable for a variety of reasons, including to help states deal with an uncertain world,⁵⁷ to reduce the costs of termination or abandonment,⁵⁸ or to make renegotiation easier.⁵⁹

⁵³ There is a significant literature on the subject of soft law. See the sources cited *supra*, at note 18. The general view of soft law in international law is that it is in some sense less 'binding' than traditional sources of international law, and states are accordingly less likely to comply: van Dijk, 'Normative Force and Effectiveness of International Norms', 30 *German YB Int'l L* (1987) 9, at 20. Perhaps the most traditional position views agreements other than treaties as nothing more than evidence of custom: see Dupuy, *supra* note 18, at 432; Steinberg, 'In the Shadow of Law or Power? Consensus-based Bargaining and Outcomes in the GATT/WTO', 56 *Int Org* (2002) 339, at 340 ('[M]ost public international lawyers, realists, and positivists consider soft law to be inconsequential.').

⁵⁴ See Hillgenberg, 'A Fresh Look at Soft Law', 10 *EJIL* (1999) 499; Lipson, 'Why are Some International Agreements Informal?', 45 *Int Org* (1991) 495, at 500; Abbott and Snidal, *supra* note 18; Gruchalla-Wesierski, *supra* note 18; Guzman, *supra* note 18.

⁵⁵ Abbott and Snidal, *supra* note 18, at 445; Lipson, *supra* note 54, at 500 ('[I]nformal bargains are more flexible than treaties. They are willows not oaks.').

⁵⁶ To the extent that the argument here is that it may at times be desirable to have weaker or less precise substantive provisions in an agreement, it is a question of what this article defines as the 'substance' of the agreement, and it is discussed in Section 3F. This article uses a definition of 'soft law' that turns entirely on questions of form – an agreement is soft if it is not a formal treaty. Given this definition, there is no *a priori* reason why soft law instruments (meaning instruments that fall short of formal treaty status) must be less precise. States could negotiate a detailed set of terms but have that exchange of promises take the form of soft law. Similarly, states can enter into formal treaty commitments that lack precision. Other scholars, in particular Abbott and Snidal, who are quoted above, see *supra* 56, use a different definition of soft law. As a result, some arguments made by other authors about 'soft law' may in fact be referring to characteristics of agreements (such as the precision of the substantive obligations) that are defined in differently in this article.

⁵⁷ See Abbott and Snidal, *supra* note 18, at 441 (stating that soft law helps states to deal with the fact that '[t]he underlying problems may not be well understood, so states cannot anticipate all possible consequences of a legalized arrangement'); Lipson, *supra* note 55, at 518 (arguing that soft law 'is useful if there is considerable uncertainty about the distribution of future benefits under a particular agreement'); Guzman, *supra* note 9, at 18 ('governments need not predict the future and can easily adjust the agreement or renege').

⁵⁸ See Lipson, *supra* note 55, at 518.

⁵⁹ See Abbott and Snidal, *supra* note 18, at 435.

The merit of flexibility, then, turns on the fact that soft law is less binding on states, allowing them to respond to unexpected future events. The problem with the argument is that flexibility of this sort reduces the value of the agreement to the parties. When entering into the agreement states have an incentive to set terms that maximize the expected payoff from that agreement. Granting each party the ability to unilaterally change those terms reduces this expected payoff. Though a state prefers that its own commitments be 'flexible' in this way, it would prefer that its counter-party be held to its promise. In conventional contract language, an efficient treaty compels performance unless the joint costs of performance exceed the joint benefits.⁶⁰

3 *Domestic Law and Politics*

A different explanation for the use of soft law instruments concerns the domestic processes by which international agreements are approved. The use of a soft law instrument rather than a treaty triggers a different set of domestic practices and this may affect the choice of form. These arguments, whatever the merits of any particular claim, are surely part of the explanation for the use of soft law. This section simply mentions three prominent explanations for soft law that turn on matters of domestic law and politics.⁶¹

Soft law agreements differ from treaties in that they do not require formal ratification and therefore can be implemented more quickly.⁶² They also lie more completely within the domain of the executive branch of government.⁶³ These traits may cause soft law instruments to be used when speed is important or when legislative support is lacking or uncertain. Soft law also differs from treaties in that treaties serve to 'commit [different] domestic agencies (especially legislatures) or political groups when those officials are able to make international agreements with little interference or control'.⁶⁴ Thus, an executive that wants to enter into an agreement can use treaties to more effectively bind these other actors. Finally, the choice between a treaty and soft law is also likely to be influenced by domestic political interests. International agreements reflect, among other things, the demands of domestic groups. When interest groups pressure a government to enter into negotiations, they typically want

⁶⁰ Some of the specific arguments about the merits of flexibility have additional problems. Claims that soft law is desirable because it makes renegotiation or termination easier seem wrong on their face, except inasmuch as they relate to matters of domestic politics, as discussed in Section 2B3. When negotiating an agreement, the parties remain free to include any termination and renegotiation provisions they wish, and can do so independently of the choice of form. They could, e.g., provide for termination without notice, or with short notice, or on whatever conditions they choose. Similarly, the parties can provide any amendment provisions they wish, regardless of the form of the agreement. E.g., the UN Charter can be amended 'by a vote of two thirds of the members of the General Assembly and ratified in accordance with their respective constitutional processes by two thirds of the Members of the United Nations, including all permanent members of the Security Council': see United Nations Charter, Art. 108.

⁶¹ This section is intended to offer only a glimpse at the domestic law arguments. It is not intended to be comprehensive. For more on the subject see Abbott and Snidal, *supra* note 18; Lipson, *supra* note 54.

⁶² Lipson, *supra* note 54, at 500.

⁶³ *Ibid.*, at 516 ('It is plain . . . that executives prefer instruments that they can control unambiguously, without legislative advice or consent.').

⁶⁴ See Abbott and Snidal, *supra* note 18, at 430.

a treaty rather than soft law.⁶⁵ This is what we would expect from a contractual perspective – those who push for an international agreement want it to be in the most credible and binding form possible. There is, of course, no guarantee that interest groups pushing for a treaty will get what they want. Governments entering into the agreement may decide to enter into a soft law agreement for any number of reasons, including the fact that other interest groups may oppose a treaty. The point here is that the political balancing of interests may cause a state to enter into a soft law agreement as a form of compromise between groups seeking a treaty and those seeking to avoid any commitment.

4 Explanations for the Rarity of Dispute Resolution

A small number of writers have commented on the reluctance of states to enter into dispute resolution procedures,⁶⁶ but they have failed to advance a convincing explanation for this behaviour. Two main arguments have been advanced.

The first proposed explanation turns on the desire of states to retain control over disputes. When a dispute arises, the argument goes, states prefer to resolve the dispute through bargaining and diplomacy rather than third-party adjudication.⁶⁷ Though this argument may explain why states do not refer cases to third-party tribunals after disputes arise, it does not shed light on the question of why dispute resolution is not included in agreements when they are signed.⁶⁸ The presence of dispute resolution, even if it is mandatory, does not prevent negotiation between the parties. Until one of the parties turns to the dispute resolution procedures and, indeed, even after the formal mechanism of dispute settlement has been put into motion, the parties are able to discuss the dispute and enter into any settlement they choose. The idea that dispute settlement procedures somehow prevent diplomatic negotiation is simply wrong. It may affect the outcome of the negotiation because it changes the consequences of a refusal to settle, but it does not prevent the negotiation itself.

⁶⁵ See Guzman, *supra* note 9, at 28 ('[M]any domestic and transnational interest groups focus on bindingness – on contractual form – as a necessary factor in international cooperation.').

⁶⁶ See Morris, 'High Crimes and Misconceptions: The ICC and Non-party States', 64 *Law and Contemporary Problems* (2001) ('States are particularly unwilling to enter into broad commitments to adjudicate future disputes, the content and contours of which cannot be foreseen.'). Rovine, 'The National Interest and the World Court', in L. Gross (ed.), *The Future of the International Court of Justice* (1976), i, at 462–473; J.G. Merills, *International Dispute Settlement* (3rd edn., 1998).

⁶⁷ 'It is one thing to show that resort to the [International Court of Justice] is preferable to armed conflict; it is quite another matter to demonstrate that judicial processes are as valuable as ordinary out-of-court bargaining and discussion': Rovine, *supra* note 67, at 314. '[T]here is a more fundamental reluctance to submit to third-party adjudication that rests on the perceived advantages to States in some circumstances of retaining control over the resolution of disputes': Morris, *supra* note 66, at 17 (citing Rovine, *supra* note 66.)

⁶⁸ Because commentators attempting to explain the absence of dispute resolution provisions frequently fail to distinguish between the inclusion of mandatory provisions in an agreement and the decision to submit disputes to third party arbitration at the time of the dispute, it is impossible to know if they seek to explain only the latter, in which case the arguments advanced seem right but the question asked is of less interest to this article; or if they hope to explain the former, in which case the arguments are flawed.

A second explanation sometimes advanced for the refusal to adopt dispute resolution clauses relies on the notion that states are afraid of losing a case.⁶⁹ Without a larger theory of state behaviour it is hard to know why a state's fear of losing a case would outweigh its interest in winning a case. The most likely explanation for such behaviour is risk aversion on the part of states.⁷⁰ Risk aversion, however, is an unsatisfactory explanation for the choice of soft law for at least two reasons.

First, states enter into many agreements and interact with other states on a regular basis. Because each individual commitment represents only a small fraction of the total set of interactions, it is hard to see why risk aversion would be a sensible strategy for most agreements.⁷¹ It would make more sense to maximize the expected value of each agreement and rely on the large number of agreements to diversify the total benefits to the state. Second, the use of a dispute resolution clause may, in fact, reduce the level of risk. Such a clause increases the probability of compliance, which, depending on the range of future states of the world, may reduce the overall risk of the agreement.⁷²

5 *Explanations for the Rarity of Monitoring Strategies*

There is only a small literature on monitoring and review mechanisms,⁷³ and virtually no discussion of why these mechanisms exist in some agreements but not in others.⁷⁴ There does not appear to be any available explanation of why states do not use monitoring mechanisms more often to increase the credibility of their promises and why the mechanisms used are often weak.⁷⁵

⁶⁹ 'Most obviously, but most fundamentally, states resist judicial settlement because they fear losing': Rovine, *supra* note 66, at 317.

⁷⁰ '[T]he more uncertain the adjudicated outcome of a particular dispute would be, the less willing a State will be to seek binding third-party adjudication': Morris, *supra* note 66; Merrills, *supra* note 66, at 293–294 ('when the result is all important, adjudication is unlikely to be used because it is simply too risky').

⁷¹ The risk aversion explanation even fails for agreements that are central to the existence or welfare of a state. Even under the most credible of international agreements the consequences of a violation are quite limited. There is no authority to compel compliance, so the harm from losing a dispute before a dispute settlement body is limited to the lesser of the costs of compliance and the costs of ignoring the decision of that body.

⁷² It is also worth noting that there are a number of alternative ways to deal with the risk of an agreement. States could, e.g., build in escape clauses triggered by poor economic performance, national crises, or other contingencies that concern the parties. This strategy reduces the exposure to risk without reducing the agreement's effectiveness in those states of the world in which the parties want compliance. An alternative strategy would be to weaken the substantive requirements of the agreement. This reduces the benefits of the agreement, but also reduces the level of commitment. Taken together, this may generate a higher expected return to the parties than an agreement with greater substantive provisions. Each of these strategies provides flexibility to the parties in a more nuanced and targeted way than simply including or excluding a dispute resolution provision.

⁷³ See Raustiala, *supra* note 4.

⁷⁴ See Helfer, 'Overlegalizing Human Rights: International Relations Theory and the Commonwealth Caribbean Backlash Against Human Rights Regimes', 102 *Colum L Rev* (2002) 1832, at 1841 (pointing out that even within the single field of human rights there is considerable diversity in human rights monitoring mechanisms).

⁷⁵ See, e.g., Frischmann, 'A Dynamic Institutional Theory of International Law', 51 *Buffalo L Rev* (2003) 679 (observing that the most international environmental agreements that include a monitoring system rely on self-reporting by states).

3 Seeking Credibility, Avoiding Commitment

A Sanctions for Violations of International Law

The explanation for why states do not make more use of credibility-enhancing devices takes account of the unique way in which state violations of law are sanctioned in the international arena. In a typical domestic contracts case between private parties, a contractual violation gives the aggrieved party the right to damages from the violating party. These damages normally take the form of a cash transfer from one party to the other. Because the penalty is a transfer, it has no impact on the joint welfare of the parties – what is lost by one party is gained by the other. For this reason, when private parties enter into a contract the fact that damage payments may have to be paid in the future does not affect the expected benefits of the contract.⁷⁶

In the international arena, however, the *de facto* consequences of a violation are quite different. When an agreement is violated the offending state rarely pays money damages to other states. In fact, violations are normally not compensated in any direct fashion.⁷⁷ One can think of examples in which a form of compensation is provided, but even these examples rarely represent the sort of zero-sum transfer that exists in the domestic case. For instance, the WTO's dispute resolution procedures have provisions for the suspension of concessions previously granted to a violating party.⁷⁸ Rather than being a zero-sum transfer, the suspension of concessions is costly for both the sanctioning and sanctioned party.⁷⁹ Furthermore, a party is permitted to impose sanctions only up to the point where the cost imposed on the violating party equals the ongoing costs of the violation, and the sanctions must stop when the violative measure is ended.⁸⁰ There is no compensation for past violations.⁸¹

That violations are not penalized through a transfer of money or other assets from the violating party to the aggrieved state, however, does not mean that they are not penalized in any way. If international law matters at all, it is because there is some sanction for its violation.⁸² There are two primary ways in which a state can suffer harm as a result of its violation of international law: direct sanctions and reputational sanctions.⁸³ Direct sanctions are those imposed by other states against a violating state because it violated the agreement. They are explicit punishments for the violation. Direct sanctions are important to some international

⁷⁶ What is meant here is that the actual transfer of funds from one party to the other does not itself affect the value of the contract. The level of damages may, of course, affect the behaviour of the parties and this, in turn, may affect the value of the agreement.

⁷⁷ See *supra* note 15.

⁷⁸ See Understanding on Rules and Procedures Governing the Settlement of Dispute (DSU), Art. 22.

⁷⁹ With a public choice perspective it is possible that the sanctions are zero sum, as discussed *infra* Section 3E.

⁸⁰ *Supra* note 79, Art. 22(4).

⁸¹ See *ibid.*

⁸² Guzman, *supra* note 14.

⁸³ See *supra* note 14 for a detailed discussion of why states comply with international law and the impact of both direct and reputational sanctions.

agreements,⁸⁴ but most agreements do not provide for explicit sanctions of this sort.⁸⁵ This leaves reputation as an important factor in the compliance decision of states.

A state that violates an international commitment signals to other states that it does not take its international promises seriously and that it is willing to ignore its obligations. When that state seeks to enter into agreements in the future, its potential partners will take into account the risk that the agreement will be violated, and will be less willing to offer concessions of their own in exchange for promises from that country. If there is enough suspicion, potential partners may simply refuse to deal with the state. A violation of international commitments, then, imposes a reputational cost that is felt when future agreements are sought. A state known to honour its agreements, even when doing so imposes costs, can extract more for its promises than a state known to violate agreements easily. When making a promise, a state pledges its reputation as a form of collateral. A state with a better reputation has more valuable collateral and, therefore, can extract more in exchange for its own promises.

B *The Impact of Costly Sanctions*

The key to explaining why states so frequently avoid credibility-enhancing devices is that the sanction for a violation of international law is costly to the parties.⁸⁶ That is, reputational losses felt by one party are not captured by the other party to the agreement. Imagine, for example, that the United States and Russia enter into an arms agreement under which both parties agree to reduce their stockpile of nuclear weapons. If Russia subsequently violates the agreement, countries around the world will observe that violation and Russia will suffer a reputational loss as a result. This loss is not captured by the United States.⁸⁷ When the agreement is violated, then, one party suffers a loss but the other party does not enjoy an offsetting gain.⁸⁸

⁸⁴ E.g., bilateral investment treaties provide for direct sanctions in the form of compensation to investors who have been mistreated by a host state: see Guzman, 'Explaining the Popularity of Bilateral Investment Treaties: Why LDCs Sign Treaties that Hurt Them', 38 *Va J Int'l L* (1998) 639; Robin, 'The BIT Won't Bite: The American Bilateral Investment Treaty Programme', 33 *Am U L Rev* (1984) 931; R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (1995), at 97–117.

⁸⁵ See Guzman, *supra* note 7, at 304 and n.3 (observing that of 100 treaties surveyed only 20 included dispute resolution provisions, and of those, 12 were BITs).

⁸⁶ The theory of costly sanctions and their use in the domestic context is laid out in Shavell, 'Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent', 85 *Colum L Rev* (1985) 1232; Polinsky and Shavell, 'The Optimal Use of Fines and Imprisonment', 24 *J Pub Econ* (1984) 89; Kaplow, 'A Note on the Optimal Use of Nonmonetary Sanctions', 42 *J Pub Econ* (1990) 245. The theory developed here is related to these earlier papers, though I am not aware of any previous work applying these ideas in the international context.

⁸⁷ The United States may benefit from its now more accurate estimate of Russia's willingness to comply, but this represents only a small fraction of the harm suffered by Russia whose reputation is harmed worldwide. This example is given in the context of a bilateral agreement. In the case of multilateral agreements a similar but more complex reasoning applies: see Guzman, *supra* note 7, at 319–320.

⁸⁸ Similar reputational effects may be at work in domestic law, but the presence of zero-sum damages creates a separate incentive to enter into contracts with efficient terms. Furthermore, the role of reputation is diminished in the domestic environment because credibility is provided by the legal system – parties do not have to rely as heavily on their reputations when they wish to enter into agreements.

Now, consider once again the decision of the parties when they enter into an agreement. To keep the analysis simple, suppose they must choose between a treaty and a 'non-binding accord'. The difference between these instruments is that the treaty is more likely to induce compliance – this is why treaties are considered the most effective instrument of cooperation.⁸⁹ A treaty, however, is a double-edged sword. If there is a compliance benefit, it must be that a violation of the treaty imposes greater costs than a violation of the accord – that is, the reputational and direct harms associated with a violation must be greater for a treaty. When choosing between a treaty and a soft law instrument, then, the parties face a trade-off. A treaty generates higher levels of compliance, which (assuming the parties select terms optimally) increases the joint payoff, but in the event of a violation it imposes a larger penalty on the violating state.

To see how this trade-off operates as the parties draft their agreement, notice that there are three categories of outcomes relevant to the choice between soft and hard law. The first category includes those states of the world in which the parties to the agreement will comply whether or not the agreement includes design elements intended to enhance the credibility of the commitments. That is, international law provides sufficient incentives even if a soft law agreement is chosen. In this category, the parties are neither better nor worse off if they opt for a formal treaty over a soft law agreement.⁹⁰

The second category consists of all circumstances in which there would be compliance if a treaty is chosen, but violation otherwise. This is the category of all cases in which the increased compliance pull of the treaty makes the difference between compliance and violation. Because compliance is preferred to violation, the parties are better off in this category if they choose a formal treaty.

The third and final category of cases includes those in which there is a violation even if a formal treaty is used. In these states of the world the use of a formal treaty would impose a larger reputational cost on the parties than would be the case if they chose a soft law agreement. There is no compliance benefit to offset this cost, so in these cases the parties are better off with a soft law agreement.

In deciding between hard and soft law, then, the states face a trade-off between the second and third categories above. In the former, the use of hard law increases cooperation and gains to the states but in the latter hard law brings net costs. To maximize the total value of the agreement the states must balance these concerns.

C The Optimal Agreement

This section considers what the above theory predicts about the strength or weakness of agreements among states.⁹¹ We begin with the assumption that the parties to an agreement are able to anticipate and provide for every possible contingency. We also assume that a dispute resolution authority is available (or can be created) and that this

⁸⁹ See Lipson, *supra* note 54, at 508 ('The effect of treaties, then, is to raise the political costs of noncompliance.').

⁹⁰ If the choice of hard law implies some additional costs such as ratification costs, then the parties would do better if they chose soft law.

⁹¹ The discussion here draws on Shavell, *supra* note 86, at 1241–1246.

authority has perfect information about both the agreement and the facts of the dispute. Though thoroughly artificial, these assumptions help to explain how agreements are affected by the fact that only costly sanctions are available. The assumptions are then relaxed to generate a more realistic picture of international agreements.

Under these extreme assumptions we expect the parties to tailor the agreement to the three outcome categories described in the previous section.⁹² First, any behaviour with total benefits that outweigh its costs will be permitted under the agreement. This set of substantive obligations maximizes the total value of the agreement. Second, harmful behaviour that cannot be deterred by any available sanction will be permitted. Because sanctions are costly to the parties, providing for them when the behaviour cannot be prevented would only increase the harm resulting from that behaviour.⁹³ Finally, behaviour that is harmful and that can be deterred will be prohibited under the agreement and will be subject to dispute resolution procedures. As part of the effort to deter this behaviour, the parties are likely to enter into a formal treaty with dispute resolution provisions and monitoring.⁹⁴ Because the behaviour can be deterred, of course, no violation will ever take place.

So if the parties could craft a complete agreement, they would prohibit only behaviour that is harmful and that could be deterred. The agreement would be optimal in the sense that it would generate as much desirable cooperation as possible without ever actually imposing the costly sanction.⁹⁵

States cannot, of course, enter into agreements that provide for every possible contingency, so we must relax these assumptions. It is clear that states cannot identify every behaviour that they would like to prevent because they cannot anticipate every circumstance. Thus, for example, the parties to a trade agreement might wish to permit the use of safeguard measures when domestic industries are threatened, but it may be impossible to verify when that is the case.⁹⁶ The agreement, then, is likely to permit some safeguard measures the parties would prefer to prohibit and to prohibit some measures the parties would like to have permitted.

With respect to deterrence, the parties to the agreement will be unable to perfectly identify behaviour that can or that cannot be deterred. In particular, some conduct that cannot be deterred will nevertheless be prohibited. Furthermore, to the extent that the parties use credibility-enhancing devices, such as hard law, dispute resolution, and monitoring, these devices will increase the reputational sanctions imposed when conduct that cannot be deterred takes place.

⁹² See text accompanying note 90.

⁹³ If, e.g., under certain circumstances a state (or its leaders) stands to gain so much by abrogating an environmental treaty that it will do so even if all available credibility-enhancing devices are in place, then the higher sanctions brought on by these devices represent a cost to the parties with no offsetting gain.

⁹⁴ It may be possible to deter the behaviour without using all of the credibility-enhancing devices, in which case a subset of them may be used. All that matters is that the sanction be high enough to deter the conduct.

⁹⁵ See Shavell, *supra* note 86, at 1241–1242.

⁹⁶ The fact that safeguards are, according to many experts, always or almost always inefficient need not concern us because what we call the objectives of states are in fact the goals of decision makers within the states: see *supra* note 35 and accompanying text.

In the world of imperfect agreements, then, greater use of costly credibility-enhancing devices generates two main effects. First, it increases compliance, which generates benefits for the parties. Second, it leads to the use of costly sanctions when an obligation is violated – an outcome that imposes losses on the parties. When deciding whether or not to use credibility-enhancing devices, then, states must consider this basic trade-off between the benefits of increased compliance and the costs of reputational sanctions.

For our purposes, the most important implication of this trade-off is that the presence of costly sanctions discourages the use of credibility-enhancing devices, at least when compared to the case of costless sanctions, such as money damages. By choosing a hard law form, for example, the parties to an agreement generate benefits in the form of increased compliance and costs in the form of imposition of the costly sanction. If the costs are larger than the benefits, of course, states will resist the hard law form.

D A Numerical Example

The above discussion is somewhat abstract, so the following numerical example is provided to illustrate the main argument regarding the choice of design elements. To keep the example simple, only one design element – dispute resolution procedures – is considered. The analysis of the other design elements discussed in the paper would be identical.

Assume that there are two countries, labelled A and B. They face a prisoner's dilemma, which they are attempting to resolve through an international agreement. For concreteness, imagine that the agreement imposes obligations on each party with respect to domestic environmental policies. The question at hand is whether the agreement should include a dispute resolution provision.⁹⁷

Assume that if both parties comply with the terms of the agreement, they each receive a payoff of 5.⁹⁸ If one or both of the parties violate the agreement, the payoffs are affected by the presence or absence of a dispute resolution clause. If there is no such clause and both parties violate their commitments, they each earn zero. If one party violates the agreement while the other complies, the complying party faces a loss of 5, while the party that violates the agreement receives a positive payoff. These payoffs reflect the fact that the violating party avoids the costs of domestic changes but may still get the benefit of compliance by its counter-party. The complying party, on the other hand, makes costly changes to its domestic regime but does not get the expected benefit of compliance by the other state.

⁹⁷ For simplicity we assume that the parties are choosing whether or not to include an established set of dispute resolution provisions. In reality, of course, states may be able to construct any number of different dispute resolution mechanisms. The example captures this wider set of options if one imagines the states choosing between any pair of approaches to the question of dispute resolution.

⁹⁸ The game as presented should be thought of as the present discounted value of a repeated game rather than a one shot game. This is important because the game must be repeated for cooperation to emerge as a possibility in the absence of an enforcement mechanism.

The size of the payoff received by the breaching party is a random variable, labelled N . The range of possible values of N is such that the agreement will be breached in some cases, but not in others.⁹⁹ In the absence of a dispute resolution clause, then, the game can be represented as follows:

		Country B	
		Cooperate	Defect
Country A	Cooperate	(5, 5)	(-5, N)
	Defect	(N , -5)	(0, 0)

If the states include a dispute resolution clause, a breached-against party can bring the breaching party before a neutral tribunal which has the authority to declare that the state is in violation of the agreement.¹⁰⁰ The presence of this dispute resolution procedure increases the likelihood of compliance because a state that loses before the tribunal suffers a reputational loss.¹⁰¹ The loss comes about because the state that loses before a tribunal finds it more difficult to establish international agreements in later periods with either its counter-party in this agreement or third parties.¹⁰² Assume that this reputational loss imposes a cost of 2 on a state.

If the parties adopt the dispute resolution clause described above, the game can be represented as follows:

		Country B	
		Cooperate	Defect
Country A	Cooperate	(5, 5)	(-5, $N-2$)
	Defect	($N-2$, -5)	(-2, -2)

Finally, assume that the probability of compliance in the absence of a dispute resolution procedure (which is determined by the variable N) is 50 per cent, and the addition of such a procedure increases that probability to 60 per cent. Now consider whether the states prefer to include a dispute resolution mechanism or not when they negotiate the agreement. If they conclude the agreement without providing for

⁹⁹ This variable could represent any number of factors exogenous to the discussion, including economic shocks, domestic political developments, international events, and so on.

¹⁰⁰ One could imagine stronger dispute resolution provisions. For example, the tribunal could be authorized to impose some form of sanction. All that matters for present purposes is that the dispute resolution provisions work to increase the costs of a violation.

¹⁰¹ See Guzman, *supra* note 14.

¹⁰² Without a dispute resolution clause, it is assumed for simplicity that there is no reputational loss in the event of a violation. It is straightforward to incorporate a positive reputational loss even in the absence of a dispute resolution clause.

dispute resolution, they each expect to earn 5 with 50 per cent probability (i.e., if there is compliance), generating an expected payoff of 2.5.¹⁰³

If instead they provide for dispute resolution, they expect to earn 5 with 60 per cent probability and lose 2 with 40 per cent probability, yielding an expected payoff of 2.2. Thus, even taking into account the increased compliance generated by the dispute resolution clause, the parties are better off without such a clause. This is so because when there is a violation, a net cost is imposed on the parties (meaning that one suffers a loss that is not offset by the other's gain). In this example, the benefits of increased compliance are outweighed by that loss.

With a small change in the assumptions, one can generate the opposite result. Assume that everything remains the same except the dispute resolution clause increases the probability of compliance to 70 per cent rather than 60 per cent as previously assumed. In that case, the parties still expect to receive 2.5 if they do not have dispute resolution, but if they provide for dispute resolution, they can expect to enjoy a gain of 5 with 70 per cent probability and a loss of 2 with 30 per cent probability, yielding a net expected gain of 2.9 ($5 \cdot 0.7 - 2 \cdot 0.3$). With this modified set of assumptions, a dispute resolution clause is beneficial to the parties.

The intuition behind this result is straightforward. A dispute settlement clause is attractive because it increases the likelihood of compliance and, therefore, the probability of the cooperative outcome. As the impact of dispute resolution on compliance increases, so does the use of dispute resolution clauses. On the other hand, even in the presence of a dispute resolution clause, breach will sometimes occur. Because the reputational loss is a net loss to the parties rather than a transfer between them, increasing that loss reduces the payoff to the parties in those states of the world in which there is a breach.

When negotiating an agreement, therefore, the parties must take into account both the increase in compliance that is generated by the dispute resolution clause and the resulting joint loss that occurs when there is a breach. These offsetting effects will lead them to include dispute resolution provisions in some agreements but not in others.

E *Public Choice*

The above discussion has proceeded on the assumption that injuries to one state that take the form of reputational losses or direct sanctions represent a net loss to the parties – that is, the harm to the violating party is not offset by a gain to the other party. That assumption may be problematic if a particular form of political economy is at work in the sanctioning state.

When direct sanctions are applied, it is at least conceivable that the political leaders applying those sanctions may benefit. Thus, for example, if a government imposes trade sanctions in retaliation for what is perceived to be a violation of the trade obligations of another state, this may enhance the political support of the government, despite the fact that it harms the citizens of the sanctioning state.

¹⁰³ By assuming that the variable N is the same for both states we ensure that if one violates the agreement the other one does as well. This assumption is not necessary for the results.

To the extent sanctions generate benefits to the sanctioning party, their influence resembles that of transfers. That is, the loss to one party is at least partially offset by benefits to the other party. Where this is true, the parties have a reduced incentive to avoid the use of sanctions because they are able to get the compliance benefits of the sanctions with a lower cost in the event of a violation. If this is the case, the design elements of interest in this article – hard law, dispute settlement mechanisms, and monitoring – are less costly to include in the agreement. Notice that if the political economy works in the way described here, it is even more surprising that credibility-enhancing devices are not used more often. Once we recognize the relevance of public choice it is clear that the predictions of the theory¹⁰⁴ are sensitive to such issues. Thus, for example, areas in which political leaders enjoy benefits when they impose a sanction (trade agreements, perhaps) are more likely to feature credibility-enhancing devices.

F Substantive Provisions and Weak Agreements

The design elements discussed in this article are procedural or structural aspects of agreements. The article intentionally limits the discussion to a small number of procedural issues because their use can be observed directly in an agreement, and because the observed practice of states seems especially surprising. It is hard to say, *a priori*, which substantive obligations one would expect to find in an agreement. The substantive terms are the product of bargaining between the states and the positions of the states are the product of a complex domestic political dynamic. On the procedural side, however, the case for strong and credible agreements is much more compelling.

The same theory, however, could be applied to any aspect of an agreement that increases the commitment of the parties but imposes a net loss on the parties in the event of a violation. This includes both other procedural provisions of agreements and substantive provisions.

Like the elements already discussed, the substance of international agreements varies widely from one agreement to another. By substance I refer not to the particular topic or subject matter of an agreement, but rather to what is sometimes called ‘depth’.¹⁰⁵ Depth can be defined as ‘the extent to which [an agreement] requires states to depart from what they would have done in its absence’.¹⁰⁶ The notion of depth is intended to capture the fact that some agreements place a considerable burden on states and demand significant changes in behaviour, while other agreements do little more than ‘codify’ what states are already doing.¹⁰⁷

There are obviously many other ways in which the substance of an agreement may vary, but this article restricts itself to a discussion of depth. It might be argued that the notion of depth is itself unsatisfactory because it requires speculation about a

¹⁰⁴ See Section 4.

¹⁰⁵ See Downs, Roche, and Barsoom, ‘Is the Good News about Compliance Good News About Cooperation?’, 50 *Int Org* (1996) 379, at 383; Raustiala, *supra* note 9, at 7.

¹⁰⁶ See Downs, Roche, and Barsoom, *supra* note 107, at 383.

¹⁰⁷ See Raustiala, *supra* note 9, at 7.

counter-factual set of actions, because it is impossible to quantify, and because a single agreement may demand large changes in some states and virtually no changes in others.¹⁰⁸ Without resisting any of these critiques, the concept is useful for our purposes, which are limited to a discussion of the fact that the depth of an agreement between states may diverge from what the states would choose but for the fact that sanctions are costly.¹⁰⁹

As with the design elements that are the main focus of this article, states are free to adopt whichever substantive provisions they wish. Under a traditional model of contracting, one would expect them to select terms that maximize the value of the agreement. Such terms generate an efficient contract when combined with efficient penalties in the event of default. Unlike the design elements discussed in the article, however, there is no simple way to observe the relationship between the chosen terms of an agreement and the efficient terms.

The theory advanced in this article, however, suggests that states may select substantive terms that are systematically weaker than those that would maximize the benefits to the states if a costless (i.e., zero-sum) system of damages were available. To see why this is so, consider a simple example. Suppose that the United States and India wish to enter into an agreement that will facilitate the practice of using Indian residents as telephone support for the US-based customers of American firms. The American government wants to enter into the agreement to assist its firms in the computer, airline and other industries that rely heavily on telephones for customer service. India is interested in the agreement for the obvious reason that it will provide employment to its residents. Imagine that the states agree on the preferred substantive terms of the agreement, which deal with the provision of training programmes by

¹⁰⁸ E.g., the TRIPs Agreement required substantial changes to the law of intellectual property in many states, including most developing countries, but was largely consistent with the existing regimes in the United States and Europe.

¹⁰⁹ A clear example of how the theory presented here might impact on the substance of an agreement is the common use of escape clauses. An escape clause allows the parties to an agreement to suspend their compliance if certain conditions are satisfied. E.g., Art. XIX of the GATT and the WTO's Agreement on Safeguards allow WTO members to suspend their obligation under certain circumstances. Like the design elements discussed throughout this article, the use of escape clauses is influenced by two offsetting effects. First, it reduces the level of commitment of the states in a manner analogous to how the omission of a dispute resolution clause reduces the incentive to comply with the terms of the agreement. The safeguards do provide that a member implementing a safeguard is to 'maintain a substantially equivalent level of concessions': Agreement on Safeguards, Art. 8(1). This requirement offsets the impact of the safeguards provisions on the level of commitment, but only partially. The state adopting a safeguard measure is given the discretion to determine how to maintain the level of concessions, and this discretion obviously reduces the extent to which the state is constrained in its actions. Secondly, because the escape clause allows a state to suspend its commitment, it reduces the sanction for doing so in a manner analogous to the way in which the omission of a dispute resolution clause reduces the sanction for a violation. When drafting an agreement, then, states must consider both the reduced likelihood of compliance with the (other) terms of the agreement and the reduction in total loss if there is such non-compliance. There are, of course, other explanations for the use of escape clauses, and the explanation offered here is intended to be complementary to these earlier theories: see Sykes, 'Protectionism as a 'Safeguard'', 58 *U Chi L Rev* (1991) 255; Rosendorff and Milner, 'The Optimal Design of International Trade Institutions: Uncertainty and Escape', 55 *Int Org* (2001) 829.

India, access for US companies to recruitment opportunities, a commitment by the United States to underwrite some of those programmes, and a promise to support and permit American firms to use Indian phone operators.

Having established the value-maximizing terms, the states could incorporate them into the agreement, as would be expected if they were private parties negotiating a contract. The states, however, are concerned about the possibility of future violations. In particular, the United States is concerned about criticism from domestic constituencies who would prefer that the jobs be in the United States.

If this were a private contract, the parties would either proceed with the contract and include the value-maximizing terms or abandon the contract altogether.¹¹⁰ If they proceeded with the contract, they would rely on an efficient sanctions regime to ensure that the United States would breach if and only if it were efficient to do so. In the event of such a breach, India would receive damages in compensation.

Because India and the United States are entering into an international agreement, however, and because we assume that sanctions are costly,¹¹¹ they behave differently. In particular, they must concern themselves with the fact that if the United States violates its commitment under the agreement, the relevant sanction will not be a transfer from the US to India. To keep the example simple, assume that the only sanction will be a reputational one, and that the harm to the US from that sanction would be more than *de minimus*. To the other costs and benefits of the agreement, then, the parties must add the cost borne by the United States in the event that it violates the agreement. This reduces the total expected value of the agreement. If the parties choose a weaker set of substantive commitments – perhaps eliminating the American funding of some training programmes – it is less likely that the United States will violate its commitment, and less likely that it will suffer the reputational harm. In drafting the agreement, then, the parties must balance a desire to include the efficient terms against a desire to avoid the consequences of a violation. This may lead them to enter into an agreement with weaker substantive terms.

4 Predictions of the Theory

This paper explains that state reluctance to use credibility-enhancing devices is the consequence of the fact that sanctions for violations of international law are costly. The theory also generates some predictions about when one would expect more or less use of these design elements.

A *Bilateral v. Multilateral Agreements*

The non-zero-sum nature of sanctions in the international arena is a fundamental difference between international agreements and private contracts, and drives the

¹¹⁰ They would proceed with the contract if its total expected value, taking into account the costs and benefits incurred by both parties and the risk of a breach, were positive.

¹¹¹ See *supra* note 15.

main results of this paper. When a state violates a commitment it suffers a reputational loss for which there is little offsetting gain to its counter-party. The reputational sanction, however, is not a pure loss. Other states get a benefit in the form of improved information about the reputation of the violating state. The more these informational benefits are internalized by the parties to the transaction the more attractive are credibility-enhancing devices.

In many bilateral contexts it is reasonable to ignore these informational benefits because the bulk of them go to states that are not party to the agreement. The non-violating state gains only a small fraction of the informational benefits. In a multilateral agreement, however, more of the informational benefits are captured by parties to the agreement. This reduces the cost of a credibility-enhancing device in the event of a violation. In the extreme, a universal organization would capture all of the informational benefits that result from a violation. In that case it seems likely that the sanctions, rather than being negative-sum as they are in most bilateral cases, would be zero-sum or perhaps even positive-sum. The notion here is that the violation allows states to form a more accurate view of the violating state's willingness to comply with commitments, which is valuable. Following a violation, then, states as a group have better information as they seek cooperative arrangements. Though the effect on the violating state is negative, it is reasonable to expect that better information yields a net benefit to all states.¹¹² The ability to capture the informational benefits of a violation offers an explanation for why agreements with near-universal membership, such as the WTO, sometimes have a formal treaty structure and dispute resolution.

More generally, the more the parties to an agreement are able to internalize the informational benefits that flow from a violation, the less costly are credibility-enhancing devices. Thus, an agreement whose parties have many dealings with one another and relatively few dealings with non-parties will capture a large share of the informational benefits. This might explain, for example, why regional agreements such as NAFTA or some regional human rights agreements (e.g., The Inter-American Commission of Human Rights) take the form of formal treaties and provide for dispute resolution.

B High Stakes v. Low Stakes Agreements

The benefits of the use of credibility-enhancing devices are felt in those states of the world in which there would not be compliance but for these devices. If this set of cases is larger the incentive to adopt such devices obviously increases. More specifically, where the compliance decision of states is likely to be influenced by reputational issues, the use of credibility-enhancing devices is more likely. Where reputation is unlikely to affect decisions, these devices will be used less often. Put another way, credibility-enhancing devices are more likely to be used when the marginal impact of such devices on compliance is larger.

¹¹² See Guzman, *supra* note 7, at 319–320 (explaining why it is not certain that the net effect will be an increase in welfare).

One implication of this relationship between reputation and compliance is that 'high stakes' agreements, such as those that concern national security or arms control, tend not to provide for dispute resolution provisions. Reputation is limited in its ability to impose costs on states and as the stakes increase, the likelihood that reputation will tip the balance falls. For very high stakes issues, then, dispute resolution offers very modest compliance benefits.¹¹³

High stakes agreements may use monitoring provisions, but this is explained by the fact that these provisions do more than simply impose reputational costs in the event of a violation. They also turn high stakes agreements into low stakes commitments. Monitoring makes it more likely that a violation will be observed shortly after it occurs. This reduces the expected benefits from a violation since it reduces the time period during which its counter-party continues to comply. In this sense, monitoring can serve to change a high stakes agreement into a low stakes one. Imagine, for example, an arms control agreement which requires the parties to limit the number of nuclear missiles they have in their possession. If a monitoring arrangement makes it impossible to exceed the agreed-upon number by more than a small amount without being detected, the gains from violation are reduced. A decision to violate the agreement, then, would offer only modest advantages over a decision to withdraw from the agreement because the state's counter-party would observe the violation before any large-scale violation and would react by demanding compliance or by terminating its own compliance.

C High Compliance v. Low Compliance

The costs of credibility-enhancing devices are only felt when an international obligation is violated. It follows that these devices are more attractive, all else being equal, when the probability of a violation is small. Imagine, for example, an agreement that the parties recognize is very likely to be violated, even if credibility-enhancing devices are used. This means that the expected reputational loss is relatively large. For any given increase in compliance, therefore, the devices are less attractive. Thus, parties entering an agreement which they expect to yield a high level of compliance are more likely to find credibility-enhancing devices worthwhile than parties entering into an agreement where the expected level of compliance is low.

5 Implications of the Theory

The main purpose of this article is to explain why states are reluctant to use credibility-enhancing tools such as hard law, dispute resolution mechanisms and monitoring. The explanation provided, however, has implications for a range of questions related to international agreements. This section highlights a few of these implications. It is

¹¹³ High-stakes agreements are frequently, though certainly not always, formal treaties. Though this is contrary to what the theory suggests, the domestic reasons to prefer a treaty seem likely to offer an explanation. The desire of the executive branch to bind domestic actors (e.g., Congress) as much as possible seems a likely explanation of the treaty form.

neither an exhaustive cataloguing of implications nor a complete discussion of the ones mentioned.

A The Interpretation of International Agreements

Each of the design elements discussed offers negotiators a tool to modulate the level of credibility and the probability of compliance, but increased compliance comes at the cost of a loss to the parties in the event of a violation. Because the design elements all feature this trade-off they are, to some degree, substitutes. For example, the decision to include a dispute resolution mechanism may generate compliance incentives that resemble those of a monitoring system, and one may be chosen over the other because of their respective impacts if one party violates the agreement.

Recognizing the interdependence of the various aspects of treaty drafting sheds light on how one should interpret and evaluate international agreements. The simple lesson for drawing normative judgments about agreements is that one cannot evaluate or interpret a treaty by looking at a single design element. If interpretation is to be based on the intent of the parties, it must take into account all aspects of the agreement. To see this, consider the example of the International Labour Organization (ILO) Declaration on Fundamental Labour Rights, which imposes a set of international labour standards.¹¹⁴ The Fundamental Declaration is binding on all member states of the ILO, and has become a focal point in the discussion of international labour rights. It is particularly important in the debate about the proper relationship between trade and labour. Among the arguments in this debate is the claim that trade sanctions are necessary to enforce the rights laid out in the Fundamental Declaration because no other effective mechanism exists.

The claim that no other effective enforcement strategy exists is quite possibly correct. The ILO itself provides no enforcement mechanism beyond some monitoring procedures,¹¹⁵ and unilateral strategies of enforcement, such as boycotts, military intervention, diplomatic protests, social labelling, and so on, lack both credibility and good evidence that they influence state behaviour.¹¹⁶ For present purposes, then,

¹¹⁴ These standards include: freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labour; the effective abolition of child labour; and the elimination of discrimination in respect of employment and occupation: ILO Declaration on Fundamental Principles and Rights at Work, International Labor Conference, art. 2, 86th Session, Geneva, June 1998

¹¹⁵ See Alvarez, 'The New Treaty Makers', 25 *BC Int'l & Comp L Rev* (2002) 213, at 222.

¹¹⁶ See Trebilcock, 'Trade Policy and Labour Standards: Objectives, Instruments and Institutions' (University of Toronto Law and Econ. Research Paper No. 02-01, 2002), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN_ID307219_code020501530.pdf?abstractid=307219, at 16–18; Diller, 'A Social Conscience in the Global Marketplace? Labour Dimensions of Codes of Conduct, Social Labeling and Investor Initiatives', 138 *Int'l Labor Rev* (1999) 99; Blackett, 'Global Governance, Legal Pluralism and the Decentralized State: A Labour Law Critique of Codes of Corporate Conduct', 8 *Ind J Global Legal Stud* (2001) 401; Howse, 'The World Trade Organization and the Protection of Workers' Rights' *J Small & Emerging Bus L* (1999) 131, at 159–161. Compensation-based strategies involve the making of some form of payment to states that achieve a positive change in their practices. They are criticized both because they involve the dubious practice of compensating states that have tolerated the worst labour

assume that trade is the only available tool and that threats of trade sanctions are, in fact, effective.¹¹⁷

The question for trade and labour, then, is whether states should be permitted to impose trade sanctions on states that violate the ILO Declaration.¹¹⁸ This is, of course, a complex question and a full discussion is beyond the scope of this article.¹¹⁹ For this discussion it is only necessary to consider whether the absence of effective enforcement other than trade advances the case for such trade sanctions. The lesson from this article is that, far from supporting a claim for trade sanctions, the ILO's failure to adopt enforcement procedures or other sanctions should be viewed as evidence against them. Though states agreed to the substantive provisions of the Fundamental Declaration, they only did so within the context of the Declaration, the ILO and the associated enforcement mechanisms. The fact that the agreement does not feature

practices, and because they generate perverse incentives. Compensation for improvement that is not accompanied by a scheme for penalizing a deterioration in those same standards generates an incentive for states to lower their standards so they can subsequently be improved and the state can capture the payment: Chang, 'Trade Measures to Protect the Global Environment', 83 *Geo LJ* (1995) 2131. The effectiveness of social labelling – the placing of a label on products that are produced by workers able to exercise their core labour rights – is also subject to significant limitations. The primary weakness of labelling is the voluntary nature of compliance and the lack of enforcement mechanisms: see Bloomfield, '“Sweating” the International Garment Industry: A Critique of the Presidential Task Force's Workplace Codes of Conduct and Monitoring System', 22 *Hastings Int'l & Comp L Rev* (1999) 567 (discussing more generally problems of enforcement and monitoring in voluntary codes of conduct for multilateral corporations); Groos, 'International Trade and Development: Exploring the Impact of Fair Trade Organizations in the Global Economy and the Law', 34 *Texas Int'l LJ*. (1998) 379, at 408 ('WTO rules mandate that goods cannot be subject to statutory labeling requirements or differentiated on the basis of how they are produced'). To the extent enforcement stems from consumer preferences, social labelling also suffers from a collective action problem. The individual consumer has an incentive to purchase lower priced goods produced under poor labour conditions, relying on other consumers to bear the cost of the higher priced goods produced under core labour standards: see Trebilcock, *supra* this note; Van Wezel, 'To the Yukon and Beyond: Local Laborers in a Global Market', 3 *J Small & Emerging Bus L* (1999) 93; Garg, 'Child Labor Social Clause: Analysis and Proposal for Action', 31 *NYU J Int'l L & Pol* (1999) 473, at 504–505.

¹¹⁷ There is serious debate about whether trade sanctions are an effective tool to influence labour policies. The most important empirical evidence on the question is in G. C. Hufbauer *et al.*, *Economic Sanctions Reconsidered: History and Current Policy* (2nd edn., 1990).

¹¹⁸ It is assumed that the WTO does not already provide an exception of this sort. This is the dominant view, but it is challenged by some scholars: see Howse and Mutua, 'Protecting Human Rights in a Global Economy' (20 February 2002), available at <http://www.ichrdd.ca/english/commdoc/publications/globalization/wtoRightsGlob.html>; Howse, *supra* note 116.

¹¹⁹ I have expressed my views on the subject elsewhere: see Guzman, 'Trade, Labor, Legitimacy', 91 *Calif L Rev* (2003) 885. The key articles in the trade and labour literature include Sykes, 'International Trade and Human Rights: An Economic Perspective', University of Chicago Law and Economics Working Paper No. 188 (2003), available at www.law.uchicago.edu/Lawecon/WkngPprs_176-200/188.aos.human-rights.pdf; Trebilcock, 'Trade Policy and Labour Standards: objectives, Instruments and Institutions', University of Toronto Law and Economics Research Paper No. 02-01 (December 2001), available at <http://ssrn.com/abstract=307219>; Charnovitz, 'The Influence of International Labor Standards on the World Trading System: An Historical Overview', 126 *Int'l Labor Rev* (1987) 565; Howse and Mutua, *supra* note 118; Leary, 'Workers' Rights and International Trade: The Social Clause (GATT, ILO, NAFTA, US laws)', in J. Bhagwati and R. Hudec (eds.), *Fair Trade and Harmonization* (1996), ii, at 177; Langille, 'Eight Ways to Think About International Labour Standards', 31 *J. World Trade* (1997) 27; Howse, *supra* note 117.

dispute resolution procedures and sanctions should be viewed as an intentional choice made by the parties; not as an unfortunate oversight that can be corrected by subjecting the Fundamental Declaration's substantive rules to the WTO's dispute settlement process.¹²⁰ There is simply no reason to infer from the existence of the Fundamental Declaration that states consented to comply with its provisions in any environment except the one established by the ILO. In particular, there is no evidence that they would have consented to the substantive provisions if they faced trade sanctions in the event of a violation or if their behaviour was subject to dispute resolution procedures.

The general lesson, then, is that states enter into agreements, including the enforcement mechanisms, intentionally and attempt to draft those agreements in such a way as to maximize their value. If enforcement mechanisms were omitted it should be presumed that this was done because the states did not feel the compliance benefits of those mechanisms were large enough to justify the costs that would be imposed in the event of a violation.

B Damages and International Law

The basic puzzle of why states do not increase the credibility of their commitments has been explained in this article by the fact that in the event of a violation the parties to an agreement suffer a net loss rather than simply a transfer from one party to the other. As a result, states may fail to enter into what would be value-maximizing agreements if zero-sum transfers were available.

In other words, if it were possible to eliminate the loss to the parties that results from a violation and, instead, have damages take the form of a zero-sum transfer from one party to the other, more efficient forms of cooperation would be possible. Even though reputational and direct sanctions would not be eliminated, the presence of transfers would reduce their importance by increasing the credibility of and compliance with international agreements without adding to the disincentive that the former sanctions generate.

The ideal form of damages would, of course, be money damages. These represent pure transfers from one state to the other, can be made in any amount, and payment is easily verifiable. Despite these advantages, states appear reluctant to call for the use of money damages in their agreements. I do not have a complete explanation for why they are so resistant,¹²¹ and am aware of no compelling

¹²⁰ See ILO Declaration on Fundamental Principles and Rights at Work, 18 June 1998, 37 ILM (1998) 1233.

¹²¹ I offer here two possible reasons why money damages may be unpopular. These are merely suggestive. I am not confident that either is an important part of the explanation for the resistance to money damages. First, states may avoid money damages because they serve as an ineffective incentive device for states. Because damages could be paid out of general revenues, the political costs of having to pay a fine may be small. Second, it may be that there are significant political costs to paying an award mandated by an international body. Indeed, there may even be political costs to receiving such an award. Imagine, e.g., an agreement between two states regarding environmental issues. There may be political resistance to the notion that one's counter-party can violate and simply pay damages. Accepting the award as full compensation may, therefore, be politically costly for government.

theory on the subject, but the observed resistance to money damages cannot be ignored.¹²²

Despite this resistance, however, there are at least some instances where states have accepted the use of money damages, suggesting that they might be encouraged to do so more often. Bilateral investment treaties (BIT), for example, typically provide for the payment of money damages from states to private parties whose investments have been expropriated.¹²³ Similarly, some human rights agreements include dispute resolution and a requirement of compensation to the victims of human rights abuses.¹²⁴ Within the EU the Court of Justice has the authority, under certain circumstances, to impose a monetary penalty on a Member State.¹²⁵ Given the benefits of money damages, states should consider adopting at least some form of monetary sanction for other violations. The easiest to imagine are those with relatively direct financial effects such as injury resulting from violations of trade obligations. In at least some cases – think, for example, of an illegal anti-dumping measure – the harm is almost purely economic and could be estimated with reasonable accuracy. In at least these cases, the use of money damages may be palatable because the harm is closely tied to economic harms.

C The Role of Soft Law

This article advances a new explanation for why states choose soft law when they could choose to make their commitments through treaties. The merit of a treaty is that it provides a relatively high level of commitment – allowing a state to rely on the promises made by its treaty partner. In other words, the commitment is more credible. The credibility provided by a treaty, however, comes at a price in the form of a higher cost associated with breach. When deciding between a treaty and other forms of commitment, then, the parties take that loss into account.

There is considerable confusion and ambiguity in how international law views soft law. This is, in part, due to the fact that commentators have tried to reconcile soft law with classical definitions of international law, which do not mention this form of agreement. This doctrinal approach is awkward because it implies that soft law is not law at all, leaving little room for discussion among legal scholars. A more promising approach starts with the question of how international agreements of all kinds affect the incentives and behaviour of states. In this sense, we begin with an eye toward compliance issues.¹²⁶ Although one can find discussions of compliance in both the

¹²² See Bhagwati, 'After Seattle: Free Trade and the WTO', 77 *Int Aff* (2001) 15.

¹²³ Guzman, *supra* note 85; Vandevelde, *supra* note 26.

¹²⁴ See, e.g., International Covenant on Economic, Social and Cultural Rights (ICESCR), Art. 9(5) ('Anyone who has been the victim of unlawful arrest or detention shall have an enforceable right to compensation.').

¹²⁵ See Treaty Establishing the European Community, Art. 228(2).

¹²⁶ I have written on compliance issues in the past: see Guzman, *supra* note 14.

legal and international relations literature,¹²⁷ I am unaware of any well-developed attempt to address soft law in this way.¹²⁸

The discussion in this article suggests that soft law is simply another form of legal promise. Like a decision to exclude dispute resolution provisions, soft law represents a choice by the parties to enter into a weaker form of commitment. Just as the absence of dispute resolution does not imply that an agreement is not 'law', the decision to use soft law should not exclude the agreement from study or somehow render it less relevant.

Rather than focus on doctrinal questions of what is soft or hard law, scholars should recognize that states draft their agreements to lie at a particular point on a spectrum of credibility and effectiveness. In doing so, they are trading off the credibility of their commitments against the cost of a violation. Ultimately, then, the study of international law should treat soft law in much the same way as it should treat treaties – as a device that promotes international cooperation. The differences between treaties and soft law – for example, the significant differences in their domestic effect – should be taken into account, but both should be considered legal commitments with the potential to affect behaviour.

In addition, soft law should not be viewed as a 'second-best' outcome.¹²⁹ The fact that states have reached an agreement does not imply that it in some sense *should* be a treaty. States may prefer to enter into soft law agreements as a way of maximizing their joint benefits, and there is no *a priori* reason why this should be viewed as a less desirable form of cooperation.

D Drafting Agreements

This article explains why states enter into agreements that contain quite limited enforcement mechanisms. This need not mean that they are disingenuous about the commitments being made. It may instead mean that they are reluctant to accept the joint loss that would be triggered by a violation. This point has implications for the way in which we view agreements and the ways in which agreements should be structured. The importance of using damages or some other sort of transfer has already been discussed, and, as pointed out, a system of damages would go a long way toward overcoming state resistance to more credible or binding commitments.

If damages are not available, however, other strategies must be considered. One lesson from this article is that states should not be discouraged from entering into agreements that appear weak and fail to make use of available design elements to

¹²⁷ See L. Henkin, *How Nations Behave* (1979), at 46–48; Chayes and Chayes, 'On Compliance', 47 *Int Org* (1993) 175, at 176; T. M. Franck, *Fairness in International Law and Institutions* (1995); Koh, *supra* note 10; Raustiala and Slaughter, *supra* note 34; Keohane, *supra* note 34, at 25.

¹²⁸ See Ratner, 'Does International Law Matter in Preventing Ethnic Conflict?', 32 *NYU J Int'l L & Pol* (2000) 591, at 654. But see E.B. Weiss (ed.), *International Compliance with Nonbinding Accords* (1997); Shelton (ed.), *supra* note 19 (analysing 'soft law' in environment and natural resources, trade and finance, human rights, and multilateral arms control).

¹²⁹ See Schacter, 'The Twilight Existence of Nonbinding International Agreements', 71 *Am J Int'l L* (1977) 296, at 304 ('non-binding agreements may be attainable when binding treaties are not').

increase the incentives toward compliance. It is possible that such agreements represent the highest value form of cooperation for the states involved, and it should therefore be pursued.¹³⁰

6 Conclusion

International agreements are at the foundation of international cooperation and international law. Yet we have no more than a crude understanding of why states structure agreements as they do. This article explains why states are not more enthusiastic about including credibility-enhancing devices in their agreements. The paper has explicitly addressed the choice of soft versus hard law, the inclusion or exclusion of dispute settlement, and the provision or omission of monitoring mechanisms, but the same reasoning could apply to any credibility-enhancing strategy that improves the probability of compliance but also increases the joint loss in the event of a violation.

The insight of this article represents only a small piece of the larger set of questions such as: Why do states behave the way they do? How do international agreements affect behaviour? When will international law succeed and when will it fail to constrain states? Which institutional strategies might be used to increase the power of international law? Though much more work remains to be done on all of these questions, this article has lessons for the way in which we view agreements. It is clear, for example, that the commitments made by a state in an international agreement should be viewed as a single undertaking that includes not only the substantive commitments, but also the procedural elements of the agreement. It is also apparent that mechanisms to allow for zero-sum sanctions in the event of a violation should be investigated and pursued. This article mentions the advantages of money damages, but other forms of sanction may exist that would increase the credibility of commitments without reducing the total benefits of the agreement in the event of a violation. More generally, further research is called for on a wide range of questions that relate to international agreements and the ways in which states make commitments. These are fundamental questions for international law whose answers will greatly increase our understanding of the discipline.

¹³⁰ The major caveat to this conclusion relates to the public choice issues that are always present in international relations. Depending on one's public choice assumptions, it may be unwise to give negotiators the ability to enter into agreements that do not include rigorous obligations and enforcement strategies. E.g., if one believes that those who negotiate agreements have a strong incentive to achieve some concrete agreement, even when the substantive impact of the agreement is virtually nil, then it may be desirable to impose discipline on negotiators by forcing them to choose between truly effective agreements and no agreement at all: see, e.g., Stephan, 'The Political Economy of Choice of Law', 90 *Geo LJ* (2002) 957, at 961 ('[T]he people who negotiate international agreements, as well as the people who serve the institutions that promote these negotiations, have powerful incentives to achieve some kind of agreement regardless of substantive outcome.').