

# THE POWER OF RATIONAL CHOICE METHODOLOGY IN GUIDING THE ANALYSIS AND THE DESIGN OF PUBLIC INTERNATIONAL LAW INSTITUTIONS

## CONCLUDING REMARKS

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### I. THE CONTRIBUTION OF ECONOMICS (AND OTHER SOCIAL SCIENCE RATIONAL CHOICE APPROACHES) TO PUBLIC INTERNATIONAL LAW

#### A. *Economics—Which Economic Theory?*

In order to discuss the contribution of economics to public international law, it is necessary to go beyond “rational choice.” It does not suffice to compare legal approaches (like the “constitutional approach”) and rational choice-based economic approaches. One needs to differentiate among economic approaches, but these distinctions must be properly structured. Distinctions between a “rational choice approach” and a game-theoretical approach, for example, are misleading since game theory is also based on the rationality assumption. Rather, one should distinguish between neo-classical economics and game theory, both based on rigid rationality assumptions, on the one side, and new institutional economics, based on the assumption of bounded rationality, on the other side.

Neo-classical theory stresses optimization/maximization of net welfare gains from designing legal norms. In contrast, game theory selects optimal solutions in a given game, where legal rules form the rules of the game. New institutional economics, on the other hand, eschews any rigid rationality assumption and focuses on comparative impact analyses of variations of institutions (legal norms and informal rules) and a hypothetical consent test.

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Each of these different economic approaches might be applied to problems of public international law. But their relative value depends on the level of abstractness and on the rationality assumptions brought into play. Rules of public international law may be understood as relevant institutions for games between various players in an international setting. Whereas an efficiency analysis of such rules might improve the normative assessment of alternative rules and thus may support the law-making process, game theory may better explain the interactions between the various players. Institutional economics, meanwhile, has to play a vital role because positive-impact analyses of alternative rules add to a better understanding of how such rules work and may thus form a solid basis for a normative analysis.

Applying tools of economic theory to problems of public international law competes with other social science approaches, including those of legal science. Whereas economic approaches make a clear distinction between positive and normative analysis—that is, they separate analyses of the factual implications of different legal rules and normative proposals—other social science approaches often start from a normative position. They review problems with a certain perspective—for example, the constitutional perspective—in order to come to normative conclusions. In this case, the introduction of economic approaches, based on rational choice methodology, cannot be compared directly with such normative approaches.

The basic difference between rational-choice-based social science approaches and others refers to the distinction between constraints/incentives and preferences. The economic approach is interested in decisions of individual actors or groups of actors with given preferences under alternative constraints/incentives. Legal rules as well as other rules, informal rules for example, are perceived by such actors as constraints/incentives. Changes of these constraints/incentives should lead to different responses. In order to predict such responses, it is necessary to introduce behavioral assumptions. Basically, “rationality” is nothing other than a methodological tool: in order to formulate hypotheses of how actors respond to changes of constraints/incentives, such as changes of legal rules, it is helpful to assume that such actors act in their self-interest and choose such activities that will raise their utility or at least will not reduce it. Economics is not so much interested in how actors should behave (in the light of given normative theories of behavior), but in how they do behave in reality. Such an approach opens the way to suggesting welfare improvements not via normatively better justified behavior, but via redesigning rules, which are working as constraints/incentives.

*B. Social Science Rational Choice Approaches: International Relations Theories (ITR)*

When studying problems of public international law from a social science perspective, it could make sense to apply international relations theories (ITR) and thus build a bridge between law and political science. But there is no single international relations theory: the realist theory competes with the institutional theory, and both of these are competing with the institutionalist theory, the liberal theory, and the constructivist theory. It is doubtful whether it makes sense—from the perspective of public international law—to develop a new taxonomy of these different social science theories. To bring rational choice methodology into play, rather, one should confront these divergent theories with two questions: (1) Who are the relevant actors?, and (2) What are the rationality assumptions? Theories that focus on nation states as relevant players are not supposed to explain the function of public international law. These theories are better at explaining the environment in which public international law works. Thus they may provide helpful insights which enrich and impact analyses of the rules for public international law.

II. SPECIFIC FEATURES OF PUBLIC INTERNATIONAL LAW (RELEVANT FROM AN ECONOMICS PERSPECTIVE)

*A. Specific Features of the Law-Making Process*

There are specific features of the law-making process that distinguish national law from public international law. This is relevant from an economic perspective. The actors engaged in lawmaking for public international law either are nation-states or are international or supranational entities endowed with law-making power. Thus the competence issue is central. In terms of institutional economics, principal-agency problems raise competency concerns. Lawmaking in public international law produces high transaction costs and preference costs. The latter are due to the long agency chains between the ultimate principal, the citizen of a nation state participating in lawmaking, and the agent, the actual persons engaged in lawmaking. The actual law makers do not have strong incentives to design rules that reflect the preferences of the ultimate principals. Rather, they tend to strengthen their own position by bargaining with law makers or representatives of the executive power on the national level.

Similarly, the complexity of procedures in lawmaking for rules of public international law has transaction cost implications. More importantly, there are the substitution effects. Because of such complexities, it often makes sense to engage in private lawmaking or in different forms of hybrid lawmaking. In private lawmaking, private entities such as business enterprises, function as law makers, for example, in the field of

codes of conduct. This leads to follow-up problems when it comes to implementation, enforcement, and legitimacy of the resulting rules and norms. In order to solve or mitigate problems of legitimacy in lawmaking by private actors, new hybrid forms of lawmaking have been created, for example, in the field of international financial reporting standards for EU-based companies. The standards are formulated by a private entity, the International Accounting Standards Board, and have to be endorsed by democratically legitimized bodies (comitology).

*B. Specific Types of Rules and Norms/Different Enforcement Mechanisms*

In the sphere of national law, legally binding formal rules and norms are predominant, whereas informal rules and norms and soft law do not play a relevant role. In public international law, however, we find a mix of formal and informal rules and norms, of legally binding rules and norms, and of soft law. The enforcement mechanisms of legally binding formal rules often lead to exorbitant transaction costs. In light of the costs and benefits of enforcing such rules, it makes sense to create other forms of non-legally binding rules and norms that may be enforced by new and cheaper enforcement mechanisms. The reputation mechanism, for example, is relatively cheap and effective, especially in the case of codes of conduct.

For traditional legal approaches, new types of non-legally binding and informal rules and norms pose difficult problems because they do not fit well into the given doctrinal framework. However, economists concentrate on cost-benefit comparisons of different types of rules and norms and enforcement mechanisms. They are not so much interested in the correct definition of a “legal rule” or “legal norm.” Instead, they analyze the function of “institutions,” including formal and informal rules. Thus, the economic approach to public international law lends itself better to the study of new developments and new phenomena than does traditional, doctrinal legal thinking.

### III. THE TOOLBOX OF ECONOMIC THEORY

*A. Positive Analysis*

*1. Fields*

Economic theory may play a role in studying the law-making process, and in applying legal rules and norms. The contribution of economic theory in the field of public international law may be especially fruitful in comparing the alternative modes of lawmaking and evaluating their respective merits. Thus economic theory should be helpful in creating new types of rules and norms as well as new enforcement mechanisms. The

comparative advantage of an economic approach is that it allows one to formulate hypotheses of how new types of rules and norms and enforcement mechanisms are supposed to function and then to test such hypotheses in real life.

In the application of rules and norms of public international law, economic impact analyses of alternative solutions may play a relatively larger role than in the field of national law because doctrinal issues are less relevant, and the catalogue of interpretation methods appears to be broader and more open. It is evident that in choosing the adequate interpretation method, one should have a closer look into the expected consequences. Legal experts recognize this when they argue that application of public international law is more politicized than the application of national law. However, it is not the political aspect which is at stake here, but rather the need to legitimize the application of public international law in a consequentialist approach. Economics is closer to consequentialism than to law.

## 2. *Methodological Issues*

When bringing economic approaches into lawmaking and application of public international law, it is necessary to clarify certain methodological issues. Whereas legal scholars tend to see nation-states as relevant actors in public international law, economists adhere to methodological individualism. The relevant actors are individual citizens. If they form collectives, one has to clarify which individual actors are acting on behalf of such collectives and which principal-agency problems arise. Economists are thus more aware of different cost aspects of public international law (as compared to national law) in the light of transaction costs, agency costs, and preference costs. Thus they tend to look more closely into alternatives of legally binding formal rules and norms.

Legal scholars do not have a strong inclination toward clarifying behavioural assumptions of their analyses. This is due to the fact that positive impact analyses of alternative legal solutions play little or no role in the process of applying legal rules and norms. In the field of lawmaking, legal scholars are experts at developing consistent solutions in line with existing law—especially with regard to general legal principles. They often leave cost-benefit analyses of alternative solutions to problems in the lawmaking process to other disciplines. Economists, who start with a positive analysis of the given problem, have to formulate hypotheses of how addressees of legal rules and norms are expected to react to different rules and norms. They need behavioral assumptions in order to formulate such hypotheses. The assumption of self-interested rational behavior has proven to serve as good heuristic tool in the study of markets and the behavior of market participants. But economists have run into problems in transferring this simple type of rationality as-

sumption to other fields of research. With the expansion of the subject matter of economics into nonmarket interactions, it has become evident that the rationality assumption needs to be modified. “Bounded rationality” today serves as a black box rather than a new rationality concept. But the usage of “bounded rationality” in New Institutional Economics signals that human actors respond to changing constraints/incentives in a more complex manner than the homo economicus assumption would suggest. Thus it makes sense that economists studying problems of public international law start with a simple rationality assumption and then find out whether and what modifications are necessary.

Last but not least, economists are confronted with the problem of systematically incomplete information. This fact has various consequences: one example is that human actors cannot predict with certainty the effects of changes to legal rules and norms. This is true for those actors engaged in lawmaking and for the addressees of such rules and norms. Thus, law makers are not in a position to design optimal rules. They cannot formulate hypotheses of how such rules are supposed to work in the future. Such hypotheses may be falsified. In light of such uncertainties, modern economists are rather skeptical when they are asked to work as social engineers. The incompleteness of legal rules and norms reflects the incompleteness of information. Factors that seem to be big disadvantages of public international law—its lack of consistency, its rather fragmented character, and its openness—turn out to be a comparative advantage in light of systematically incomplete information.

### *B. Normative Analysis*

In the preceding subpart, the discussion of positive analysis touched upon some normative aspects, e.g., how incomplete problem solutions in public international law, which are not automatically a disadvantage, may nonetheless have their merits.

In the field of normative analysis, frictions between legal and economic approaches to public international law are to be expected because the disciplines start from different positions. Whereas neoclassical economic theory stresses (allocative) efficiency and welfare maximization, legal scholars often try to derive normative solutions in public international law from general principles. Whereas economists are adherents of consequentialism, legal scholars are adherents of axiomatic approaches.

But there is no single normative approach in economics; there are competing concepts. Thus, it is necessary to clarify which normative concepts are being introduced to answer which questions. If the relative merits of alternative problem solutions are to be evaluated, for the purpose of lawmaking, a cost-benefit approach may serve as the starting point. As easy as this might appear in theory, it is quite difficult in practice. Costs and benefits are not confined to phenomena measurable in terms of money. Thus, the calculation of costs and benefits might be-

come extremely difficult and controversial. The time horizon plays a vital role. And the problem of systematically incomplete information does not allow for a straight forward cost-benefit analysis, but rather fosters cost-benefit comparisons between alternative problem solutions.

When economists introduce efficiency as the ultimate goal to be attained, legal scholars object to the idea that general legal principles can be broken down to efficiency. On the other hand, there are many economists who cast doubt on the heuristic value of the efficiency concepts in light of difficulties in defining efficiency and difficulties in proceeding from static to dynamic efficiency. Thus, one may get the impression that it does not make sense to introduce the goal of efficiency into public international law.

Despite the difficulties mentioned, the efficiency analysis might be helpful as a starting point. First of all, one has to state that "efficiency" is not just "economic efficiency": the concept comprises all welfare effects, material and nonmaterial. Thus, the concept is broader than many legal scholars expect.

Efficiency concepts working with a concept of Pareto-superior solutions are easier to defend than those that are working with the Pareto optimum or the Kaldor-Hicks test. The reason is that a search of the Pareto optimum tends to produce extremely conservative solutions. The Pareto optimum means that no solution can be found in which at least one person is better off without making at least one person worse off. Tradeoffs between winners and losers are not permitted.

The deficiency of the Kaldor-Hicks test, which suggests that a solution is efficient if the winners could compensate the losers, lies in the necessity of interpersonal utility comparisons, which are highly questionable. If it is possible to find Pareto-superior solutions, the winners are better off after having compensated the losers; interpersonal utility comparisons are not necessary when losers accept the compensation in light of their individual utility functions.

Thus economists are on a safe ground if they can prove that a given problem solution in public international law is Pareto superior. But even then, they are confronted with the problem of "dynamic efficiency." If they connect a positive impact analysis of expected effects of alternative legal rules and norms with a normative analysis, they can formulate the result of the positive analysis as a refutable hypothesis. Then they can ask whether this implies a Pareto-superior solution. When the underlying hypothesis is being refuted, the normative conclusion has to be given up. Thus, normative proposals can only be made under the caveat of nonrefuted hypotheses of the underlying positive analysis.

If economists are able to make normative proposals in the field of public international law in the manner described, legal scholars might nevertheless object that such proposals are not in accordance with superior legal principles. This friction between a consequentialist and an

axiomatic approach cannot be cured. From an economic perspective, normative economic analysis is able to make visible the implied costs of given legal principles. The underlying reasons for these frictions between consequentialist and axiomatic approaches are the different normative foundations of such approaches. Whereas the economic approach introduced here rests on the fundament of normative individualism and thus on the given preferences of individual actors, an axiomatic approach has to start with a given hierarchy of principles and values, where the top-ranking principle or value does not need legitimisation. In a democratically organized society, this would mean that the citizens are not free to alter the hierarchy of principles and values even if it is not in accordance with their preferences. Economists entertain the suspicion that certain members of a given society define the hierarchy of values, which are then binding on others.

The normative approach using the criterion of Pareto superiority is very close to another normative approach used by economists, namely New Institutional Economics (NIE). They ask whether individual actors, who do not know how a proposed change of institutions is expected to affect them, could agree on such a change if they have to decide under this veil of ignorance (hypothetical consent). The assumption that they are deciding under the veil of ignorance does not mean that they are making just hypothetical decisions; they know the implications the given change will have on different actors without being able to know in which position they will find themselves. In such a situation, they will supposedly agree on Pareto-superior solutions but not necessarily on solutions that pass the Kaldor-Hicks test.

#### IV. PUBLIC INTERNATIONAL LAW AS A CHALLENGE FOR ECONOMIC THEORY?

##### A. *Public International Law and Law & Economics*

It has become evident that economic theory based on rational choice methodology may contribute to public international law in two ways. First, it can provide positive analyses of alternative legal solutions and thus clarify the expected outcomes of lawmaking and of the application of legal rules in public international law. Second, it can shed light on normative propositions from a perspective of normative individualism. The specific challenge public international law poses to economic theory involves differences in lawmaking, differences in types of legal rules and norms, and differences in enforcement mechanisms.

##### B. *Public International Law and New Institutional Economics*

When choosing between different economic approaches for application in the field of public international law, NIE will play a prominent

role for three reasons: (1) NIE can deal with formal as well as with informal rules and thus is an adequate approach in a field of law with a mixture of formal and informal rules; (2) in NIE, the rational choice methodology takes into account issues of systematically incomplete information and issues of bounded rationality, making NIE more advanced than other economic approaches; and (3) the issues of vertical allocation of law-making competences is being treated in a subdiscipline of NIE—constitutional economics. The same is true for the analysis of hybrid lawmaking.

Therefore, public international law is a challenge for economic analysis. The branch of NIE provides the necessary methodological tools to treat the specific problems of that field of law.

#### V. SOME REMARKS CONCERNING PAPERS PRESENTED

In wrapping up these ideas that have emerged from the Bonn Conference, it is worthwhile to revisit the papers included in this issue that it produced.

The Abbott paper demonstrates the difficult task of integrating elements of different approaches of International Relations Theory (ITR) without going back to the methodological fundamentals of economics. It is valid proof of the difficulties of incorporating rational choice methodology in social science approaches, which have no direct link to modern economics.

The Ginsburg, Chernykh, and Elkins paper discusses incorporation of international law into national constitutions as a signalling device and a credible commitment, a new contractarian approach on the international level: a Hobbes's Leviathan in a globalized world?

The Kontorovich paper presents a normative analysis of "universal jurisdiction." The question is whether a transaction cost approach or constitutional economics approach provides the more adequate methodology.

The Sandler paper introduces a distinction between lawmaking and implementation into strategic considerations of treaty formation. This opens the way to a theory of incomplete international treaties and a rising complexity of game theoretical models.

The Helfer paper presents a two-stage law-making process and challenges the consent paradigm. This approach could be further developed by linking it to the economics of incomplete contracts and the letter of intent in the realm of private law.

The Nzelibe paper treats WTO sanctions as optimal hostage taking and presents good (economic) reasons not to change the WTO sanctions regime. Thus, the paper advocates a comparative interest analysis as a tool to prevent false reforms.

The Elkins, Guzman, and Simmons paper builds upon the authors' earlier empirical work in which they posited competition as a central explanation for the growth of bilateral investment treaties as mechanisms of direct investment in developing countries. Updating their findings with data from 2000 through 2006, the authors find no reason to amend their conclusions.

The Norman and Trachtman paper, finally, employs models of game theory to provide a rational choice explanation for state compliance with international law. They rely on this rationalist analysis to frame a social-scientific justification for customary international law and treaty law alike.

#### VI. CONCLUDING REMARKS: PUBLIC INTERNATIONAL LAW AND ECONOMICS: A RECIPROCAL LEARNING PROCESS

The potential lessons of a reciprocal learning process for public international law might include: (1) stressing the functional approach to public international law; (2) expanding the subject matter; (3) taking into consideration costs and benefits of alternative solutions, even in the realm of private law (e.g., economic contract theory; human rights comparable to property rights as private rights of individuals); and (4) reconceptualizing the legitimisation paradigm.

The lessons for economics, on the other hand, include: (1) stressing institutional economics (including constitutional economics) and (2) starting a dialogue with social science rational choice approaches.