Public Choice and International Regulatory Competition

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INTRODUCTION

In my article, *Choice of Law: New Foundations*,[1] published in this issue, I sought to lay out a new framework for the analysis of choice-of-law problems. In particular, I sought to explain how strategic interaction among states might cause choice-of-law rules to affect substantive policies. In response to my article, Professors Erin O'Hara and Paul Stephan have offered thoughtful and constructive essays.[2] I owe both of these scholars thanks for their willingness to engage with my ideas and for advancing my own thinking on the subject.

The Stephan and O'Hara comments make a number of points, and it would be neither possible nor fruitful for me to respond to all of them. Instead, I will focus my reply on two themes that appear in both responses and in my own article: public choice issues and the desirability of international cooperation. How can we take public choice issues into account when thinking about choice of law? How can we go about making policy decisions in the face of public choice issues and the uncertainty they introduce? In this short reply I cannot hope to provide a full analysis and discussion of these issues. Rather, I offer some thoughts on the subject and indicate why I think the case for international cooperation remains strong.

Although O'Hara, Stephan, and I disagree on some aspects of choice-of-law and international regulatory issues, we all agree that choice of law is important. Often thought to be a minor procedural topic,[3] the discussion here demonstrates that it represents far more than that. Choice of law affects the substantive law adopted by states, it influences the welfare of private parties, and it has a central role to play in the way domestic governments respond to the challenge of internationalization. The debate contained in the pages of this law journal is precisely the sort of exchange that is needed if we are to improve our understanding of this subject.

This reply proceeds as follows. First, I respond to Stephan and O'Hara's concerns about the desirability of international cooperation, including the impact of public choice, the pro-agreement bias of negotiators, the risk of entrenchment by international bureaucrats, and the take-it-or-leave-it fashion in which agreements often come before legislatures. Second, I explain the relationship between internationalization, public choice, and my article. Third, I explain

1. Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L.J. 883 (2002).

2. Erin Ann O'Hara, *Economics, Public Choice, and the Perennial Conflict of Laws*, 90 GEO. L.J. 941 (2002); Paul B. Stephan, *The Political Economy of Choice of Law*, 90 GEO. L.J. 957 (2002).

3. *See, e.g.*, Steward Sterk, *The Marginal Relevance of Choice of Law Theory*, 142 U. PA. L. REV. 949 (1994).

why, despite the public choice issues raised by Stephan and O'Hara, I believe cooperation should be pursued. Finally, I offer some thoughts on the diverse levels of cooperation that are available and when each should be used.

I. FOSTERING INTERNATIONAL COOPERATION

Erin O'Hara's response to my article points out that normative conclusions are difficult to draw in the choice-of-law arena.[4] Paul Stephan strikes a similar tone, issuing a call for skepticism and caution with respect to international cooperation.[5] At one level, there is little disagreement among us. For example, although Stephan's response focuses on the risks of agreement while my article focuses on the benefits, neither of us claims to be able to predict the welfare implications of any particular agreement. A different reading, however, would conclude that we have distinctly different views of international cooperation. Though we both recognize that normative conclusions must be reached cautiously,[6] Stephan's pessimism on the subject stands in contrast to my optimism. In the interests of making our differences clear, then, let me say explicitly that I believe international cooperation is likely to be welfare-improving in the majority of contexts, though the exact nature of that cooperation must vary from one subject to another.[7] That said, I cannot and do not claim that cooperation is always desirable or that it should be pursued without consideration of the risks. Stephan and O'Hara, in their prior writings[8] and in their responses to my article, advance the debate on choice-of-law and international regulatory issues by identifying the potential hazards of cooperation. Before I address those hazards, it is useful to clarify the points on which we agree and disagree.

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4. O'Hara, *supra* note 2, at 942–43.

5. Stephan, *supra* note 2, at 960–69. Stephan has made similar statements elsewhere. *See* Paul B. Stephan, *Regulatory Cooperation and Competition: The Search for Virtue*, *in* TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 167 (George Bermann et al. eds., 2000).

6. Stephan's response says so explicitly. My article avoids the sort of conclusions that Stephan cautions against. This is why his comments are directed at what he believes I have implied in my writing, rather than what I have explicitly said. *See, e.g.*, Stephan, *supra* note 2, at 960 ("The argument is correct as far as it goes, but proves less than Guzman implies.").

7. I have argued elsewhere, for example, in favor of a regime of "portable reciprocity" or issuer choice in the regulation of international securities. *See* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998).

8. William H. Allen & Erin A. O'Hara, *Second Generation Law and Economics of Conflict of Laws: Baxter's Comparative Impairment and Beyond*, 51 STAN. L. REV. 1011 (1999); Erin A. O'Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 VAND. L. REV. 1551 (2000); Erin Ann O'Hara & Larry E. Ribstein, *Conflict of Laws and Choice of Law*, *in* 5 ENCYCLOPEDIA OF LAW AND ECONOMICS 631 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151 (2000); Erin O'Hara & Larry E. Ribstein, *Interest Groups, Contracts and Interest Analysis*, 48 MERCER L. REV. 765 (1997); Francesco Parisi & Erin A. O'Hara, *Conflict of Laws*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 395 (1998); Paul B. Stephan, *Barbarians Inside the Gates: Public-Choice Theory and International Economic Law*, 10 AM. U. J. INT'L L. & POL'Y 745 (1995); Stephan, *supra* note 5.

First, we all agree that facilitating transfers or, as they put it, logrolling, makes agreement more likely. Permitting such transfers represents a reduction in the transaction costs facing negotiators, making it more likely that a welfare-increasing deal can be struck. Stephan's concern is that facilitating transfers also increases the probability of an international agreement that reduces world welfare.[9] To the extent there is a disagreement between us, it is in our beliefs about the likelihood and the costs of welfare-reducing agreements. Second, we agree that an agreement will be reached if and only if it makes all decisionmakers better off. Third, there is no disagreement that the decisionmakers are the representatives of states and not the states themselves. Fourth, to the extent Stephan is simply observing that welfare-reducing agreements are possible, I have no quarrel. The important question, of course, is whether such an outcome is likely.[10] In the balance of this Part, I respond to the specific concerns that cause Stephan and O'Hara's skepticism about international cooperation.

A. INTEREST GROUPS AND CHOICE OF LAW

The most important of the reasons to be cautious regarding international cooperation is that government leaders may weigh the interests of some constituents more heavily than those of others.[11] This possibility is discussed in some detail in my Article, where it is shown that the main analytical results of my Article, referred to as "Choice-of-Law Lessons,"[12] remain intact and require only minor modifications to account for this asymmetric weighting of interests.[13] In the discussion of the "Lessons" themselves, I explain how these public choice issues affect the analysis.[14] Most relevant for the present discussion, I qualify the results, obtained under an assumption of public-interested decisionmakers, that territoriality leads to underregulation and extraterritoriality leads to overregulation.[15] In both cases one can only draw normative conclusions after making some form of public choice assumption.[16] Rather than making one such assumption, my article demonstrates how the results change depending on which assumption is made. The six other "Choice-of-Law Lessons" are unaffected by public choice assumptions. I recognize that there is no consensus on the question of how governments make decisions, even in particular issue areas. In light of this disagreement, my article put forward a framework that can accommodate a wide range of assumptions.

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9. Stephan, *supra* note 2, at 961. O'Hara also expresses concerns about the potential costs of logrolling. O'Hara, *supra* note 2, at 948–56. I address this point below.

10. Stephan identifies why an international agreement might reduce welfare, but does "not assert that it is inevitable, or even that this outcome is necessarily more likely than an agreement that optimizes consumer welfare." Stephan, *supra* note 2, at 963.

11. *See id.* at 961.

12. Guzman, *supra* note 1, at Part III.

13. *Id.* at 900–04.

14. *Id.* at Part III.

15. *Id.* at 906, 908–09.

16. *See id.* at Parts III.A and III.B.

The key point is that while analysis is capable of generating normative conclusions, some of those conclusions require assumptions about the political economy that is at work. Rather than making controversial assumptions about government behavior, my article explains how any given set of assumptions can be used to generate conclusions and demonstrates that many of the results presented are invariant to the public choice assumptions.[17]

B. BIAS TOWARD AGREEMENTS

Another concern that is always present when international agreements are discussed is that "the people who negotiate international agreements, as well as the people who serve the institutions . . . have powerful incentives for achieving some kind of agreement regardless of substantive outcome."[18] I certainly share the view that some individuals face incentives that bias them in favor of consenting to cooperative agreements. I am not convinced, however, that this represents an important reason to resist international cooperation.

First, we should not lose sight of the fact that international negotiators are selected and monitored by states. The former act as agents for the latter. The private incentive to reach an agreement, therefore, is constrained by the interests of the principals who have a much more modest incentive to reach a deal. To the extent a pro-agreement bias exists among the agents, the principals have an incentive to correct for this through a change in the negotiators, a change in the reward scheme for negotiators, or simply through a heightened skepticism about reports from negotiators.

Second, international law provides a myriad of ways to "reach a deal" without imposing significant commitments on a state. Many international agreements are explicitly nonbinding or aspirational, for example.[19] Furthermore, an agreement may impose such mild substantive requirements as to be harmless. Some information-sharing agreements in the antitrust area might fit this description.[20] Furthermore, negotiation of a substantively unimportant agreement, rather than an important one, is likely to be a preferred strategy for overzealous negotiators with a pro-agreement bias. It achieves their goal of getting an agreement and yet makes it unlikely that their political masters will mount significant objections.

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17. The one place in my article where the weighting of interest group influence is relevant but not explicitly discussed is in the brief application of the article's analysis to international antitrust. *See id.* at Part V.B.3. However, I have discussed this issue in other writing. *See* Andrew T. Guzman, *Antitrust and International Regulatory Federalism*, 76 N.Y.U. L. REV. 1142, 1152–54 (2001); Andrew T. Guzman, *Is International Antitrust Possible?*, 73 N.Y.U. L. REV. 1501, 1530–31 (1998) [hereinafter Guzman, *Is International Antitrust Possible?*].

18. Stephan, *supra* note 2, at 961("Association with a concluded agreement brings prestige, opportunities to offer interpretation, and invitations to participate in subsequent negotiations.").

19. For example, much of the cooperation with respect to international monetary matters is based on nonbinding agreement. *See* Kal Raustiala, *Compliance & Effectiveness in International Regulatory Cooperation*, 32 CASE W. RES. J. INT'L L. 387, 426 n.200 (2000).

20. *See, e.g.*, Agreement Between the Government of the United States of America and the Government of Australia on Mutual Antitrust Enforcement Assistance, Apr. 27, 1999, U.S.-Austl., Hein's No. KAV 5639, Temp. State Dep't No. 99-145.

Third, even if a bias remains towards agreement on substantive issues, when viewed in the context of the overall negotiating structure of international law, such a bias may be helpful rather than harmful. Recall that international agreements require the consent of every participating state. This unanimity rule represents a high barrier to agreement. The barrier is further raised by the fact that transfers among states are difficult to negotiate and do not normally take the form of cash transfers. Because transfers are difficult to arrange, Kaldor-Hicks-efficient agreements will often not be achieved because the parties are unable to use transfers to make them Pareto-efficient. Put simply, a unanimity rule frustrates many valuable agreements.

Because a unanimity requirement causes too few agreements to come into being, a modest pro-agreement bias among negotiators may actually be welfare-increasing. An agreement that offers large benefits to one country but imposes a small net cost on the other, for example, normally would not be approved without the use of transfers, but may be approved if the second country has a pro-agreement bias. As long as the bias is modest, no country will consent to a deal that imposes a large harm—setting an upper bound on the potential harm. On the other hand, in the absence of transfers, an agreement can be rejected even if it confers substantial net benefits on participating states. The result of the bias, then, may be to permit many more value-increasing deals, including some that represent a large increase in welfare, and to permit a few value-reducing deals, none of which imposes more than modest costs. It is easy to see that this may be a better outcome than what would result in the absence of the pro-agreement bias.

C. ENTRENCHMENT OF BUREAUCRATS

Stephan expresses a related concern regarding entrenchment by international bureaucrats.[21] He claims that multilateral agreements based on consensus make it impractical for states to manage the process of updating agreements over time. As a result, authority is delegated to international institutions.

This concern, however, can be addressed more subtly than simply by reducing the level of cooperation. Many forms of cooperation can proceed without formal international institutions, the individuals within those institutions can be kept in check by national governments, policy decisions can remain in the hands of government representatives, and so on. Ultimately, concern about entrenchment is primarily a concern about the form of cooperation rather than its merit.

D. TAKE-IT-OR-LEAVE-IT OFFERS

Stephan's final concern is more puzzling. He states that "legislatures that must approve these agreements face take-it-or-leave-it choices . . . . [T]hus they

21. *See* Paul B. Stephan, *Accountability and International Lawmaking: Rules, Rents and Legitimacy*, 17 NW. J. INT'L L. & BUS. 681, 706 (1996–1997).

are less likely to reject agreements that may reduce overall welfare."[22] This argument is problematic for a couple of reasons. First, the take-it-or-leave-it choices faced by the legislature are framed by the negotiators of the agreement, including the country's own negotiators. Those negotiators, in turn, are typically controlled by the executive.[23] The state, then, has an opportunity to shape the content of the agreement. More importantly, the fact that the legislature receives a take-it-or-leave-it decision does not imply that it is more likely to approve a value-reducing agreement. Presumably, agreements that further the objectives of decisionmakers will be approved and others will be rejected. As with any agreement, a value-reducing deal will come about only if at least one (and possibly more than one) government consents to an arrangement that is welfare-reducing for its country. The take-it-or-leave-it nature of the decision does not seem to be relevant.

II. INTERNATIONALIZATION AND PUBLIC CHOICE

Studying the behavior of states at the international level is complicated by the fact that decisions are made by individuals rather than states. Those individuals may have interests that diverge from the maximization of national welfare. This public choice problem is at the root of the comments made by Professors Stephan and O'Hara and is present in almost any discussion of international cooperation.

The clearest analysis of public choice issues in the international context, it seems to me, identifies two separate problems. The first of these problems is the public choice one. To understand international behavior, we need to understand state behavior. This requires a model of state conduct. A public choice approach looks to the interest group dynamic within a state to create that model. Once generated, the model can be used as an input to the analysis of the international problem described below. The difficulty, of course, is that we do not have a public choice model of state conduct. This is so despite the fact that state behavior is the subject of careful study by scholars in law, political science, economics, and other disciplines.[24]

The second problem for an analysis of international legal issues is the effect of internationalization, which involves understanding the impact of cross-border

22. Stephan, *supra* note 2, at 961.

23. It is also worth noting that in parliamentary systems the executive and legislative branches are not so easily separated. As a result, executive control of the negotiation process is not so different from legislative control thereof.

24. JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962); DONALD P. GREEN & IAN SHAPIRO, PATHOLOGIES OF RATIONAL CHOICE THEORY: A CRITIQUE OF APPLICATIONS IN POLITICAL SCIENCE (1994); MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965); Steven P. Croby, *Public Interested Regulation*, 28 FLA. STATE U. L. REV. 7 (2000); Daniel A. Farber & Philip P. Frickey, *Foreword: Positive Political Theory in the Nineties*, 80 GEO. L.J. 457 (1992); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

activity on the policies of states and the welfare of individuals in comparison to what would exist without that internationalization.[25] To isolate this issue, imagine for a moment that all governments are motivated by a desire to maximize the overall welfare of their constituents. In a closed economy, then, the government pursues optimal policies. Once the economy is opened, however, states have an incentive to externalize costs while internalizing benefits. In this sense, states compete with one another. This competition can generate state incentives and policies that, from a global point of view, are inefficient and undesirable. This sort of competition is inevitable because in any reasonable model of state behavior, a state cares more about its own interests than those of other states.[26]

My article is aimed primarily, though not exclusively, at the internationalization problem. As with any analytical problem, progress is best made by focusing on one aspect of the problem at a time. An attempt to unravel both the internationalization and public choice issues within choice of law would surely fail, if for no other reason because we lack a good model of government decisionmaking.[27]

III. THE CASE FOR COOPERATION

Once one understands the impact of internationalization on choice of law, the question remains of how that understanding should affect policy issues. As pointed out by Professors Stephan and O'Hara, without a clear public choice model it is impossible to draw firm conclusions about the impact of various choice-of-law rules on welfare. It is fair to ask where all of this leaves us. As a theoretical matter, international cooperation may increase or decrease global welfare, yet we must decide whether to pursue such cooperation. Addressing that question is the task of this Part.

The problem is one of making policy decisions under uncertainty. Some critics might suggest that without better information the only option is to throw up one's hands and admit that no policy can be defended. In the international sphere at least, this is hardly an answer. Some level of international cooperation must be chosen. Resisting cooperation represents no less of a choice than does embracing it, a point that is understood by both Stephan and O'Hara. Faced with uncertainty, my own view is that we should work toward cooperation to address important international challenges, while keeping an open mind when confronted with claims that cooperation in a particular area is likely to lead to a welfare loss.

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25. Andrew T. Guzman, *A Compliance Based Theory of International Law*, 90 CAL. L. REV. (forthcoming 2002), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=260257.

26. *See* Guzman, *supra* note 1, at 899 n. 62; Alan O. Sykes, *Externalities in Open Economy Antitrust and Their Implications for International Competition Policy*, 23 HARV. J.L. & PUB. POL'Y 89, 92 (1999).

27. Even those studying only the U.S. government have no consensus view on how to model the public choice problem inherent in any government decision. *See* Kenneth Shepsle & Barry Weingast, *Positive Political Theories of Congressional Institutions*, *in* POSITIVE THEORIES OF CONGRESSIONAL INSTITUTIONS (Kenneth Shepsle & Barry Weingast eds., 1995).

Stephan is on record sounding the warning that international cooperation has pitfalls and should be approached cautiously.[28] His comments in our present debate return to that same theme, stating that presenting competition policy as an example demonstrating that a cooperative regime "might make us worse off than we are now."[29] His observations on this score are well-taken but fall short of policy recommendations. He is careful not to argue explicitly that international cooperation will reduce welfare and simply says that it is a "possibility." I adopt a similar strategy in my own article, avoiding claims that international cooperation always increases welfare.

Absent context-specific evidence to the contrary, there are several reasons to think that we should encourage cooperative efforts. Before laying out the case for cooperation, however, I wish to be clear that this represents a set of intuitions rather than a formal analysis. It would be preferable to have a stronger case than the one presented here, but that case does not yet exist. Until the political economy of international regulatory issues is better understood, policy decisions must be made based on the best information we have rather than all the information we would like.

First, the most obvious reason to favor cooperation is that many issues have become global in scope, eroding the ability of our national authorities to regulate those activities. There is no doubt that the level of international integration is increasing over time and, without international cooperation, continued internationalization will further reduce the power of national governments to implement their policies effectively. As noncooperative strategies become less and less successful, international cooperation will become more and more attractive. Stephan argues that we simply do not know whether the marginal benefits from additional cooperation exceed the marginal costs.[30] What we do know is that international activity looms larger than ever on the regulatory agenda of states, and cooperative efforts have not kept pace.

Second, even if one adopts a pessimistic view of international cooperation and international institutions, it is clear that cooperation is desirable and has succeeded in certain areas. The most obvious example is trade, where the World Trade Organization has generated a dramatic liberalization of trade and a corresponding increase in welfare.[31] The increase in welfare associated with cooperation in trade probably exceeds, by itself, the sum of all welfare losses that can be attributed to value-reducing cooperation.

Third, as already discussed, the public choice problem is the strongest argument in the claim that cooperation can be welfare-reducing. Once one

28. Stephan, *supra* note 21; Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743 (1999); Stephan, *supra* note 5.

29. Stephan, *supra* note 2, at 962.

30. Stephan, *supra* note 2, at Part I.

31. *See* MICHAEL J. TREBILCOCK & ROBERT HOCUSE, THE REGULATION OF INTERNATIONAL TRADE 21 (2d ed. 1999).

makes public choice assumptions, however, the argument for cooperation may be strengthened rather than weakened. The most prominent example is once again in the trade area. In the absence of international cooperation, import-competing firms were able to lobby effectively to get substantial trade barriers put into place to protect them from foreign competition. Exporters wanted to open up foreign markets but had little incentive to lobby for liberalization at home. At the risk of oversimplification, it is fair to say that trade negotiations allowed exporters to lobby their governments and encourage liberalization on a reciprocal basis. By expanding the number of interest groups with a voice, international cooperation caused states to take a broader range of interests into account and the result has been a dramatic growth in trade and welfare.

More generally, international cooperation makes it possible for states to influence the policies of other states through the exchange of concessions. This opens the door for interest groups that care about foreign laws to play a role—they can lobby their own government, which in turn can negotiate for the desired policy changes. Though there are no guarantees, increasing the number of interests that participate in the formulation of policy will often lead to a better result.

A case-by-case, issue-by-issue analysis of the potential for welfare-increasing cooperation is certainly appropriate, and the risk of a value-reducing deal should not be ignored. On the other hand, we should not be paralyzed by the specter of public choice. The same problem is present in the domestic sphere, yet democracies manage adequately well and we do not generally hear calls to frustrate policies simply on the grounds that there is a public choice problem. When we hear such calls is when there is some evidence (perhaps disputed) that the public choice problem is likely to lead to bad outcomes. This last point serves as a reminder that cooperation among imperfect governments must be compared to noncooperation among equally imperfect governments, rather than some idealized model of government.[32] When this is done, it is clear that many public choice problems remain, even if states choose not to cooperate.

Erin O'Hara expresses skepticism regarding the value of a reduction in the transaction costs of international negotiations. In her view, an exchange of concessions is unlikely to generate efficiency-enhancing cooperation because larger states "are systematically advantaged by using choice of law to enhance the welfare of their own residents."[33] Stephan also suggests that cooperation may be difficult to obtain, and illustrates this point with reference to interna-

32. From time to time, Stephan seems to criticize international cooperation for its inability to solve all problems of government, including those that would be present in a less cooperative regime. For example, in his criticism of cooperation in the area of competition policy he cites the ability of states to "use competition law to attack offshore threats to national champions." Stephan, *supra* note 2, at 962–63. This ability, however, is the product of extraterritoriality, a noncooperative extension of jurisdiction. Resisting cooperation will in no way reduce the strategic use of competition policy.

33. O'Hara, *supra* note 2, at 949.

tional competition policy.[34] Rather than casting doubt on the value of transfers, the observation that cooperation is difficult bolsters the argument that a reduction in transaction costs is desirable. If powerful states benefit from an inefficient regime, they will be reluctant to consent to a change. But a move toward efficiency generates rents, and reducing the cost of making transfers among states makes it more likely that those rents can be distributed so as to make every state—including powerful states—better off. O'Hara may respond that this sort of cooperation is difficult to achieve. I agree, and have said so in print.[35] Rather than dissuade us from efforts to facilitate agreement, however, this fact should motivate us to look for structures that increase the probability of successful international cooperation.

IV. WHAT COOPERATION SHOULD BE SOUGHT?

If one is concerned about international cooperation, especially if that concern relates to the entrenchment of an international bureaucracy, one might wish to limit cooperation to the minimum necessary to achieve an efficient regulatory outcome. In fact, this is a sound policy even if one believes that all governments pursue welfare maximization on behalf of their state. International cooperation has the potential to improve the functioning of our increasingly globalized society, but as discussed by Stephan and O'Hara, it comes with costs that should not be ignored.

First, international cooperation lacks an enforcement mechanism that compares to what exists in developed states. A full discussion of the enforcement issue is beyond the scope of this reply, but represents a critical issue in international law.[36] Domestic legal structures feature a longer history, well-established and relatively clear substantive and procedural rules, a relatively large number of experienced and competent legal practitioners and judges, and a state with police powers ready to enforce court judgments. The international sphere cannot offer anything similar. As a result, we should try to use domestic judicial structures rather than their international counterparts whenever possible.

In addition, international agreements come with significant transaction costs. They take a long time to negotiate, they demand the attention of many individuals who must be taken from other tasks, they generate friction among states, and they can be expensive to implement if a new organization or institution must be established. Perhaps most importantly, as the level of cooperation deepens, the difficulty associated with getting an agreement and the probability of failure increase.

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34. Stephan's discussion of competition policy is presented as an example demonstrating that a cooperative regime "might make us worse off than we are now." Stephan, *supra* note 2, at 962. The example, however, simply observes that cooperation has not been achieved. It does not suggest that it has been harmful.

35. Guzman, *Is International Antitrust Possible?*, *supra* note 17, at 1548 ("International agreements on antitrust policy will continue to be difficult—and may be impossible—to reach.").

36. I have offered some comments on this question in other writings. *See* Guzman, *supra* note 25.

As compared to domestic systems, international agreements are also difficult to change. Like the establishment of the agreement itself, changes can be cumbersome to negotiate (not least because they normally require unanimity), and attempts to implement changes can lead to conflict. The alternative of an international institution or bureaucracy generates its own costs in bureaucratic entrenchment and a lack of democratic control.[37] Domestic rules, on the other hand, can be changed within domestic systems, which deal with such issues every day. Again, the advantage of domestic institutions suggests that we should tailor strategies that rely on those institutions, as opposed to international ones, as much as possible.

With the above concerns in mind it is possible to establish a rough hierarchy of international cooperation which begins with the lowest level of cooperation and proceeds to the highest level. Whenever a lower level of cooperation can achieve the desired outcome it should be favored over a higher level. One of the goals of my article is to provide the analytical framework within which one can determine the appropriate level of cooperation.[38]

The lowest level of cooperation, of course, is a laissez-faire system. Under such a system each jurisdiction can proceed as it wishes without regard to the policies of other jurisdictions. A policy of this sort is followed among U.S. states in the corporate law area and many scholars believe it to be a desirable regulatory system for corporate law.[39] In the international securities literature there are calls for a similarly decentralized regulatory structure.[40] This noncooperative approach is effective when there are no spillovers from one jurisdiction to another or when the strategic interaction of the states leads to a race to the top.[41] Although there is little explicit cooperation in this regime, there may be

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37. *See* Stephan, *supra* note 2, at 960–61.

38. The discussion below addresses questions posed by both Stephan and O'Hara. Stephan writes, "When states have rejected territoriality, as they largely have as to antitrust, securities regulation, trademark law and bankruptcy, we seem to face a Hobson's choice: unbridled use of the effects test leading to suboptimal noncooperation, or creation of international institutions to mediate conflicts over regulation." Stephan, *supra* note 2, at 966. The options outlined below offer several potential strategies that lie in between the two extremes presented by Stephan. As discussed in my article, I believe that of the four areas mentioned in Stephan's quote, two—securities regulation and bankruptcy—can be addressed without the need for a formal international institution. O'Hara writes, "No state has much incentive to unilaterally adopt sensible choice-of-law rules; rather, the problem can be resolved only by getting the states to coordinate their efforts." O'Hara, *supra* note 2, at 949. Though some coordination of choice-of-law rules will often be necessary, the discussion below suggests that, in at least some cases, states do have an incentive to adopt good rules unilaterally.

39. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212–27 (1991); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1–12 (1993); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

40. See Choi & Guzman, *supra* note 7; Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1; Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998). *But see* Merritt Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997) (arguing in favor of regulation by the issuers home country).

41. Permitting states to choose their contract law, for example, may fit this description. *See* Guzman, *supra* note 1, at Section III.D.

reason to try to establish a minimal choice-of-law rule that permits the parties to a transaction to select the governing law.[42]

Moving up the cooperative ladder by one rung, a state may set the terms of its interaction with other states through a unilateral selection of choice-of-law rules. This is done, for example, in the bankruptcy context where some states provide for the turnover of local assets to a foreign bankruptcy proceeding under specific circumstances, and all states that address international insolvency issues specify how their system will interact with other systems.[43] In fact, a unilateral choice-of-law rule is used in many other regulatory areas, including antitrust and securities. As I discuss in previous writings, it should be possible to achieve a desirable outcome in the bankruptcy area through a unilateral rule coupled with a reciprocity provision.[44] This is so because the efficient outcome not only increases the size of the pie, it distributes the gains in a Pareto-improving fashion as long as all countries adopt the efficient rule. The one problem—that every country is better off if its neighbors adopt the efficient policy while it retains the inefficient approach–can be overcome by a reciprocity requirement.

If a unilateral choice-of-law rule cannot achieve an efficient outcome, it may be desirable to seek more significant cooperation. The next rung on the ladder consists of an agreement on choice-of-law rules without any commitments on substantive rules. This is so because negotiation over choice-of-law rules is less likely to be frustrated by differing national preferences and priorities.[45] Though a choice-of-law rule can affect outcomes (and subject local individuals to foreign laws), states remain free to adopt the substantive laws of their choosing. Agreement on choice-of-laws rules might represent an effective strategy in some areas of commercial law, for example, where it is important for the applicable legal rules to be clear, but there is disagreement on what that rule should be.

If a higher level of cooperation is needed, one might consider harmonization of substantive laws. This strategy has obvious disadvantages, including the fact that it may be impossible to achieve any agreement. The problem is worse still when one considers that rules must change over time. If there is harmonization, how do changes take place? Despite the challenges, harmonization may represent a viable strategy in some areas, including health and safety standards (perhaps only regionally), reporting requirements in areas such as antitrust and

42. If a rule of party choice is not adopted, some level of cooperation may nevertheless be necessary. *See* Alan O. Sykes, *Regulatory Competition or Regulatory Harmonization? A Silly Question?*, 1 J. INT'L ECON. L. 257 (2000).

43. *See, e.g.*, 11 U.S.C. § 304 (2000).

44. Lucian A. Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J.L. & ECON. 775 (1999); Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177 (2000).

45. One should not exaggerate the distinction between negotiations over choice-of-law rules and substantive rules, however. Choice-of-law rules can cause a given transaction to be governed by different substantive laws. This may cause some "domestic" aspects of a transaction to face foreign law.

patent law, compatibility issues such as those present in clearance systems, and so on.

Finally, if all else fails, one can consider supranational standards and regulation.[46] The best examples of this strategy are international trade and international intellectual property at the WTO, and international banking regulation done through the Basle Accord. I have suggested that a similar strategy should be used for antitrust.[47] Supranational regulation has the potential to reduce the cost of transfers among states, which makes it easier to reach an agreement. This is especially true when transfers must be made across issue areas.

CONCLUSION

O'Hara and Stephan argue convincingly that normative work in the choice-of-law area is difficult. Despite this difficulty, however, governments and regulators must respond to the challenge of globalization. An effective response requires a better understanding of how choices with respect to international cooperation affect outcomes. Choice-of-law issues are one aspect of the more general problem of regulating international conduct in a world of national laws. As such, choice of law should be embedded within a larger debate on international regulatory competition and cooperation. To date, the debate about international regulation and the debate about choice of law have seen very modest overlap. I hope the present exchange among individuals interested in both areas will contribute to greater synergies between the two lines of scholarship.

In contrast to the way so much choice-of-law scholarship has proceeded in the past, O'Hara, Stephan and I agree that the focus of scholarship on choice of law should be individual welfare.[48] This approach has the benefit of a metric by which good and bad policies can be distinguished. It also demonstrates more clearly why the subject matter is important. Poor policy choices will lead to a poorer world while better choices will lead to a richer one.

Of course, we agree on more than just the need to focus on welfare. We also agree on virtually all the positive claims that each of us makes. These areas of agreement, however, do not extend to policy recommendations. At least relative to Stephan, I remain optimistic and enthusiastic about international cooperation. True, there are risks, but the risks of resisting cooperative efforts strike me as far larger. The world continues to get smaller, and national governments continue to fall behind the globalization of business and other activities. The distortions and losses generated by governments attempting to shift costs to other states and by private actors trying to take advantage of an anarchic regulatory world will continue to mount unless governments find cooperative

46. One could distinguish supranational standards from supranational regulation on the grounds that it is only in the latter case that an international institution can change the applicable rules. For present purposes, however, it is sufficient to treat them as a single category.

47. Guzman, *supra* note 1, at Part V.B.3.

48. *See* O'Hara, *supra* note 2, at 942 ("Obviously, we strive to maximize aggregate welfare. . . .").

ways to address their regulatory goals. The solutions are almost certainly different from one subject area to the next,[49] so no single prescription can be made.

I do not deny that there are problems with international cooperation that make it inferior to well-functioning domestic systems. That is why I believe that as much of the regulatory system as possible should be left in the hands of national governments. On the other hand, when competition among governments threatens to undermine effective regulation, cooperation is necessary.

Appropriately, the final word in this exchange will be devoted to the public choice problem. This problem is not, of course, uniquely about choice of law or even international law. Any policy discussion has a public choice dimension, and any normative international law work must wrestle with the issue. Despite the difficulty with public choice, policy decisions must be made. Jurisdiction must be exercised extraterritorially or not, international negotiations must be undertaken or not, and agreements must be signed or not. The role of scholars, then, is twofold. First, we must do all that we can to determine what we know to be true and, just as importantly, what we do not know to be true. Second, we must offer our judgment about how to respond to the uncertainty surrounding policy decisions. There is, of course, plenty of room for debate here, and the responses to my article as well as this reply offer an example of just such a debate. Only this sort of dialogue can lead us through the messy terrain of policy in the international regulatory arena. As Paul Stephan states in concluding his response, "normative work cannot proceed any other way."[50]

49. I have proposed, for example, a regime of issuer choice in securities regulations, with each state providing its own set of substantive laws and with minimum international standards beyond an enforceable contract mechanism. In antitrust, on the other hand, I am in favor of at least some supranational regulation, preferably through the WTO. *See* Guzman, *supra* note 1, at section V. B.3.

50. Stephan, *supra* note 2, at 13.