EDITORIAL COMMENT

ECONOMIC "NECESSITY" IN INTERNATIONAL LAW

*By Alan O. Sykes**

Exigent circumstances can extinguish or suspend a wide range of legal obligations. They may empower governments to seize property or quarantine individuals. They may excuse the nonperformance of private or public contractual obligations. And, of especial interest here, they may permit governments to deviate from their obligations under treaties or customary international law (CIL).

The focus of this Comment is on exigent economic circumstances that may afford a defense of "necessity" to the nonperformance of CIL obligations or that become a basis for deviation from commitments pursuant to express treaty language delineating necessity-like contingencies. An example of such language—prominently at issue in a number of investment disputes between U.S. investors and Argentina—is Article XI of the U.S.-Argentina bilateral investment treaty (BIT):[1] "This treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its essential security interests."

As described at greater length below, Argentina invoked both this language and the CIL defense of necessity as a basis for certain measures that it had taken during a period of domestic economic crisis and that would otherwise violate investment treaty obligations. A series of controversial arbitral decisions followed, along with subsequent annulment decisions, raising a variety of questions about the scope of the necessity defense and the appropriate construction of Article XI. Some of the underlying disputes remain ongoing.[2]

The issues raised by the Argentine investment cases have received much attention from legal scholars. With particular reference to necessity and Article XI, the issues that have been addressed include the contours of the necessity defense in CIL, the question whether Article XI implicitly incorporates the limits of the CIL defense or is instead a broader and less restrictive defense, the question whether Article XI should be viewed as a "defense" or as a "primary rule" that averts any violation altogether, the question whether Article XI can be construed as self-judging, and the question of what happens when the exigent circumstances abate

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[1] Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., Nov. 14, 1991, 31 ILM 124 (1991).

[2] The status of cases against Argentina under World Bank arbitration (International Centre for Settlement of Investment Disputes) may be found at the ICSID website, https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/AdvancedSearch.aspx?gE=s&rntly=ST4.

(including the possibility that compensation may be owed to investors for their losses). Other commentators have done an extensive job of analyzing these doctrinal issues and their historical origins.[3]

Considerably less attention has been paid to the necessity defense and related legal principles (such as those contained in Article XI of the U.S.-Argentina BIT) from an optimal contracting perspective.[4] What inferences can be drawn from the history of the CIL necessity defense about its economic logic and function? How can an understanding of its function enlighten its application to situations of exigent economic circumstances? Why would rational treaty drafters include a provision such as Article XI, and how might conditions of economic distress relate to its objectives? Are matters of "necessity," "public order," and "essential security interests" verifiable by adjudicators? What is the economic function of the word necessary? How do the answers to these questions bear on the degree of moral hazard created by the opportunity to deviate from international obligations? When is a deviation from commitments an appropriate policy instrument in response to necessity when other instruments may be available?

The goal of this Comment is to suggest possible answers to these questions and to offer some thoughts on how they might be used in the future to guide adjudicators in their thinking about when and to what extent economic exigency should excuse or postpone legal obligations under the CIL rubric of necessity or some similar treaty principle. Part I reviews necessity and related ideas in other fields of law, with an emphasis on the apparent economic rationale for these pockets of doctrine. It will suggest several hypotheses about the possible function of necessity and related concepts in CIL and treaty law. Part II reviews the CIL defense of necessity as it pertains to economic exigency. Part III turns to the particular subject of economic distress in the investment law area and assesses Argentina's defenses from an economic perspective. It further considers the verifiability of circumstances that give rise to necessity and related exigencies, and the attendant implications for accommodating the tension between the need to address economic emergencies, on the one hand, and the need to limit opportunism and moral hazard, on the other, as well as the need to encourage an appropriate choice of policy instruments. The role of compensation requirements is a particular focus.

[3] The literature addressing the Argentina cases in whole or in part includes José Alvarez, *The Public International Law Regime Governing International Investment*, 344 RECUEIL DES COURS 193, 369–443 (2009); José Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, [2009] 1 Y.B. INT'L INVESTMENT L. & POL'Y 379; José Alvarez & Gustavo Topalian, *The Paradoxical Argentina Cases*, 6 W. ARB. & MEDIATION REV. 491 (2012); Andrea K. Bjorklund, *Emergency Exceptions: State of Necessity and Force Majeure*, *in* OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 459 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008); William W. Burke-White, *The Argentine Financial Crisis: States Liability Under BITs and the Legitimacy of the ICSID System*, 3 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 199 (2008); Jurgen Kurtz, *Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis*, 59 INT'L & COMP. L. Q. 325 (2010); August Reinisch, *Necessity in Investment Arbitration*, 2010 NETH. Y.B. INT'L L. 137; JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES 342–48 (2012); Alec Stone Sweet, *Investor-State Arbitration: Proportionality's New Frontier*, 4 L. & ETHICS HUM. RTS. 47 (2010); Anne van Akken, *Smart Flexibility Clauses in International Investment Treaties and Sustainable Development: A Functional View*, 15 J. WORLD INVESTMENT & TRADE 827 (2014); and MICHAEL WAIBEL, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS (2011).

[4] A general discussion of "commitment" versus "flexibility" in investment treaties, touching briefly on the necessity cases, can be found in Anne van Akken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 J. INT'L ECON. L. 507 (2009).

I. Necessity and Related Concepts in Other Areas of Law: Possible Lessons

Exigent circumstances, including exigent economic circumstances at times, allow actors to circumvent obligations that would otherwise be unavoidable in a variety of fields of law. Examining the apparent rationale for these principles helps to understand how necessity and similar ideas might contribute usefully to CIL and international investment law. This part offers a non-exhaustive survey of how exigent circumstances may excuse obligations in other contexts. It begins with the most familiar territory in tort and contract law, and then addresses the area of international trade.

Before beginning this survey, however, it is helpful to delineate precisely what is meant by an "act of necessity." For purposes of the present discussion, such an act is a voluntary act by the defendant that intrudes on some ordinarily recognized right of the plaintiff. The act is done to avert some harm that threatens the defendant's or a third party's interests and that emanates from a source other than the plaintiff. By "voluntary," I mean that the defendant has the capacity to choose some other course of conduct. Thus, situations of necessity are to be distinguished from cases of *force majeure,* for example, where the defendant is unable to protect the plaintiff's rights because of some superior force. They are also to be distinguished from situations in which the defendant's act is compelled by coercion or duress. Finally, because the exigent circumstances are not attributable to the plaintiff, acts of necessity must be distinguished from cases in which the defendant's act constitutes a form of self-defense or countermeasure.

Tort and Contract

Most first-year law students in the United States are familiar with the classic tort tandem of *Ploof v. Putnam*[5] and *Vincent v. Lake Erie Transportation*,[6] both involving situations in which a boat owner secured a boat to a dock owned by another party during a severe storm rather than take the boat out in the storm at great risk to the boat and its crew. In *Ploof,* the dock owner's servant responded by casting the boat adrift, and the owner was held liable for damages. In *Vincent*, the dock owner sustained significant damages to its property from the boat that was secured during the storm, and recovered damages.

A conventional summary of the necessity defense in this area suggests that it includes the following components: "(1) the defendant acted to avoid a significant risk of harm; (2) no adequate lawful means could have been used to escape the harm; and (3) the harm avoided was greater than that caused by breaking the law."[7] This description of necessity contains its own economic rationale; necessity's purpose is to enable an actor to avoid a greater harm either by causing a lesser harm at the expense of the plaintiff or by violating an otherwise applicable legislative enactment. In this sense, acts of necessity are efficient acts.

Buried in this simple description of necessity, however, are several additional considerations. Although necessity cases, by definition, involve some threat to the defendant's interests emanating from a source other than the plaintiff, the classic cases typically do not address whether the condition of necessity might have been occasioned, in part, by the defendant's imprudence

[5] 71 A. 188 (Vt. 1908).

[6] 124 N.W. 221 (Minn. 1910).

[7] *Necessity*, *in* The Free Dictionary by Farlex, *at* http://legal-dictionary.thefreedictionary.com/Necessity+defense.

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and, if so, whether the privilege to act out of necessity should be lost. In *Ploof*, for example, there is no discussion of whether the boat owner should have put into port sooner due to prospects of an impending storm or perhaps should not have taken the boat out at all given the weather, rather than risk encountering the peril that necessitated a trespass to save the boat and crew. One suspects, however, that even if the boat was imperiled by an imprudent decision to be on the water, the court would still take a dim view of the dock owner casting off the boat to founder, perhaps causing the people on board to drown.

If this suspicion is right, a moral hazard problem is immediately apparent; actors will take risks that imperil them to an excessive degree if they can save themselves by imposing costs on others. A similar issue arises when the defendant sacrifices the plaintiff's property interest to save his own, as in *Vincent*. Even if such behavior is considered acceptable when what is saved is more valuable than what is lost, what incentivizes the actor to make that choice properly?

Both problems are addressed by a requirement that the defendant who acts out of necessity must pay for the actual harm caused to the plaintiff—the principle that emerges from *Vincent*. The boat owner who saves his boat from the storm by tying up to the plaintiff's dock must pay for the damage to the dock.[8] This mechanism eliminates the inefficiencies that would arise if the defendant could damage the dock with impunity. The compensation requirement forces the defendant to internalize the costs and benefits of each decision in sequence—the decision to take the boat out in questionable weather conditions and the decision to save the boat after the storm arises at the expense of damaging the plaintiff's dock.

To be sure, a compensation requirement is not the only way to address these concerns. An alternative legal rule might provide that one loses the privilege to act out of necessity if one's own negligence contributed to the condition of necessity. Likewise, the privilege to act out of necessity might be denied if a court determines ex post that the defendant acted in a manner that sacrificed a greater interest to save a lesser interest. The rule of *Vincent* is a type of strict liability rule (the actor must pay for harm caused), whereas the alternatives are a form of negligence rule (the actor must pay if, and only if, the act was inefficient). Either mechanism can, in principle, induce efficient acts.[9] The negligence mechanism, however, requires the adjudicator ex post to gather and evaluate the information bearing on the efficiency of the defendant's behavior, which may be costly or even impossible to obtain—a consideration that favors the strict liability approach.

Finally, the scope of the necessity defense may depend, in part, on whether the actor is serving his own interests or the interests of third parties. Suppose that a wildfire threatens a town, and the fire department makes a reasonable decision to destroy property belonging to one citizen to create a firebreak that will stop the fire from reaching the town. Should the property owner have a cause of action for damages against the official who makes this decision? A simple answer might be that damages are zero because the plaintiff's property would have been destroyed anyway. But suppose the wind later shifted, and the property would have avoided fire damage—although at the time of the fire department's decision, all experts would agree that the firebreak was the appropriate precaution to take. The defense of public necessity shields

[8] This principle may be limited to cases where physical damage is done; it is doubtful that a boat owner trespassing under circumstances such as those in *Ploof* could be held liable for the fair rental value of a dock that suffered no actual damage. This result has economic justification, however, if the dock owner suffers no opportunity cost due to the temporary use of the property by another.

[9] *E.g.*, Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1 (1980).

public officials who make such decisions from liability.[10] The evident rationale is to insulate the actor from personal liability when the act of necessity spares other parties' interests. If the actor were required to compensate, and thus bore the costs of the act but did not reap the benefits, efficient acts would be discouraged. The broader lesson is that liability may chill socially beneficial decisions and that the liability rule must be attentive to that possibility. The concern is especially acute when the relevant actor must make a decision that implicates the interests of third parties.

Turning from tort to contract, threats of physical harm that create necessity are much less common, but exigent economic circumstances often arise. These situations beget doctrines that are related to necessity, even if they do not employ that label.

The treatment of exigent circumstances in contract proceeds from the observation that contracting parties are free to provide for such contingencies explicitly, and often do. Specific provisions regarding the contracting parties' rights in exigent circumstances will be respected. Contracts routinely address transactions that are complex, however, and the transaction costs of contracting prevent parties from addressing every conceivable contingency. The "complete contingent contract" in economic parlance is simply too expensive to write. Instead, most contracts are "incomplete." Contract law supplements incomplete contracts with background default rules, some of which address rights and responsibilities in the event of various unspecified, often unanticipated, and sometimes exigent contingencies.

One default principle facilitating efficient deviation from commitments in response to economic exigency is the standard U.S. remedy for most contract breaches: expectation damages.[11] A virtue of expectation damages is that it facilitates what has become known in the literature as "efficient breach." If the costs of performance to a promisor exceed the value of performance to the promisee, performance is socially inefficient. With a rule of expectation damages in place, and neglecting complications associated with litigation and error costs, a rational promisor will breach and pay damages if breach is efficient.[12] To be sure, parties to an incomplete contract can also achieve efficient deviation from obligations through renegotiation (the only option where the default remedy is specific performance). Defenders of the expectation-damages rule argue, however, that such renegotiation is costly and may be afflicted by holdup and strategic bargaining behavior, which renders it inferior to the expectation damages liability rule. Proponents of the specific performance remedy observe, among other things, that the computation of lost expectation is costly and often fraught with error.[13] The general lesson is that the best options for facilitating efficient deviation from commitments are unlikely to be the same in all cases. A liability rule approach affording compensation is more likely to be useful, other things being equal, the less costly and error prone the computation of compensation.[14]

[10] *E.g.*, Mayor of New York v. Lord, 18 Wend. 126 (N.Y. 1837).

[11] To be sure, this rule applies not only to cases of economic exigency but to much more mundane settings, as when the seller of a good receives a better offer from another buyer.

[12] The classic article is by Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466 (1980).

[13] The arguments on both sides are found in Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979).

[14] Expectation damages may be seen as a liability rule since the breaching party need not secure permission to avoid performance. Specific performance is a "property rule" that forces a party who wishes to breach, to perform the required action anyway. The distinction originates in Guido Calabresi & A. Douglas Melamed, *Property, Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

Other aspects of contract law are tailored more directly to situations in which exigent economic circumstances warrant deviation from commitments in incomplete contracts. Two principles that excuse performance altogether are the impossibility doctrine under the common law and its analogue under the Uniform Commercial Code (UCC)—commercial impracticability. Both the common law impossibility doctrine and especially the commercial impracticability doctrine of the UCC encompass some instances[15] in which performance has become extraordinarily costly because of some unanticipated contingency. The First Restatement of Contracts extended the concept of impossibility to "not only strict impossibility but impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved."[16] UCC section 2-615 addresses performance that has "been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made."

A prominent example is *Mineral Park Land Co. v. Howard*, in which the defendants agreed to take their requirements of gravel from the plaintiff's land, bearing the cost of excavation themselves and also paying five cents per ton to the plaintiff.[17] They later discovered that much of the gravel was below the water table, increasing the cost of excavation ten- to twelvefold, and the court excused performance. Another group of cases involve crop failures,[18] in which it has been held that if a contract calls for the delivery of crops grown on a particular parcel of land and is followed by a complete or partial crop failure, the promisor is discharged to the extent that the crop volume falls below the contractual commitment. The crop failure cases are also best viewed as cases of impracticability rather than true impossibility because the promisor could be required to perform by procuring cover for the buyer from another source.

Careful economic analysis of such cases raises many doubts concerning the efficiency of the impossibility and impracticability doctrines as applied in practice.[19] Nevertheless, one can detect two general themes in the cases and the commentary in support of the doctrines. In a situation such as *Mineral Park*, it is a safe bet that performance had become inefficient due to an unanticipated contingency and that it was best for the defendant to source its gravel elsewhere. A discharge of contractual obligations facilitates that result. In addition, contingent discharge of obligations may in some cases improve the efficiency of risk sharing between the contracting parties. The crop failure cases, in particular, insulate potentially risk-averse farmers who have already suffered heavy losses due to crop failure from the further burden of compensating buyers for the costs of cover.[20] The broader point—potentially applicable in the international setting as well—is that when a commitment becomes exceptionally burdensome due to events that were not anticipated at the time of contracting, the optimal contractual response depends not only on the efficiency of performance but also on the parties' attitudes toward risk.

[15] To be sure, the cases in which nonperformance results from true impossibility—such as the death of the promisor to a personal services contract—do not involve acts of necessity as defined herein and are not pertinent.

[16] AMERICAN LAW INSTITUTE, RESTATEMENT (FIRST) OF CONTRACTS §454 (1932); *see also* AMERICAN LAW INSTITUTE, RESTATEMENT (SECOND) OF CONTRACTS §261 (1981).

[17] Mineral Park Land Co. v. Howard, 156 P. 458 (Cal. 1916).

[18] *E.g.*, Pearce Young Angel Co. v. Charles R. Allen, Inc., 213 S.C. 578, 50 S.E. 2d 698 (1948).

[19] Alan O. Sykes, *The Doctrine of Commercial Impracticability in a Second-Best World*, 19 J. LEGAL STUD. 43 (1990).

[20] *E.g.*, Richard Posner & Andrew Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

Finally, the literature on impossibility and impracticability cautions against certain collateral consequences of discharging obligations because performance has become impracticable. In particular, if a promisor can take measures to avert impracticability—perhaps the farmer can store water against the danger of drought or use pesticides to guard against pest-related crop failures—a discharge of the promisor's obligations can uneconomically diminish the incentive to take such precautions. Likewise, the incentive to gather information about possible adverse events, so as to guard against them or hedge against them in insurance markets, may be diminished.[21] Where such matters are important, rules that force actors to internalize the consequences of their actions to others may be superior, such as rules requiring expectation damages to be paid regardless of exigent circumstances.

International Trade

International trade agreements address exigent circumstances in a variety of provisions. In the interest of brevity, this section will focus on the law of the World Trade Organization (WTO), although related provisions may be found in various preferential trade agreements.

The most direct analogy to necessity under CIL and to Article XI of the U.S.-Argentina BIT is to be found in the General Agreement on Tariffs and Trade (GATT) Article XXI on security exceptions (and its parallel provision in the General Agreement on Trade in Services Article XIV *bis*):[22]

> Nothing in this Agreement shall be construed . . .
>
> (*b*) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
>
> (i) relating to fissionable materials or the materials from which they are derived;
>
> (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
>
> (iii) taken in time of war or other emergency in international relations[.]

This provision has not been a subject of any formal dispute since the founding of the WTO, although it was at issue several times during the GATT years, most prominently in relation to British Commonwealth measures against Argentina because of the Falklands dispute,[23] a U.S. embargo against Nicaragua during the Reagan administration,[24] and European measures against Yugoslavia during the Balkans crisis of the early 1990s.[25]

A brief attempt to invoke GATT Article XXI to deal with difficult economic circumstances in a domestic industry was made by Sweden in 1975, when it imposed restrictions on certain footwear imports. It argued that footwear was an essential domestic industry that had to be

[21] Sykes, *supra* note 19.

[22] General Agreement on Tariffs and Trade 1994, Apr. 15, 1994 [hereinafter GATT], Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1A, 1867 UNTS 187; General Agreement on Trade in Services, Apr. 15, 1994, WTO Agreement, *supra*, Annex 1B, 1869 UNTS 183.

[23] *See* 1 WORLD TRADE ORGANIZATION, GATT ANALYTICAL INDEX 601–03 (1995).

[24] *Id.* at 603.

[25] *Id.* at 604–05.

preserved at some minimum production capacity to protect Sweden's national security interests. The restrictions were the subject of intense criticism in the GATT Council, and Sweden ultimately withdrew them after less than two years.[26]

Why has Article XXI proven relatively uncontroversial over the seventy-year history of the GATT/WTO system? The key provisions quoted above are explicitly self-judging; a party may take action "which it considers necessary for the protection of its essential security interests." This attribute suggests that adjudicators will afford great deference to national government decisions to invoke Article XXI or else conclude that they lack a basis for adjudication (as occurred with a GATT panel composed to address the U.S. embargo of Nicaragua).[27]

But Article XXI is limited to concerns about fissionable materials, arms trafficking, and measures taken during war or during other *international* emergencies. Despite its self-judging character, opportunistic use of Article XXI to address domestic political or economic concerns seems squarely out of bounds. The only serious disputes have related to measures undertaken in relation to bona fide military conflicts.

The general lesson is that narrowly tailored security exceptions, limited on their face to circumstances that are well defined and observable, can function reasonably well, even when made self-judging. It is noteworthy that Article XXI does *not* encompass exigencies such as a member government's financial distress or domestic economic crises that are unrelated to war and international emergencies.[28] Opportunism is policed by the same self-enforcement mechanism that holds trade agreements together under ordinary circumstances; cheating is observable and is likely to carry a cost in the form of formal and informal retaliatory measures, and perhaps reputational sanctions.

GATT Article XX, on "General Exceptions," contains additional provisions permitting deviation from commitments under enumerated circumstances. Permitted deviations include those "necessary to protect public morals," "necessary to protect human, animal or plant life or health," and "relating to the conservation of exhaustible natural resources," among others. A complete discussion of Article XX's history and interpretation is far beyond the scope of this comment, and none of the provisions involve circumstances that one can easily characterize as economic necessity. Nevertheless, a few features warrant brief mention. Article XX is plainly not self-judging, and WTO/GATT panels have often been asked to ascertain whether a challenged measure falls within its purview. Nevertheless, the general tendency of WTO adjudicators has been to defer to members' claims that their policy aims come within the enumerated exceptions.[29] Adjudicators have been much less deferential to the choice of means to achieve these objectives, however, and regularly inquire whether a measure is "necessary" to achieve the

[26] *Id.* at 603.

[27] *Id.* at 601.

[28] Interestingly, some more recent investment treaties provide exceptions for adopting reasonable measures for prudential reasons, such as those to maintain the integrity of the financial system. *See* Article 10 of the 2004 Canadian model BIT, *available at* http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf. Such exceptions are not self-judging, however, and leave open the question whether the cancellation of a debt would ever be a "reasonable measure."

[29] To give two examples, the WTO has ruled that measures to protect extraterritorial seal populations against animal cruelty fall within the "public morals" exception and that measures to protect clean air come within the "exhaustible natural resources" exception. *See* Appellate Body Report, European Communities—Measures Prohibiting the Importation and Marketing of Seal Products, WT/DS400/AB/R & WT/DS401/AB/R (adopted June 18, 2014); Appellate Body Report, United States—Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (adopted May 20, 1996).

stated objective or whether it violates the prohibition on "arbitrary or unjustifiable discrimination" in the Article XX chapeau.[30]

In broad brush, Article XX's jurisprudence may thus be characterized as deferential to members' policy objectives but considerably less deferential to their choice of policy instruments. Measures that intrude importantly on other members' trading interests and that require justification under Article XX often receive a searching "least restrictive means" analysis grounded in textual hooks such as "necessary" and "discrimination."[31] This approach has the virtue of preserving a broad degree of policy sovereignty for members to pursue nontrade objectives, while ensuring that they do not deliberately or inadvertently impose excessive costs on trading partners. Its efficacy depends, however, on the capacity of adjudicators to make reasonably accurate judgments about the existence of less trade-restrictive alternatives. This task is a plausible one for WTO adjudicators because of their trade expertise and attendant ability to weigh the trade impact of alternative approaches to the same policy goal. When adjudicators possess both the information and expertise to evaluate policy alternatives, least-restrictive-means analysis or its equivalent under another rubric can play a useful role in policing unnecessary deviation from international commitments.

We now turn to two other aspects of WTO/GATT law that address circumstances of economic exigency. The first, GATT Article XIX,[32] as elaborated by the WTO Agreement on Safeguards,[33] concerns "Emergency Action on Imports." The standard for such action, known as a safeguard measure, is found in GATT Article XIX:1(a):

> If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

The evident objective is to permit WTO members to escape the economic consequences of negotiated import concessions that result in unexpected import surges that seriously imperil an import-competing industry.

Much has been written about the economic rationale for safeguard measures. Although the stated goal of safeguards under national law (such as section 201 of the 1974 U.S. Trade Act)[34] is to allow measures that restore the competitiveness of domestic firms or permit a more "orderly" contraction of a declining industry, it is difficult to offer a convincing account of how safeguard measures are desirable for such purposes on grounds of efficiency as conventionally

[30] *See*, *e.g.*, Appellate Body Report, Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WT/DS161 & WT/DS169/AB/R (adopted Jan. 10, 2001) (necessity test violated); Appellate Body Report, United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R (adopted Nov. 6, 1998) (chapeau violated).

[31] The proposition that such analysis can be understood as a form of cost-benefit analysis that is attentive to error costs is developed in Alan O. Sykes, *The Least Restrictive Means*, 70 U. CHI. L. REV. 403 (2003).

[32] *Supra* note 22.

[33] Apr. 15, 1994, WTO Agreement, *supra* note 22, Annex 1A, 1869 UNTS 154.

[34] 19 U.S.C. §2251 (2012).

defined. Worthwhile efforts to restore competitiveness should be financed by the capital markets, and "orderly contraction" typically delays the inevitable while exacerbating the economic costs due to a period of protectionism. If any intervention is useful in times of labor market rigidities, direct intervention in the labor market through adjustment assistance makes more sense.[35]

Nevertheless, safeguard measures can be "efficient" in a political sense, and political accounts of the safeguard mechanism have come to predominate. One account posits that safeguard measures address situations of political exigency in which government officials will be compelled to deviate from their international trade commitments. If such deviation is defined as "cheating," trade agreements may unravel; it is in the parties' interest to permit temporary "cheating" to preserve long-term cooperation.[36] An alternative perspective emphasizes that the politicians who agree to treaties are concerned about their own political futures and face uncertainty about the consequences of treaties. It makes sense for them to provide options to deviate from commitments that prove unexpectedly burdensome from a political standpoint, particularly if the actors who are allowed to deviate enjoy significant political gains by so doing, while their counterparties' political losses remain modest. Protection for troubled industries besieged by unexpected import competition arguably fits the bill.[37] The safeguard mechanism has the further virtue that it makes politicians less skittish about negotiating trade concessions and leads to more concessions ex ante, even if some are temporarily revoked ex post.[38]

One difficulty with the safeguard mechanism, however, is that the conditions under which deviation from trade commitments is politically efficient are difficult to observe and verify; indeed, the legal preconditions for the proper use of safeguards under GATT Article XIX are defined in exceedingly imprecise terms. What is an "unforeseen development"—unforeseen by whom and at what point in time? What is "serious injury?" How does one determine whether "increased quantities" of imports, rather than something else, are the "cause" of serious injury? Article XIX (as well as the more recent WTO Agreement on Safeguards) leaves these questions largely open, raising the danger of the opportunistic use of safeguard measures.

The original solution in Article XIX was to require compensation. Members invoking Article XIX were obligated to negotiate compensatory trade concessions with affected parties or else suffer limited "retaliation" in the form of those parties' withdrawal of "substantially equivalent concessions."[39]

[35] *See* Alan O. Sykes, *Protectionism as a "Safeguard": A Positive Analysis of the GATT "Escape Clause" with Normative Speculations*, 58 U. CHI. L. REV. 255 (1991); ALAN O. SYKES, THE WTO AGREEMENT ON SAFEGUARDS (2006).

[36] Kyle Bagwell & Robert W. Staiger, *A Theory of Managed Trade*, 80 AM. ECON. REV. 779 (1990).

[37] Declining industries are commonly observed to invest heavy resources in the pursuit of trade protection. This phenomenon has two possible explanations: (1) they are more likely to succeed in securing protection because they are politically sympathetic suitors due to high unemployment among their workers, and (2) the returns to protection will not be competed away by the entry of new firms as long as investment returns do not rise above the competitive level. Likewise, if competing foreign exporters that would be affected by safeguards measures are growing and profitable, restrictions on their exports may not engender as much political outcry if the exporting firms expect their returns to be diminished anyway by competitive entry. These observations afford a plausible account of why protection for troubled industries against efficient foreign competitors may yield joint political gains to treaty partners on average, even if it reduces economic efficiency in the conventional sense. Sykes (1991), *supra* note 35.

[38] See sources cited *supra* note 35.

[39] GATT, *supra* note 22, Art. XIX:2–3.

The compensation requirement was itself problematic, however, in part because the "substantial equivalence" standard is also vague. Demands for compensation were often high. To avoid the requirement, GATT members began to negotiate extralegal arrangements—often termed "voluntary restraint agreements"—which were discriminatory and potentially permanent, and which sometimes ignored the prerequisites for the use of safeguards. The proliferation of extralegal measures resulted in the WTO Agreement on Safeguards, which elaborated some of the prerequisites for safeguards, with an eye toward adjudication (not very successfully as it turned out),[40] while softening the compensation requirement to allow safeguard measures for a period of three years without compensation in many cases.[41] The agreement was accompanied by an arbitral process that can assess "substantial equivalence" pursuant to the WTO Dispute Settlement Understanding. Finally, the agreement introduced further provisions to limit and discourage opportunism; if a nation imposes safeguards in a particular industry, it must phase them down over a few years, remove them altogether after at most eight years, and cannot reapply them for a period equal to the length of time that they were in force.[42] With regard to the latter principle, a nation that invokes the safeguards mechanism opportunistically may find itself confronted with a legitimate need to use safeguards later yet be unable to act. Opportunism becomes riskier and less likely.[43]

In summary, the WTO/GATT escape clause is an example of a treaty provision aimed at facilitating deviation from the bargain under exigent economic circumstances—albeit circumstances that create political exigency more than any conventional efficiency justification for deviation. The political actors who negotiate treaties under conditions of uncertainty may find such provisions optimal. We return in part III to the question whether a provision such as Article XI of the U.S.-Argentina BIT can be understood through the same lens.

Such provisions tend to create additional challenges in administration because economic exigency can be much more difficult to define with precision than emergency conditions associated with wars, arms trafficking, hazards to human health, and the like. The result tends to be vague standards regarding conditions that other parties find difficult to observe and that adjudicators find difficult to verify. In turn, serious problems of opportunism may arise. A compensation requirement is one possible solution, although not the only option.

The other GATT provisions that address economic exigency concern balance-of-payments crises. These provisions (GATT Articles XII–XV) are complex, but the central intuition is simple. Assume that a government wishes to maintain a fixed exchange rate or at least a rate within some narrow band. Assume further that it runs a substantial balance-of-trade deficit at this exchange rate, so that it imports considerably more than it exports. The demand for foreign currency to buy imports then exceeds foreigners' demand for domestic currency to buy exports. Unless foreigners are content to accumulate the domestic currency for investment purposes, the excess demand for foreign currency will cause foreign currency to appreciate relative to the domestic currency. But this situation may push the exchange rate away from the target value.

[40] The jurisprudential confusion engendered by these issues is address in Alan O. Sykes, *The Safeguards Mess: A Critique of WTO Jurisprudence*, 2 WORLD TRADE REV. 261 (2003), *reprinted in* THE WTO, SAFEGUARDS, AND TEMPORARY PROTECTION FROM IMPORTS (Chad P. Bown ed., 2006).

[41] WTO Safeguards Agreement, *supra* note 33, Art. 8.3.

[42] *Id.*, Art. 7.

[43] Kyle Bagwell & Robert W. Staiger, *Enforcement, Private Political Pressure and the GATT/WTO Escape Clause*, 34 J. LEGAL STUD. 471 (2005).

To avoid that result, the domestic government must use its reserves of foreign currency to intervene in exchange markets, buying domestic currency to support its price and selling its holdings of foreign currency. But what happens if its reserves start to run out? It may be unable to support its currency, and devaluation may become imminent. Private actors holding assets denominated in domestic currency will then want to dump them, foreign capital will pull out of the country, and difficult macroeconomic circumstances may follow.

This problem was a common concern in the days of fixed exchange rates, as contemplated at the formation of the International Monetary Fund (IMF). Nations obliged to maintain their currency's par value could easily find themselves running short of foreign exchange reserves. They could borrow reserves from the fund, but it was also contemplated that import restrictions might be necessary to curb the excess of imports over exports. GATT permits such restrictions for the purpose of addressing balance-of-payments crises, but limits them. Article XII: 2(a) provides:

> Import restrictions instituted, maintained or intensified by a contracting party under this Article shall not exceed those necessary:
>
> (i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or
>
> (ii) in the case of a contracting party with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.[44]

Additional obligations require that the measures be limited to the period of balance-of-payments distress and that they be administered in a nondiscriminatory fashion among the foreign exporters of competitive products (Article XIII).

The demise of fixed exchange rates for most developed countries reduced the need for currency market intervention by major countries such as the United States, but developing countries often seek to maintain fixed exchange rates today, in part to "tie their hands" against irresponsible monetary policies. Macroeconomic crises attributable to loss of confidence in local currencies still occur (recall the Asian financial crisis of the 1990s, which began when Thailand was forced to abandon its peg for the baht).

In short, economic exigency may at times arise because of balance-of-payments crises that threaten capital flight. Such exigencies afford a justification for deviation from trade commitments in the WTO when they are properly linked to bona fide crises and properly time limited. So, too, might they justify deviation from other international commitments if reasonably necessary to conserve important and scarce foreign exchange reserves. We will return below to the question whether investment treaty commitments might fall into this category.

Like the security provisions and general exceptions of GATT Articles XXI and XX, the balance-of-payments provisions have proven to be reasonably enforceable in adjudication. Although they have been invoked opportunistically in the past to afford a pretense for selective protectionism in politically sensitive industries, adjudicators have proven able to rule that they are illegal when a close linkage to a serious monetary reserve crisis is absent.[45]

[44] *Supra* note 22.

[45] *See* Appellate Body Report, India—Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/AB/R (adopted Sept. 22, 1999).

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II. THE NECESSITY DEFENSE IN CIL

The preceding review of necessity and related concepts in other fields of law offers important insights into what might be meant by necessity, how economic exigency might create circumstances relating to necessity, and how necessity might bear on collateral issues, such as the obligation to compensate for acts of necessity. We now turn to the evolution of necessity as a defense in CIL. Many of the same ideas emerge.

The CIL necessity defense dates back to Grotius.[46] It has been acknowledged in a number of CIL decisions through the years and is now enshrined in the International Law Commission (ILC) Articles on State Responsibility.[47] Article 25 provides:

> 1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
>
> (a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
>
> (b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.
>
> 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
>
> (a) The international obligation in question excludes the possibility of invoking necessity; or
>
> (b) The State has contributed to the situation of necessity.

A review of the cases suggests that necessity here, as in other fields of law, arises only if the interest to be saved by an act of necessity exceeds in value the harm done by the violation of an international obligation. Necessity has been invoked to justify a wide range of actions under circumstances that seemingly satisfy this criterion, including a brief incursion into the territory of another state to interdict support for rebels (the *Caroline* case),[48] measures to protect animal populations from serious overfishing or hunting to extinction (the *Fisheries Jurisdiction*[49] and *Russian Fur Seals*[50] cases), the destruction of a foundering ship to prevent a massive oil spill (the

[46] "In cases of necessity men have a right of using that which has already become the property of others. To sanction this indulgence, the necessity must be such that it cannot otherwise be avoided." HUGO GROTIUS, ON THE LAW OF WAR AND PEACE [DE JURE BELLI AC PACIS], bk. II, ch. 2 (A. C. Campbell trans., 1814), *available at* http://www.bartleby.com/172/202.html.

[47] Articles on Responsibility of States for Internationally Wrongful Acts, *in* Report of the International Law Commission on the Work of Its Fifty-Third Session, UN GAOR, 56th Sess., Supp. No. 10, at 26, UN Doc. A/56/10 (2001). The ILC commentaries on what were then the draft articles, UN Doc. A/56/10, at 59, include a thorough history of the ILC discussions. For the commentary relevant to our current discussion, see *id.* at 80–84 [hereinafter ILC Commentary].

[48] *See id.* at 81 (discussion).

[49] Fisheries Jurisdiction (Spain v. Can.), 1998 ICJ REP. 432 (Dec. 4).

[50] ILC Commentary, *supra* note 47, at 81.

Torrey Canyon case),[51] and the appropriation of foreign property that was necessary to provide subsistence to troops engaged in resisting a rebellion (the Anglo-Portuguese dispute of 1832).[52]

Considerable support exists for the proposition that economic exigency may create necessity, as in the series of cases regarding obligations to repay external debt in times of economic crisis.[53] At an international law conference in 1930, the South African government expressed the following view:

> Foreigners lending money to a particular State can hardly expect not to be prejudicially affected under any circumstances by the vicissitudes of the State in question. If, through adverse circumstances beyond its control, a State is actually placed in such a position that it cannot meet all its liabilities and obligations, it is virtually in a position of distress. It will then have to rank its obligations and make provisions for those which are of a more vital interest first. A State cannot, for example, be expected to close its schools and universities and its courts, to disband its police force and to neglect its public services to such an extent as to expose its community to chaos and anarchy merely to provide the money wherewith to meet its moneylenders, foreign or national. There are limits to what may be reasonably expected of a State in the same manner as with an individual. If, in such a contingency, the hardships of misfortune are equitably divided over nationals as well as foreigners and the latter are not specially discriminated against, there should be no reason for complaint.[54]

This view, more or less, has received broad acceptance. In *Société Commerciale de Belgique*,[55] Belgium had won arbitral awards against Greece that had not been paid. In an action against Greece seeking a declaration that Greece had violated its international obligations, Greece pleaded necessity on the grounds that its budgetary and monetary situation was dire, and Greece could not afford to pay the award at the time. Counsel for Greece argued that "the duty of a Government to ensure the proper functioning of its essential public services outweighs that of paying its debts."[56] Both parties accepted that proposition in principle, with Belgium insisting only that such circumstances merely suspended the debt obligation and did not discharge it.[57] A similar argument was advanced by the Ottoman Empire to avoid repayment of a debt to Russia in the *Russian Indemnity* case. Once again, the tribunal accepted that such a defense might be available but disputed that it applied at the time to the situation facing the Ottoman Empire.[58] The argument and outcome were similar in the *Serbian Loans* case, where Serbia resisted payment in gold to its foreign bondholders, claiming that necessity allowed it to pay in paper francs instead.[59] The tribunal quarreled with the factual basis for the claim but not the underlying principle.

[51] The "Torrey Canyon," Cmnd. 3246 (1967) (UK).

[52] ILC Commentary, *supra* note 47, at 81.

[53] A nice review of "financial necessity" arguments in cases involving sovereign debt defaults may be found in chapter 5 of MICHAEL WAIBEL, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS (2011).

[54] *See* Roberto Ago (Special Rapporteur), Addendum to the Eighth Report on State Responsibility, [1980] 2 Y.B. INT'L L. COMM'N, pt. 1, at 13, 24, UN Doc. A/CN.4/318/ADD.5-7 (emphasis deleted) ("The internationally wrongful act of the State, source of international responsibility").

[55] Société Commerciale de Belgique (Belg. v. Greece), 1939 PCIJ (Ser. A/B) No. 78, at 160 (June 15).

[56] As quoted in Report of the International Law Commission on the Work of Its Thirty-Second Session, UN GAOR, 35th Sess., Supp. No. 10, at 37, UN Doc. A/35/10 (1980).

[57] *See* Addendum to the Eighth Report on State Responsibility, *supra* note 54, at 25.

[58] *Id.* at 22–23.

[59] *Id.* at 24.

The debt cases thus add another form of economic exigency to the scenarios contemplated in, for example, the balance-of-payments provisions of GATT. Where compliance with an international obligation would impose such an economic burden that vital public services would be jeopardized, there is no violation of international law in *postponing* payment. None of the cases suggests, however, that payment should be discharged altogether. The Articles on State Responsibility also preserve that issue in Article 27, which provides: "The invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to . . . [t]he question of compensation for any material loss caused by the act in question."

Finally, the Articles on State Responsibility take a hard-line approach to policing the moral hazard problem that may accompany a necessity defense. Under Article 25, the necessity defense is not available if the "State has contributed to the situation of necessity." As noted earlier, however, an alternative approach to policing moral hazard is a compensation requirement that encourages states to internalize the costs to others from its acts, even if they may be said to "contribute" to the necessity. The effect of "cost internalization" by states is subject to some uncertainty, however, which will be addressed further below.

III. "NECESSITY" AND RELATED ISSUES IN THE INVESTMENT CONTEXT

We now turn to the investment treaty setting and to the question of when economic exigency might justify a departure from ordinary investor-protection rules. The discussion will be much informed by the role of economic exigency in the other settings discussed above, but the investment context assuredly injects some additional wrinkles.

Economic theorizing regarding the rationale for investment treaties is limited and generally informal. The conventional account in the literature emphasizes the time-inconsistency problem that can arise in countries that have difficulty making credible commitments to investors through their domestic legal systems. After investors incur the costs of sunk investments,[60] host countries may adopt policies that impair the returns to investment in a variety of ways—expropriation, onerous tax policies, breach of contract, and so on. These prospects create risk for investors (and "uncertainty" as well, in the sense of Knight).[61] Risk will increase the net price of imported capital (the required rate of return) by an amount that exceeds its expected cost to investors if investors are risk averse. The net price of imported capital will also increase to the degree that the expected costs to investors exceed the expected benefits of these policies to the home country, even if investors are risk neutral.[62] In addition, uncertainty in the sense of Knight makes it difficult even for risk-neutral investors to price the risk that they are facing, potentially scaring them away. Asymmetric information further complicates the problem since host countries may know their own propensities to engage in policies that impair investment

[60] A sunk investment is an investment that cannot be sold to recover its cost. If an investor drills an oil well, for example, it is impossible to "undrill" the well to recover the initial cost. Many capital investments have a significant sunk component.

[61] Knight distinguishes risk, which is quantifiable, from uncertainty, which is not. Uncertainty is more difficult for markets to handle because by definition it is difficult to price. FRANK KNIGHT, RISK, UNCERTAINTY, AND PROFIT (1921).

[62] Because investments are sunk, host countries have no reason to limit their policies to measures that generate joint efficiency gains.

returns yet be unable credibly to disclose their "type" in that respect, leading investors to overestimate the risk of dealing with relatively "safe" host countries.[63]

Accordingly, to reduce the price of imported capital (an unambiguous benefit to a capital-importing nation), many host countries would like to make credible commitments not to act opportunistically toward the owners of sunk investments.[64] Some countries may be able to do so through commitments under domestic law that are difficult to modify (for example, the takings clause of the U.S. Constitution) and that are enforceable in domestic courts that investors consider unbiased and reliable. But commitments under domestic law may not be credible, especially in developing countries afflicted by problems such as weak legal systems, corruption, and political instability. Investment treaties afford a partial solution. They typically give investors the right to pursue claims before neutral international arbitrators and often provide a right of action for money damages. Although the collection of judgments may still prove problematic, these investor rights under international law may considerably improve on the credibility of host country commitments to investors.[65]

To be sure, capital-importing countries have important policy goals in addition to their desire to enjoy cheaper imported capital, and optimal investment treaties do not eliminate all risk for investors. Instead, they ideally eliminate all *inefficient* risks—risks that increase the price of imported capital by more than the value of retaining the policy flexibility that creates risk.[66] Various strategies may be employed to this end. Primary obligations may be construed to insulate desirable domestic policy measures from challenge.[67] Express exceptions to primary obligations may be included for the same purpose; Article XI of the U.S.-Argentina BIT is an obvious example.[68]

[63] This situation is a variant of the classic "lemons" problem. The seminal article is George Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

[64] *See*, *e.g.*, Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1997); van Akken, *supra* note 3. This conventional account of the rationale for investment treaties is subject to some dispute, however, based on various pieces of empirical evidence. They include some studies that find little impact of BITs on inbound foreign direct investment and survey evidence suggesting that the signing of a BIT does not affect investor decisions or political risk insurance premiums. See generally Lauge Poulsen, *The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence*, 2010 Y.B. INT'L L. & POL'Y, and the articles collected in THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND FOREIGN INVESTMENT FLOWS (Karl P. Sauvant & Lisa E. Sachs eds., 2009). A more recent survey of the empirical evidence, however, observes that "the majority of studies conclude that [international investment agreements] have a positive impact on [foreign direct investment]." UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, THE IMPACT OF INTERNATIONAL INVESTMENT AGREEMENTS ON FOREIGN DIRECT INVESTMENT: AN OVERVIEW OF EMPIRICAL STUDIES 1998–2014 (2014), *at* http://investmentpolicyhub.unctad.org/Upload/Documents/unctad-web-diae-pcb-2014-Sep%2024.pdf.

[65] *See* Alan O. Sykes, *Public Versus Private Enforcement of International Economic Law: Standing and Remedy*, 34 J. LEGAL STUD. 631 (2005).

[66] *See generally* van Akken, *supra* note 3. It is also important to note that investment treaties are not the only way for investors to avoid risk; political risk insurance can serve as a partial substitute. Insurance does not eliminate risk, however, but simply transfers it to a less risk averse entity. An appropriate investment treaty may actually eliminate inefficient risk by discouraging opportunistic behavior toward sunk investments.

[67] For example, sensible domestic regulatory measures that reduce the value of foreign investments might be deemed not to constitute measures "tantamount to expropriation." *See*, *e.g.*, Vicki Been & Joel Beauvais, *The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International Regulatory Takings Doctrine*, 78 N.Y.U. L. REV. 30 (2003).

[68] See also the exceptions for health and conservation measures contained in Article (8)(3)(c) of the 2012 U.S. Model Bilateral Investment Treaty, *at* https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.

But investment treaties cannot address all possible contingencies clearly and expressly, any more than trade treaties or private contracts. They are inevitably incomplete, requiring ex post interpretation of vague obligations (e.g., "essential security interests") and possible gap fillers derived from sources such as CIL. This concluding part offers some thoughts on the relevance of economic exigency to this incomplete contracting problem.

The first of the three sections below considers possible circumstances in which economic exigency plausibly supports deviation from investment treaty obligations. The second section discusses the recent spate of litigation against Argentina, its claims of CIL necessity, and its invocation of Article XI of the U.S.-Argentina BIT. Finally, the third section considers the question whether economic exigency should ever discharge treaty obligations or merely suspend them, including the possible role of compensation for harm done to investors during the period of economic exigency.

When Might Economic Exigency Justify a Departure from Investor Protection Rules?

The earlier discussion of economic exigency as a basis for deviation from commitments in other settings immediately suggests some macroeconomic scenarios of potential importance in the investment context. It also suggests the importance of some attention to risk-distribution and political-efficiency issues.

Fiscal and currency crises. Drawing on the CIL cases involving repayment of external public debt, the host country may experience a severe imbalance of revenues and obligations to the point that a prospect of curtailing vital public services may result. If departure from an investor protection rule allows the host government to conserve its funds and maintain essential public services such as education, public health, and the like, then it may well be efficient ex ante for the operation of the rule to be delayed until the period of crisis abates. Examples might include an obligation to make payments to investors under a contractual agreement that comes within the "umbrella clause"[69] of a BIT, or the obligation to pay compensation for a taking of investor property.

This rationale for a suspension of obligations rests on the assumption that the host government cannot borrow in the capital markets at reasonable rates to cover its obligations—a plausible assumption, for example, in the case of a country that has defaulted on its external public debt or is threatening default, or when default has been avoided only through some mechanism such as an IMF bailout. One can then view a suspension of obligations as an opportunity to engage in borrowing more cheaply from creditors in the short term.[70] A mere suspension of obligations, rather than a substantial restructuring, makes sense (more below) if the fiscal crisis is likely to be transitory (in other words, if the problem is more one of liquidity than insolvency). The implications of this observation are elaborated in "Accommodating the Tensions" (see below).

The GATT balance-of-payments provisions suggest another possibility. If an obligation to investors is denominated in outside currency and can be met only with scarce currency reserves

[69] Many investment treaties contain "umbrella clauses" that allow investors to pursue treaty-based claims for violations of host state obligations that arise in another context, such as by contract or domestic statute. *See* SALACUSE, *supra* note 3, ch. 11.

[70] IMF bailouts, of course, have the same property; they are of little value unless they are implicitly undertaken at below market rates.

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that are needed to support the price of the home currency, thereby to avoid capital flight and serious macroeconomic consequences, then it may be efficient to delay the obligation until the reserve crisis abates.

At first blush, fiscal and currency crises offer a rationale for suspending the rules only in cases where the obligation in question requires an expenditure of funds or currency reserves by the host country government. This view, however, is too narrow. Suspending payments owed to investors by private actors might facilitate taxation to address a fiscal crisis or might enable the government to control the expenditure of scarce foreign exchange in private hands so that it can be redirected to assist the government in rebuilding its reserves (for example, by enabling the government to purchase it from private actors at the target exchange rate). A direct savings to the government is not necessary as long as a clear linkage can be made to a source of funds for the government to address the fiscal or currency crisis.

Four additional observations apply to this class of cases. First, fiscal and currency crises are generally observable and verifiable. Outsiders can determine whether a country faces a severe imbalance of revenues and expenditures (consider the recent Eurozone crises in Greece and elsewhere), and whether downward pressure on the currency stresses currency reserves and may lead to sudden capital flight (for example, the Asian financial crisis). To an extent, therefore, the authority to suspend the rules under such conditions will not be subject to false claims of crisis.

Second, a suspension of obligations is not justified if alternative policies can address the crisis adequately. As noted, countries facing fiscal and currency crises will typically have a great deal of difficulty borrowing in international capital markets at reasonable rates. Nevertheless, other changes in tax policy, monetary policy, and the like may be possible to address the crisis, along with options such as IMF assistance. An issue arises as to the optimal mix of policy instruments in this regard and whether a suspension of obligations to creditors is a part of that mix.

Third, and related, a discriminatory suspension of investor protection rules will rarely be justified. Just as GATT requires a degree of nondiscrimination in balance-of-payment measures,[71] it will be difficult to justify the targeting of particular foreign investors over others in fashioning policies to address fiscal and currency crises, or the targeting of foreign investors and not domestic investors. Only if suspending the rules for a subset of investors can be shown to advance legitimate public policy goals (such as ensuring a supply of essential goods) would discrimination seem justifiable.

Finally, fiscal and currency crises are not always exogenous events. Host country fiscal and monetary policies often contribute to such conditions, and if economic exigency relieves the host government of substantial costs attributable to the government's own policy choices, a significant moral hazard arises. This observation has important implications for the scope of flexibility that can be justified by economic exigency.

Risk distribution? Recall the pocket of contract doctrine that applies to crop failure cases. The common justification for discharging the farmer's obligation rests on the proposition that

[71] It is something of a puzzle as to why GATT allows any discrimination in balance-of-payments measures. Article XIII requires that the producer of competing products be treated equally, but why allow a nation facing a currency crisis to restrict imports of footwear, say, but not imports of electronics? Perhaps the answer is that certain categories of products are more essential and that the burden of a currency crisis should fall on the imports of less essential products. But the WTO/GATT system has done little historically to implement such a principle, leaving it to importing nations to decide which categories of products to target.

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farmers are typically risk averse, the farmer has already suffered a large casualty loss, and an obligation to pay damages to the promisee for cover would impose a sizable additional risk on the farmer. Contractual discharge splits the loss in a manner that is more likely to accord with optimal risk sharing. In effect, the argument is that the promisee serves as an efficient partial insurer for the farmer's potential losses.

Is the relationship between a host country obligor and an investor ever analogous to the relationship between an insured and an insurer, so as to provide a further justification for relaxing investment obligations under times of financial stress? With regard to the investors, those holding a diversified portfolio of investments may indeed be approximately risk neutral. Investors with large sunk costs in a particular investment, however, may be poorly diversified and thus risk averse, as may the managers of such operations. Indeed, as noted, part of the gains from an investment treaty may lie in the reduction of risk borne by risk-averse investors.

Might a host country nevertheless be *more* risk averse than investors? Not exactly, but a host country government may exhibit characteristics akin to risk aversion. In individuals, risk aversion is a product of the diminishing marginal utility of money.[72] Governments may also experience shocks that affect the marginal utility of money. Indeed, we have already discussed some of them. For a government facing a fiscal or balance-of-payments crisis, when the funds to provide essential public services or to support the local currency may be lacking, the implicit marginal utility of money may increase much as it does to individuals who experience an adverse shock to wealth. A justification might then arise for shifting the risk of fiscal distress from the government to investors. This argument for relaxing investor obligations during fiscal and currency crises, however, is just another way of phrasing the points made earlier.

But host governments may experience other shocks to the implicit marginal utility of money. Imagine a developing country facing a deadly tropical disease, and suppose that a costly cure has just been discovered. The government may then have an extremely valuable use for funds that it did not have before. Accordingly, to the list of economic exigencies plausibly justifying measures to conserve government funds, we might add certain scenarios in which the government experiences a new and pressing need for funds to address some unanticipated domestic emergency—a public health crisis, a natural disaster, and the like. To be sure, one must again ask whether a suspension of investor obligations is a sound option in relation to possible alternative sources of funds.

Political crises? Recall the prevailing economic understanding of the GATT escape clause. Few commentators believe that temporary protection for troubled industries is economically efficient in the **c**onventional sense. Rather, troubled industries create intense political pressure for renewed protection, and politicians wish to retain the option to respond to it. If they could not, trade agreements might unravel, and politicians might be reluctant to make trade concessions in the first place. The temporary protection allowed by the escape clause may be the lesser of evils. In any event, the political officials who enter trade treaties will inevitably seek to promote their own political welfare and so will reserve the right to deviate whenever it is jointly optimal from a political standpoint.

Can a similar logic support deviation from investment treaty obligations to address situations of great political exigency? The answer may well be yes. The issue involves a considerable degree of speculation, however, as I am not aware of any theorizing as to which investment

[72] *See, e.g.*, Kenneth Arrow, ESSAYS IN THE THEORY OF RISK BEARING (1970).

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treaty commitments might prove especially problematic ex post from a political rather than conventional welfare standpoint. One conjecture is that scenarios might arise in which an investor reaps a windfall return at the expense of ordinary citizens. Perhaps the investor was promised an opportunity to price its output in foreign currency even though its production costs are largely paid in local currency, and an unanticipated depreciation of the local country results in an output price far above costs and hence a windfall profit. If the output is an essential good or service that is not subject to much competition (for example, if the investment is the local waterworks), one can imagine that the government would be under great political pressure to relieve the citizens of exorbitant prices for that necessary good or service, and that such a policy would contravene some treaty obligation (such as an umbrella clause).

No doubt other scenarios can be imagined. The range of low-probability, politically exigent circumstances that might warrant some departure from the bargain may be vast—yet, because of transaction costs, be unlikely to be addressed specifically in a treaty. A justification may then exist for a broad catchall provision that allows departure from treaty obligations under somewhat vague standards that are elastic enough to capture conditions involving intense political pressure to deviate.

The difficulty, of course, is that vague standards—particularly those encompassing political exigency rather than readily observable phenomena such as fiscal or monetary crises—raise a greater possibility of opportunism (much like the GATT escape clause). If outsiders cannot observe and verify the conditions that justify a departure from commitments, adjudicators have little hope of policing such opportunism. One must then wonder whether the cure is worse than the disease. In some cases, mechanisms might be devised to police opportunism in other ways, such as a requirement that investors be compensated for losses in appropriate cases.

"Public" necessity? As discussed earlier, necessity doctrine in tort includes a special rule immunizing public servants against *personal* liability for acts of necessity (recall the example of a fire department that destroys private property to create a fire break). The evident rationale is to relieve individual actors of liability for socially constructive acts when others enjoy the benefits, lest the actors be discouraged from acting. To what degree might analogous considerations be operative in the investment context?

At first blush, the answer seems to be "not at all." Investment treaty liabilities attach to host governments, not to individual public officials. But the issue is more complex.

Public policy decisions are taken by government officials. What incentivizes those decisions is unclear. Agency costs and the familiar insights of public choice theory regarding interest group politics raise a variety of doubts about public officials' incentives to act systematically in the public interest. It is easy to hypothesize scenarios in which officials may be led to make poor choices out of political self-interest. Imagine a policy choice that results in a substantial welfare gain to a minority of the population, yet the costs are spread throughout the population via the tax system. The majority of voters might then oppose the policy choice even if the net benefits to society as a whole are clear and substantial. A self-interested political official might well respond to the majority preference despite the net social costs.

Transplanting the concern to the investment context, one can imagine scenarios in which the obligation to compensate investors for the effects of policy changes might discourage socially desirable policy adaptations. This observation is hardly novel and lies at the heart of a literature discussing "regulatory chill"—questioning the wisdom of requiring compensation

for "regulatory takings."[73] The harder question is whether it should factor into the definition of "necessity" and related justifications for departing from investment law commitments.

Ideally, these issues will be addressed through proper delineation of basic obligations (such as the definition of "expropriation" and "fair and equitable treatment") rather than through exceptions such as necessity. One is thus tempted to suggest that this rationale for limiting investor obligations does not add to the list of conditions that create necessity. One cannot rule out the possibility, however, that exigent circumstances might distort public officials' incentives in a manner that warrants a relaxation of the usual rules regarding exigent circumstances.

The Argentina Litigation

The last century of economic history in Argentina has been turbulent indeed. Political instability, cycles of boom and bust, sovereign debt defaults, and bouts of hyperinflation have plagued the country since the 1930s. Argentina went from being one of the ten richest nations in 1930 (in per capita terms) to having, in recent years, a per capita income about 30 percent that of the United States.[74]

One of the most dismal periods in the last century occurred in the late 1970s and 1980s. Following a military coup in 1976, economic growth slowed, external public debt began to rise sharply, and inflation accelerated. Argentina sought IMF assistance on multiple occasions and borrowed from friendly nations such as the United States. A first period of hyperinflation led to the substitution of the austral for the peso but was followed by yet another hyperinflation and another IMF bailout package. In 1992, the austral was replaced by a new peso that was to be pegged to the U.S. dollar at a one-to-one ratio.[75]

During this period a number of government-owned enterprises were privatized. Foreign investors were important participants in the process of privatization, including the privatization of various utility services. But the monetary reform of 1992 was not enough to persuade investors that monetary stability would persist; the experience with the austral was clear evidence that monetary reforms did not always succeed. Accordingly, various investors in enterprises that were regulated by the government or that sold output under long-term contracts sought and received arrangements that allowed them to price their output in U.S. dollars and to index their prices to inflation using an external price index such as the U.S. Producer Price Index.

Initially, this sort of arrangement was quite favorable to investors since their prices rose with U.S. inflation at a time when the relative prices of other things in Argentina were falling. But difficulties soon returned. A series of events led to a crisis of confidence in the peso, including a steep expansion of public debt. Investors began to convert pesos to dollars, straining the country's exchange reserves. Banks were forced to take on government debt, leading to bank runs and an eventual freeze on withdrawals. The one-to-one peg between the peso and the dollar became unsustainable and was abandoned. A partial debt default occurred in December 2001.

[73] *E.g.*, Been & Beauvais, *supra* note 67.

[74] Eugenio Diaz-Bonilla, *Argentina: The Myth of a Century of Decline*, ECONOMONITOR (Feb. 27, 2014), *at* http://www.economonitor.com/blog/2014/02/argentina-the-myth-of-a-century-of-decline/.

[75] *See* Graciela Kaminsky, Amine Mati & Nada Choueiri, Thirty Years of Currency Crises in Argentina: External Shocks or Domestic Fragility? (2009), *at* http://home.gwu.edu/graciela/HOME-PAGE/RESEARCH-WORK/WORKING-PAPERS/argentina.pdf.

By 2002, the peso had depreciated to roughly four pesos to the dollar.[76] In the background, unemployment and poverty rates increased dramatically.

The details of the ensuing investor claims against Argentina vary somewhat, but I will focus here on a set of measures that were common to a number of cases. As noted, a number of investors had secured the right to price in U.S. dollars and to index their prices to U.S. inflation. As part of its response to the economic crisis of the late 1990s and early 2000s, however, Argentina decreed that obligations denominated in dollars would be repaid in pesos at a one-to-one rate. Indexing was suspended.[77] Thus, in effect, investors would receive going forward about 25 percent of the amount per unit of output that their original arrangements provided, with no further indexation. The measures were nondiscriminatory in the sense that they applied to all obligations, regardless of the nationality of the obligee. But they were said to breach other investment treaty obligations, such as the obligation of fair and equitable treatment, and "umbrella clauses" that ostensibly enabled investors to bring breach of contract claims and similar matters under the treaty.

I assume *arguendo* that these claims were meritorious, save for the possible applicability of two "defenses" offered by Argentina—the CIL defense of necessity and, in the case of claims by U.S. investors, a defense based on Article XI of the U.S.-Argentina BIT. Detailed surveys of how these two issues were resolved by various arbitral panels and subsequent annulment panels may be found elsewhere.[78] Painting with a broad brush, a frequent response to the CIL necessity defense was to suggest that it was inapplicable because of the condition in ILC Article 25 denying the defense when the "State has contributed to the situation of necessity." A defense based on Article XI of the U.S.-Argentina BIT was considered more plausible, particularly by some annulment panels. The dire economic conditions in Argentina, including high unemployment, poverty, and social unrest, were within the broad sweep of conditions that posed a threat to "public order" or to Argentina's "essential security interests."[79] Some panels were inclined to import into Article XI the additional condition of the CIL necessity defense that no state could invoke Article XI if it had "contributed" to the state of necessity,[80] whereas others rejected that proposition.[81] Still other panels saw no textual basis for importing that requirement[82] or were not persuaded that Argentina's contribution to the situation was sufficient to justify rejecting the defense.[83]

[76] *See* J. F. Hornbeck, *Congressional Research Service Report for Congress: The Argentine Financial Crisis: A Chronology of Events* (2003), *at* http://fpc.state.gov/documents/organization/8040.pdf.

[77] *See* Alvarez, *supra* note 3, at 368–70.

[78] *See especially* José Alvarez & Gustavo Topalian, *supra* note 3. As noted earlier, some of the Argentina cases are still pending.

[79] *E.g.*, LG&E Energy Corp. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, paras. 226–61 (Oct. 3, 2006); Continental Casualty Co. v. Argentine Republic, ICSID Case No. ARB/03/9, Award, para. 178 (Sept. 5, 2008).

[80] National Grid P.L.C. v. Argentine Republic, Award, paras. 260–62 (UNCITRAL Arb. Trib. Nov. 3, 2008).

[81] *E.g.*, CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, paras. 128–35 (Sept. 25, 2007).

[82] Contrast the original decision on liability in *Sempra Energy Int'l v. Argentine Republic*, ICSID Case No. ARB/02/16, with the decision on annulment in the same case (paragraphs 198–219).

[83] *E.g.*, *LG&E Energy Corp.*, *supra* note 79, para. 256; Enron Creditors Recovery Corp. v. Argentine Republic, ICSID Case No. ARB/01/3, Decision on the Application for Annulment, paras. 355–405 (July 30, 2010).

My objective is not to critique any particular panel decision or to opine on which panel, if any, "got it right." The analysis above suggests a number of considerations that may help to clarify certain issues, however, and suggests others that deserve more extensive attention.

Two important considerations cut in favor of Argentina's "defenses." First, the conditions facing Argentina in the early 2000s unquestionably involved fiscal and currency crises within the potential scope of the CIL necessity defense historically as well as within the balance-of-payments exceptions to other international obligations, such as those of GATT. Argentina faced a heavy external debt, much of it denominated in foreign currency. It lacked the resources to service the debt and, in fact, defaulted partially in 2001. Domestic fiscal expenditures were deeply curtailed at a time of severe macroeconomic distress. Currency reserves were low and being depleted. Ordinary citizens suffered from extraordinary levels of unemployment and poverty.

Second, the measures taken by Argentina in the face of this crisis were, in important particulars, nondiscriminatory. Foreign investors were not targeted, nor were particular sectors targeted. Nothing in the course of events suggests that the measures taken were other than measures of general applicability applied in a reasonably evenhanded fashion.

But there are weighty concerns on the other side that cut against Argentina. In particular, why did investors seek arrangements that allowed them to price in dollars and use a dollar price index in the first place? The answer, of course, is that Argentina's history of excessive borrowing and inflationary monetary policies created grave doubts about the ability of the country to avoid a repetition of the same mistakes in the future. Dollar-peso convertibility at parity was a comforting first step at "hand-tying" in the monetary realm, but it was not credible and could always be abandoned (as indeed it was). Pricing in dollars gave investors much more confidence that their investment returns would not be wiped out by a free-falling peso. Thus, the economic rationale for the investor protection arrangements that Argentina abrogated in the early 2000s was a fear of precisely what happened— excessive government borrowing, burdensome public debt, and a policy of printing more pesos when money ran short for the government. It is jarring to assert that investors forfeit their treaty remedy when a government acts in exactly the way that the investment protections were meant to counteract.

The broader issue, noted at several points in the analysis above, is the moral hazard problem that attends the opportunity for a host country to invoke necessity or a related defense when it has contributed to the condition of necessity. The incentive to avoid the mistakes of the past is seriously undermined. Indeed, it borders on deceit if a country can agree to arrangements to protect investors from unsound macroeconomic policies and then abrogate those arrangements within a decade, using the excuse that unsound macroeconomic policies have wrecked the economy.

Yet it remains uncomfortable to suggest that a country is disabled from taking steps essential to avoid macroeconomic disaster and massive social unrest because of its political officials' past mistakes. A crude analogy is to the boat owner in *Ploof v. Putnam*, who may have been negligent to take the boat out on the water in the face of an impending storm. Despite such negligence, most of us would resist the notion that the defendant should be permitted to cut the boat adrift and send the boat to founder and its passengers to drown in the name of policing moral hazard.

A hard-line approach to the moral hazard problem—such as that embodied in ILC Article 25—seems compelling only if it can be expected systematically to deter imprudent behavior

that contributes to exigent circumstances. That hope may be unrealistic with respect to imprudent macroeconomic policy, whether in Argentina or elsewhere. The political officials who are responsible for imprudent policies do not bear the costs directly, with the bulk of the costs falling on ordinary citizens. Argentina's history is replete with political revolt against a sequence of administrations with failed economic policies, and the notion that a strict application of investor protection rules will eliminate the problem of unsound macroeconomic policy seems fanciful. For this reason, a more nuanced approach to the moral hazard problem may be preferable. The next section offers some thoughts in this regard.

Yet a further issue plagues Argentina's position. Under ILC Article 25 an act of necessity is acceptable only if the act is "the only way for the State to safeguard an essential interest." Article XI of the U.S.-Argentina BIT is slightly softer but nevertheless applies only to measures that are "necessary" to the maintenance of public order or an essential security interest. Even if some drastic measures were necessary to address the fiscal and currency crises facing Argentina in the early 2000s, could Argentina have gotten by without the particular measures that impaired investor protection in the cases that resulted in claims? Argentina might have discriminated *in favor* of foreign investors, for example, suspending dollar-peso convertibility only for obligations not protected by its investment treaties. Of course, discriminatory policies might produce their own economic distortions, but are they enough to establish that the actual policies were "necessary?"

Putting discriminatory actions to the side, a host of macroeconomic policy options exist for a nation facing macroeconomic distress, encompassing tax policy, monetary policy reform, IMF assistance, and the like. How can one plausibly know if abrogating investor protection rules is "necessary" in such a context? Even more to the point, how can an arbitral panel composed of experts on international economic law begin to assess the optimal policy instrument package for responding to a macroeconomic crisis? One suspects that the arbitral process is ill equipped to pursue that task and that an adjudication as to whether the policies at issue were "necessary" or "the only way" will be fraught with speculation and error.[84] Here, especially, the information that is essential to adjudicate the issue is unlikely to be observable by outsiders or is at least unlikely to be verifiable in the adjudicative process. This problem, too, should inform how "necessity" and related defenses are construed and implemented.

Accommodating the Tensions: Moral Hazard and Policy Instrument Uncertainty

The preceding section identifies two core problems with implementing a necessity or similar defense under the conditions that confronted Argentina. Adjudicators can plausibly observe and verify the existence of fiscal and currency crises, but they are not in a position to assess whether abrogation of international obligations is "necessary" or "the only way" to address them. Likewise, where a state has contributed to the underlying crisis through imprudent policy choices, excusing obligations can encourage the behavior that leads to these crises.

One can imagine three sorts of options for dealing with these issues. The first option is simply to ask adjudicators to do the best they can in assessing the necessity of abrogating international obligations and in deciding whether the moral hazard issue is sufficiently acute that

[84] See the discussion in *Continental Casualty Co.*, *supra* note 79, paras. 196–236 (importing WTO law into the interpretation of "necessary").

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allowing a necessity defense under the circumstances would do more harm than good. ILC Article 25 incorporates this basic approach, with the further proviso that any evidence of imprudent behavior by a state seeking to invoke necessity results in denial of the defense. Article XI of the U.S.-Argentina BIT, by contrast, entrusts the necessity issue to adjudicators but is silent on the moral hazard issue.

A second approach is suggested by the WTO Safeguards Agreement,[85] which employs an imprecise standard for allowing deviation from commitments that turns on issues that are hard to verify. As noted earlier, one mechanism found in the agreement is a rule that any member that employs a safeguard measure must phase it out and is disabled from instituting a new measure in the same industry for a period of years. The limitation on duration encourages members to use the measures only during times of genuine and pressing need, as does the prohibition on using them again in the near future. Likewise, such limitations on the use of safeguard measures can penalize moral hazard to a degree by increasing the costs to governments of policies that may create conditions of distress. They also, to a degree, encourage governments to use efficient policy instruments to respond to distress, lest they lose the opportunity to deviate from international obligations in situations where that course of action is actually the best option.

No formal structure along these lines is to be found in CIL or the U.S.-Argentina BIT, but both can plausibly be interpreted with these considerations in mind. The "only way" principle in ILC Article 25 could be interpreted permissively for measures that are tightly circumscribed in time, in effect affording a deferential standard of review for short-term emergency measures; but the inquiry might be considerably more searching when a government seeks to invoke necessity for longer periods. The "necessary" standard of Article XI of the U.S.-Argentina BIT can be similarly implemented, on the premise that the longer a measure remains in place, the more reasonable it is to expect a government to identify other effective policy instruments.

A third approach is suggested by the necessity doctrine in tort law, the original safeguards system under GATT Article XIX, and the expectation-damages approach to facilitating "efficient breach" in contract. An adjudicator can defer to a nation claiming necessity or a similar defense (such as that under Article XI of the U.S.-Argentina BIT) but require that a measure of compensation be paid for the harm done due to breach of international obligations. The compensation can be deferred until such time as the state claiming necessity has recovered from the emergency situation sufficiently to be in a position to compensate without impairing its essential interests. Likewise, measured against the rates that the host country would have to pay to borrow during the depths of crisis, the interest rate (if any) on the deferred obligation may need to be "below market" to provide meaningful relief; in this sense, compensation will be partial.

This approach is readily available under the ILC Articles on State Responsibility. Article 27 provides in pertinent part: "The invocation of a circumstance precluding wrongfulness [such as necessity] in accordance with this chapter is without prejudice to . . . (b) The question of compensation for any material loss caused by the act in question." Thus, an arbitral panel applying the necessity defense under CIL has the discretion to rule that compensation is required, at least after the period of necessity abates.

In my view, Article XI of the U.S.-Argentina BIT can be construed in this manner as well. Consider the phrase "this treaty shall not preclude the application by either party of measures

[85] *Supra* note 33.

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necessary" to maintain public order or protect an essential security interest. If a measure such as the suspension of dollar pricing and indexing in Argentina is "necessary," the treaty shall not preclude it. But once the measure is taken, the treaty is arguably silent on the question of compensation. Only if a compensation requirement would itself "preclude" a "necessary" measure does the text seem to rule out compensation. It is difficult to imagine why a requirement of compensation, deferred until such time as the exigent circumstances abate and the nation has the resources to compensate, and appropriately limited in magnitude, would be preclusive.

Among the three options discussed above, only the compensation option can induce a state that deviates from its international obligations to "internalize" a substantial portion of the cost. As noted earlier, cost internalization can do much to eliminate the moral hazard problem, at least for private actors who also internalize the benefits of their choices. It further encourages actors to select the least expensive way to protect their interests (the optimal policy instrument).

One must acknowledge some limitations and concerns about compensation, however, especially when required from governments. First, recalling the debate in the contract literature over the utility of expectation damages versus specific performance, compensation induces efficient choices only if it can be computed and administered with reasonable accuracy. In some investment disputes, valuation issues can be challenging (such as determining the fair value of expropriated property when market valuation is absent). This objection does not seem terribly compelling, however, since the same techniques of valuation can be used here as in domestic takings and related cases. Further, many investment claims are not difficult to value using market benchmarks (such as the claims for lost revenue from abandoning dollar pricing and indexing in the Argentina cases).

Another concern is the possibility that compensation requirements will induce excessive "reliance" investments by those who are to be compensated. The contract damages literature makes the point nicely. A promisee who makes investments in reliance on a contract, and who is guaranteed the return of its expectancy in the event of breach, will make excessive investments. The reason is that from a private perspective, the returns to investment are a certainty, whereas from a social perspective, the reliance investment is valuable only in those states of the world where breach is inefficient.[86] Similar points have been made about compensation in the takings literature.[87] An investor guaranteed compensation for a taking, for example, may invest in enhancing the value of the investment on the assumption that its resulting stream of returns is a certainty, even if significant probability exists that future developments will justify shutting down the investment for some public purpose. When other mechanisms to police excessive investments of this sort are lacking, a degree of undercompensation may be desirable,[88] which perhaps affords a further argument for below-market interest rates in computing the award. It seems unlikely that *zero* compensation will be the best response to the problem, however, as it provides no incentive for a promisor to respect commitments that have become privately unattractive but are jointly efficient.

Another type of objection to compensation emphasizes that policy decisions are made by public officials who do not internalize the social benefits of those choices. When a government

[86] *See* Shavell, *supra* note 12 (discussion of excessive reliance expenditure under expectation damages).

[87] *See* Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CAL. L. REV. 569 (1984).

[88] *See* Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENVTL. L.J. 110 (2002).

is required to pay full compensation, it "internalizes" costs, but by no means can one assume that officials will henceforth respond by making efficient choices (as would a private actor who internalizes the benefits of choices in its own self-interest).[89]

Undoubtedly, government officials do not always make decisions that are first-best efficient from a cost-benefit standpoint. Moreover, there is no widely accepted model of what bureaucrats "maximize" and, consequently, no conventional wisdom as to how they will be affected by a prospect of governmental liability. They may well have incentives to pursue their personal or political objectives reasonably efficiently, however, because resources that are wasted cannot be used to reward politically influential interest groups. If so, governments may be motivated to minimize or at least reduce the costs of providing services and also may, to some degree, respond to liability in ways similar to that of a profit-maximizing (cost-minimizing) private firm.[90] A compensation requirement in the investment setting thus has the potential to encourage both the curtailment of moral hazard and the best choice of policy instruments to address crises, even if it does not induce ideal behavior in this regard.

Moreover, the cost internalization that is brought about by a compensation requirement may be expected to incentivize *politically efficient* policy choices. An analogy may be found in the modern theory of trade agreements, in which internalizing the harm that tariffs and other trade barriers cause to foreign nations leads to politically efficient trade agreements.[91] Politically efficient choices can have normative appeal. If government officials are the citizenry's faithful agents, choices that deviate from the economic "first best" nevertheless have democratic legitimacy and may be understood as responsive to other citizen concerns, such as income distribution.

More generally, it is a commonplace in the literature on policy making with international externalities to suppose that governments tend to ignore the welfare of actors who are not among their constituents,[92] such as foreign investors. A compensation requirement forces governments to consider the welfare of those who might otherwise be ignored, plausibly leading to policy choices that better serve the global interest rather than simply the national parochial interest.

Nonetheless, compensation requirements imposed on political systems that reflect various types of agency problems can create a variety of distortions. One must be attentive to arguments in particular cases that the potential distortions are serious and may swamp the benefits of compensation requirements—a familiar type of problem in the economic theory of the "second best." As with most second-best concerns about public policy, however, it may be prudent to proceed pragmatically on the assumption that second-best problems are also second-order problems, at least in the absence of compelling evidence to the contrary.

[89] The potential lack of efficiency is the core of the concern about compensation requirements in Daryl Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345 (2000). *See also* Been & Beauvais, *supra* note 67.

[90] See the discussion of municipal liability for constitutional torts in Larry Kramer & Alan O. Sykes, *Municipal Liability Under §1983: A Legal and Economic Analysis*, 1987 SUP. CT. REV. 249.

[91] *See* KYLE BAGWELL & ROBERT W. STAIGER, THE ECONOMICS OF THE WORLD TRADING SYSTEM (2002).

[92] *See* ERIC A. POSNER & ALAN O. SYKES, ECONOMIC FOUNDATIONS OF INTERNATIONAL LAW, ch. 1 (2013).

IV. CONCLUSION

Conditions of economic exigency that are sufficient to justify a suspension of international obligations can surely arise—a proposition that has been accepted by the international community for many years in various settings. The full range of such conditions is difficult to specify ex ante, although certain scenarios such as fiscal and currency crises can be identified fairly accurately. The much harder problem relates to the question whether the opportunity to deviate from international obligations will create an unacceptable moral hazard in policy making and whether deviation from international obligations is the best policy instrument for addressing exigent circumstances. Such issues are not easily adjudicated because the necessary information can be difficult to observe or verify.

A possible response to the problem that preserves policy flexibility for states facing exigent economic circumstances, while policing both the moral hazard problem and the incentive to choose efficient policy instruments (albeit no doubt imperfectly), is to marry deference to a state's claim for a need to apply emergency measures with a compensation requirement, appropriately limited in magnitude and timed to allow states facing economic emergencies to recover from them before compensation is payable. Arguably, this approach is permissible under existing principles of customary international law and under more specialized treaty provisions, such as Article XI of the U.S.-Argentina BIT.