

# Unbundling the State: Legal Development in an Era of Global, Private Governance\*

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August 2021

## Abstract

Global, private regimes with the power to write, interpret and enforce commercial rules have proliferated in recent decades. Much of the research in this area focuses on transnational regimes themselves, often neglecting the broader implications this new form of governance carries for domestic political and legal development. How do local development incentives shift when authority that has traditionally been rooted in the domestic state has been delegated to transnational institutions? This paper examines this question through a study of the global privatization of commercial dispute resolution. I present a theoretical framework for understanding how governmental tasks that have traditionally been “bundled” together in state institutions become “unbundled” and outsourced to private bodies. Depending on the design of that unbundling, the resulting public-private governing complex is expected to exert either an enhancing or stagnating effect on the underlying unbundled public institution. I apply this framework to international commercial arbitration (ICA), a private, transnational system of cross-border commercial dispute resolution that serves as an essential pillar supporting the modern global economy. I argue that ICA provides key interest groups that would otherwise lobby for rule-of-law reforms an exit option from weak local institutions which in turn reduces pressure on the state to invest in needed rule of law enhancing reforms. I test this proposition using semiparametric analysis, finding that the enactment of strong protections for ICA leads to the gradual erosion of the quality of local legal institutions. The effect is most pronounced in weak rule of law states.

**Keywords:** Dispute settlement · Commercial arbitration · Global governance · Political development

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\*Acknowledgments: For their valuable comments on earlier versions of this paper, the author would like to thank Elizabeth Acorn, David Di Micheli, Matthew Evangelista, David Lektzian, Aditi Sahasrabuddhe, Christopher Way and Whitney Taylor as well as the participants at the Cornell International Relations Workshop and the 2020 Annual Meeting of the Southern Political Science Association.

## I. Introduction

Global, private governance regimes with the power to write, interpret and enforce commercial rules have proliferated in recent decades. We witness this in a variety of issue areas including environmental regulation,<sup>1</sup> forestry,<sup>2</sup> financial accounting standards,<sup>3</sup> food safety,<sup>4</sup> and others.<sup>5</sup> As John Braithwaite wrote, many countries have “become rule-takers rather than rule-makers.”<sup>6</sup> Because much of the work on this form of private regulation focuses on the transnational regimes themselves, we know relatively little about the consequences of this changing institutional landscape for domestic political development.<sup>7</sup> In this paper, I argue that one under appreciated aspect of the growth of private, transnational authority is that this pattern carries with it an implicit model of political and legal development—what I called the “unbundled state”—that cuts against traditional models of political development. “Unbundling” governance refers to the delegation of rulemaking authorities—that is, the power to write, interpret or enforce rules—that have traditionally been “bundled” in centralized public institutions. Under this model, rather than supporting holistic competence building with strong institutions, states have the option of delegating piecemeal governance tasks through actors with little accountability to domestic publics. As I argue below, one unintended byproduct of these institutions is that countries with weak state capacity are particularly susceptible to the proliferation of such regimes because the availability of these privatized governance services to powerful domestic interest groups risks eroding the domestic sources of political and economic pressure states face to invest in capacity-enhancing institutional reform.<sup>8</sup>

On its face, there appears to be a net gain when states privatize governance tasks like contract enforcement. Perhaps private arbitration, for example, simply eases the process by which firms involved in international business enforce contracts and settle disputes while no one else is made worse off. The central theoretical claim put forward below is that modern global governance practices do have important implications for governance beyond the boundaries of whatever individual issue-area is made subject to a complex, transnational web of public and private rulemaking bodies.

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1. Green 2014.

2. Overdeest and Zeitlin 2014.

3. Bütte and Mattli 2011.

4. Meidinger 2009.

5. For a useful classification of dozens of such regimes see Abbott and Snidal 2009, 512-519

6. Braithwaite 2008, 3.

7. C.f. Ginsburg 2005; Nougayrède 2013; Sharafutdinova and Dawisha 2017.

8. Sonin 2003.

I argue that this is due to the externalities of highly bundled and centralized institutions. Centralization establishes simple lines of accountability and creates externalities that, when positive, benefit a wider constituency, and, when negative, ease the process of building broad coalitions for reform. This means that the effect of unbundling on the underlying public institution depends on how the public and private bodies interact, specifically whether the private bodies acts as a complement or substitute to the public institution. Substitution provides actors an exit option from the public institution, thereby reducing the incentive for civil society groups to monitor and lobby for institutional improvements while also limiting the positive governance externalities of highly bundled, public institutions. Reducing incentives for the state to invest in rule-of-law reforms leads to an overall reduction in the competence of local legal institutions over time. The complementarity hypothesis, by contrast, expects unbundled institutions to enhance governing quality because civil society actors remain invested in the quality of the public institution while the state can direct the private body and take advantage of the private body's greater expertise and adaptability.

In this paper, I examine this “unbundling” process through a close study of the interaction between private arbitration and domestic courts. The process of de-localization and privatization of services traditionally entrusted to public institutions is particularly prevalent in the area of international commercial dispute resolution.<sup>9</sup> Delphine Nougayrède refers to this phenomenon as the “outsourcing” of law.<sup>10</sup> Resource rich individuals and firms can access strong contract enforcement infrastructure by submitting disputes to foreign jurisdictions or arbitral tribunals, while those without such resources are left to deal with sub-par, local domestic legal infrastructure. A key element of modern global economic governance facilitating legal outsourcing has been the development of international commercial arbitration (hereafter, ICA). ICA refers to a widely-used system of private arbitration for the adjudication of international commercial disputes. ICA allows disputants to design the dispute resolution forum to fit their needs by allowing them to choose the relevant procedural and substantive laws and pick the arbitrators who will hear the case, among other things. Parties typically enter into ICA through contractual provisions that stipulate disputes will be sent to private arbitration.<sup>11</sup>

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9. Cutler 2003; Sharafutdinova and Dawisha 2017.

10. Nougayrède 2013.

11. By one estimate, nearly 90% of international commercial contracts contain an arbitration clause, see Berger 2010, 145

ICA has accomplished the outsourcing of law in large part through the diffusion of two legal instruments bearing the imprimatur of the United Nations: the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958), commonly referred to as the New York Convention (NYC), and—the focus of this paper—the UN Commission on International Trade Law’s (UNCITRAL) Model Law on International Commercial Arbitration (hereafter, the Model Law). The New York Convention is a multilateral treaty that allows for the enforcement of arbitration awards in any signatory country so long as the award was made subject to the jurisdiction of another signatory.<sup>12</sup> The Model Law is a ready-made legislative text incorporating key features of the “state-of-the-art” in ICA. It limits judicial intervention in the arbitral process by severely circumscribing the scope of judicial oversight while at the same time requiring courts to enforce arbitration agreements and awards unless one of a very narrow set of exceptions are met. Over one hundred jurisdictions have enacted legislative reforms based on the Model Law.<sup>13</sup> The NYC has helped eased global enforcement, while the Model Law has been integral to harmonizing and promoting the practice of ICA around the world.

Since the inception of modern commercial arbitration in the early 20<sup>th</sup> century, arbitration has sparked intense and persistent debate about the role of private authority in public affairs.<sup>14</sup> This debate has taken on added urgency in light of the increasing deference legislatures and judiciaries around the world have granted to arbitration.<sup>15</sup> This paper joins this debate by providing a framework for conceptualizing the interaction between international arbitration practice and local legal institutions. I then examine empirically the second-order effects of the spread of ICA on domestic legal development in low-capacity states that promote the practice typically as a means of attracting foreign capital and trade. Contrary to the claims of arbitration advocates, I argue and present evidence in support of the claim that the growth of international arbitration has had a deleterious effect on the development of domestic rule of law institutions, particularly in countries with already weak legal institutions.

The structure of this paper is as follows. In the next section, I briefly present the arguments of

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12. An arbitration “award” refers to the legally binding decision of an arbitration panel. The NYC requires enforcement regardless of where the award was made, but it allows for countries to submit reservations that limit the scope of enforcement to awards made in other signatory countries. Many countries have filed this reservation.

13. I use the word “jurisdictions” because many sub-state units have enacted legislation based on the Model Law, while the national unit has not. Texas and Illinois, for instance, are Model Law states but the US is not.

14. Cutler 2003; Szalai 2013; Aragaki 2014.

15. Resnik 2015; Stone Sweet and Grisel 2017.

the two main competing hypotheses concerning the interaction between private and public systems of commercial dispute resolution. I then seek to synthesize the conflicting approaches particular to international arbitration by contextualizing the debate within the literatures on political development, globalization and the growth of transnational, private governing bodies. Following that, I apply this theoretical framework to the case of international commercial arbitration. I argue that ICA is best thought of as a substituting institution that risks hindering investment in local legal reform efforts. And in the final section, I test this hypothesis using semiparametric analysis examining the effect of the enactment of strong protections for ICA (in the form of the Model Law) on the development of a country’s judicial system. I find that the implementation of strong protections of domestic ICA laws leads to the gradual degradation of public legal institutions in weak rule-of-law countries.

## II. International Commercial Arbitration and the Rule of Law

This section draws from the literature on the interaction between national courts and international arbitration in the form of either investor-state dispute settlement (ISDS) or ICA. ISDS refers to the of settlement of international law violations (typically through arbitration), while ICA, rooted in contract, concerns the resolution of cross-border contract disputes. Until recently, much of the debate around international arbitration and local legal development has focused specifically on ISDS.<sup>16</sup> While ISDS and ICA can be thought of as distinct systems, there are many legal and substantive similarities between them and they enjoy similar levels of protection from oversight by domestic courts.<sup>17</sup> For instance, many ICA disputes are between between foreign investors and public entities, but these cases are considered to be “ICA” because the source of the arbitration panel’s jurisdiction is a contract, rather than an international legal source like a bilateral investment treaty (BIT). In such cases, the distinction between the ICA and ISDS is little more than a technical jurisdictional matter. The social and demographic composition of the arbitration professionals who preside over ICA and ISDS overlap, as well. It is not uncommon for a single arbitrator to move between cases of either type, sitting on an ISDS panel one month and an ICA panel another. The

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16. C.f. Rogers 2015; Rogers and Drahozal, forthcoming.

17. Stone Sweet and Grisel argue that we should think of ICA and ISDS as mutually constituting a single international arbitration regime.

basic structure of ISDS and ICA vis-à-vis national courts is essentially the same: each is designed to be a private, transnational alternative to national courts in their capacity to issue legally binding rulings over commercial disputes.<sup>18</sup>

The remainder of this section provides an overview of the debate over the interaction between international arbitration and local legal institutions. We can divide the literature into two camps: those who think arbitration will enhance the rule of law and those who think arbitration will subvert the rule of law.

*International arbitration enhances the rule of law.* One group of scholars argue that international arbitration enhances local rule of law. Susan Franck contends that a successful international investment regime requires the mutual support of both national courts and international arbitration, in other words that arbitration and courts are complementary.<sup>19</sup> In addition to serving as a steward for international arbitration and as a potential venue for the resolution of national legal disputes, Franck writes that international arbitration also provides a “useful model” that helps “promote adherence to the rule of law” through both the power of example and the introduction of competitive pressures on judiciaries.<sup>20</sup> Arbitration, Franck argues, increases competitive pressure on judiciaries by taking away cases that would otherwise go to court, thereby spurring local reform efforts by jealous judiciaries to win back disputes that are being diverted away from their courtrooms.

Catherine Rogers shares Franck’s central hypothesis but argues that we should expand our focus to include the role of ICA as well.<sup>21</sup> Unlike ISDS, which is rooted in international law, ICA is directly tied to reform of domestic institutions through national legislation and domestically oriented initiatives meant to promote and legitimize arbitration. As Dezalay and Garth note in their study of the Egyptian arbitration profession after Egypt enacted reforms based on the Model Law, “These activities [such as implementing the UNCITRAL Model Law] gain legitimacy for arbitration locally and legitimacy for local leaders in the centers of arbitration.”<sup>22</sup> This legitimacy

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18. Despite their similarities, the empirical section of the present paper focuses on ICA rather than ISDS for two reasons. First, the broader jurisdictional scope of ICA risks substituting for a significantly larger set of disputes than would otherwise go to a local court and be subject to local laws. Second, in certain circumstances ISDS allows for a higher degree of national oversight than ICA does. I elaborate on these reasons before turning to a more detailed discussion of ICA as an unbundling institution in section IV.

19. Franck 2007, 367-370.

20. 372.

21. Rogers 2015.

22. Dezalay and Garth 1996, 242.

depends, however, on the integration between national and transnational arbitral practice. This is fostered through activities like creating national arbitration centers and working with transnational pro-arbitration bodies like UNCITRAL to fund promotional activities such as training exercises, conferences and moot competitions. Rogers notes that local legal elites, eager to integrate into transnational business and legal networks, will work to entrench rule-of-law norms locally through “legislative reforms, judicial training, reforms in legal education, and attorney training that improve rather than detract from national legal institutions.”<sup>23</sup> In this way, rule-of-law norms are expected to spillover from the transnational to the national setting. In a subsequent extension and empirical analysis of this theory, Rogers and coauthor Christopher Drahozal argue that pro-ICA reforms will support the diffusion of rule-of-law norms for two reasons. First, ICA will create new business opportunities for local legal elites who will work to diffuse stronger rule of law norms in order to secure those opportunities.<sup>24</sup> Second, legal and business elites will demand a similar level of treatment from local courts that they enjoy in international arbitration: “attorneys and arbitrators trained in international standards for conflicts of interest are less likely to accept much lower standards in domestic arbitration or in national court litigation.”<sup>25</sup> Using a two-way fixed effects model, they find that the enactment of the UNCITRAL Model Law exerts a positive effect on domestic rule-of-law institutions.

*International arbitration subverts the rule of law.* Others argue that, rather than providing complementarities that facilitate the spillover of rule-of-law norms or institutional competition that leads to a “race to the top,” the substitution of courts by ICA and ISDS may instead lead to the deterioration of local legal institutions.<sup>26</sup> The argument presented by this group of scholars is reminiscent of Hirschman’s concept of institutional “exit.”<sup>27</sup> Much like the Nigerian railroad that failed to improve its service in response to competition from the growth of trucking, local judiciaries are shielded from competitive pressures because they enjoy a monopoly over other areas of dispute resolution and are not compensated on a per-case basis. In contrast to the models offered by Franck and Rogers and Drahozal, exit from local courts is expected by this group to lead to an overall reduction in political pressure for progressive rule-of-law reforms because commercial actors exiting

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23. Rogers 2015, 74.

24. Rogers and Drahozal, forthcoming, 5-9.

25. 8.

26. Puig and Shaffer 2018.

27. Hirschman 1970.

to arbitration no longer have a stake in the quality of local courts. Tom Ginsburg argues that the availability of international arbitration therefore “may reduce courts’ incentives to improve performance by depriving key actors from a need to invest in institutional improvement.”<sup>28</sup> Ginsburg finds limited support that signing BITs containing binding arbitration clauses leads to reduced local rule-of-law outcomes. The harmful effect of substitution may be exacerbated in developing countries or already weak rule-of-law states. In a study of commercial arbitration in Sudan, Mark Massoud argues that the Sudanese regime promoted ICA in order to relieve pressure from commercial actors to reform the Sudanese judiciary.<sup>29</sup> In the absence of a transnational exit, Sudan would have faced pressure from investors to install independent, neutral judges in local courts which might put the regime at risk if politically sensitive cases come before those same judges. Arbitration thus grants a key interest group access to a highly competent and neutral contract enforcement institution, without undermining the regime’s use of the judiciary as a tool for maintaining a repressive public order.

In sum, the literature has identified three causal pathways through which the growth of international arbitration is expected to influence the development of local rule-of-law norms. They are summarized in Table 1. While the existing models describing the interaction between international arbitration and local courts arrive at conflicting conclusions, they nevertheless seem to agree on the set of mechanisms that could be at work: competitive pressures, elite-driven norm transfer and broad-based reform efforts. They disagree, however, over how those mechanisms are operating. Both sets of scholars largely agree that arbitration will to some extent deprive local courts of cases. But we do not know to what extent this diminishes state control over the adjudicative process or lessens political pressure from commercial interest groups for reform.<sup>30</sup> Many would agree that promoting integration with transnational arbitral practice may lead to some knowledge and normative transfer, but, again, we do not know how much knowledge is transferred, to whom and whether that translates to broader reform and therefore improved outcomes overall. In the next section I situate the specific debate about international arbitration and the rule of law in the broader literature on globalization and the development of transnational, private governing institutions. Bringing these strands of research together provides useful tools for understanding the

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28. Ginsburg 2005, 119.

29. Massoud 2014.



	Competition	Norm Transfer	Reform Pressure
Franck	↑		
Rogers		↑	
Ginsburg			↓

Table 1: Causal Pathways and Expected Effect on Legal Development

domestic effects of transnational legal institutions by integrating the mechanisms of substitution and knowledge spillover within a common analytical framework.

### III. Transnational Legal Institutions and the Unbundled the State

In this section, I draw on the concept of “unbundling” from work on globalization and apply it to political and legal development. One of the key consequences of technological change over the last two centuries has been the incremental “unbundling” of commerce.<sup>31</sup> The first victim of the unbundling dynamic was the tight nexus between the locations of production and sale. Cheaper transport costs allowed for firms to fragment supply lines and production around the globe and ship to consumers anywhere. More recently, the firm itself has become unbundled as technology allows for the decoupling and sale of an increasingly large set of service-based tasks that were not thought of as tradable before the reduction of communication costs.<sup>32</sup> The common theme in each of these examples is that the efficient allocation of tasks between and within firms, occupations, etc. is largely a function of external and contingent technological and institutional constraints. As these constraints disappear or change, pressures build to alter the distribution of tasks which, in turn, disrupts traditional forms of political economic organization. Prior research on the relationship between unbundling at the occupational-level and political attitudes has shown, that unbundling carries important political consequences.<sup>33</sup> While this literature has focused primarily on the effect of technological change on the organization of production, firms, and occupations, I posit

30. Curiously, none of the studies mentioned here examine this mechanism. We know little about whether international arbitration is in fact substituting for domestic courts. In a separate chapter of my dissertation I find evidence in support of substitution.

31. Baldwin 2006.

32. 22-35.

33. Owen and Johnston 2017.

that we can fruitfully extend the concept of bundling and unbundling to state institutions in an age characterized by the proliferation of private and transnational sites of rulemaking authority unmediated by state actors.

A typical modern state is made up of “bundled institutions” that have authority over a wide set of diverse governance tasks. The judiciary is a prime example of a bundled, public institution. Broadly speaking, the same court will hear cases in any number of issue areas. This allows for a high degree of professional movement and knowledge sharing within bundled institutions. The same judge might sit on a national security case one week then an intellectual property case the next. Even in jurisdictions with distinct commercial courts, such as England and Wales, the judges appointed to the court are part of broader, more general judicial organization and often sit on other courts hearing non-commercial cases. In addition to intra-institutional knowledge building, bundling also provides simple lines of accountability linking task to institution to outcome. Bundling thereby “internalizes externalities” which helps resolve collective action problems.<sup>34</sup> Because the policies of a bundled institution affect a wider range of actors, it is easier to identify negative externalities. This eases the process of building a coalition for reform as the policy affects a larger set of actors than it would have if the policy were implemented by an institution with a smaller task-set (and therefore a smaller constituency). This is especially true with respect to the law. Bundled legal institutions enhance public accountability through the development and application of broad principles to disparate cases, reducing the risk of contradictory rules forming in different issue areas.<sup>35</sup>

Bundling comes with risks, as well. Generalist public officials and broad principles, while providing simplicity, might not offer the most optimal solution to any given problem. One benefit of unbundling is the creation of specialized, nimble governing authorities. In the regulatory space, private authorities often develop when consumer demand is unmet by unresponsive or overstretched public entities. One example of this occurred after food scares in the 1990s, when the British government imposed steep fines and strict liability on retailers for tainted food products they sold. That liability both incentivized the food retail industry to create strong private mechanisms for

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34. Gerring and Thacker 2004, 322-324.

35. Legal fragmentation is a common critique of unbundled judicial systems like that of international criminal law and investment law. The solution to both these critiques has been to bundle: through the creation of the International Criminal Court and the EU’s recent attempts to construct a multilateral investment court.

standard setting and monitoring of food safety practices, but also provided the state a mechanism for ratcheting up or down the level of regulation through its interpretation of that liability. This ultimately led to creation of what is now called GLOBALGAP, an effective transnational, private food regulatory body.<sup>36</sup> GLOBALGAP is one of many such bodies making up the global field of private regulatory bodies for food. One key to its success has been the sustained role of the state in directing the goals of GLOBALGAP and its relation to other bodies in the space. This dynamic, whereby the state retains some degree of responsibility and authority over the scope of regulation, is often referred to as the “orchestration model” of transnational private governance. It refers to the ability of state institutions to direct private regulatory bodies to act in concert and towards the state’s desired goals.<sup>37</sup>

While the orchestration model was developed to explain varying outcomes in transnational regulation, the concept carries implications for the underlying bundled institution as well. Given the state’s continued involvement in the maintenance of the regulatory space, civil society remains invested in the quality of the public institutions orchestrating the private bodies. Adopting an orchestration model can thus lead to enhancements in the quality of the bundled state institution. The state institution must commit resources to monitor, learn and direct its regulatory intermediaries. By successfully deploying its ideational and material resources to orchestrate the unbundled, private rulemaking authority, the state remains a site of political accountability.<sup>38</sup> Orchestration thus creates dependencies and complementarities between the private and public institutions. This allows for the resulting public-private governing complex to take advantage of both the flexibility and expertise of the specialized, unbundled task-set while retaining the simple lines of authority that enhances public accountability. For example, Franck argues that national courts are natural complements to investor-state arbitration because the success of ISDS depends on the “critical support” public courts provide to the process.<sup>39</sup> They do this by staying parallel judicial proceedings, enforcing interim measures, appointing arbitrators and so on. If courts provide the necessary infrastructure for arbitration to succeed, then local actors retain an interest in promoting reforms that benefit users of the legal system outside of commerce.<sup>40</sup> If, however, arbitration has minimal

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36. Meidinger 2009.

37. Meidinger 2009; Abbott and Snidal 2009, 242-244.

38. Abbott et al. 2016, 4.

39. Franck 2007, 367-370.

40. Though, as I argue below, only a very limited set of courts, typically in countries like the US, UK, France and

to no institutional linkages with local legal institutions, then we should expect a reduction in the incentive to invest in reform due to commercial actors' diminished reliance on local institutions.

The growth of transnational rulemaking institutions disconnected from public bodies does not only risk reducing international reform pressure, but domestic pressures as well. Because of the latitude given to contractual parties in defining what constitutes an “international” contract or dispute and the mobility of capital today, domestic actors can take advantage of the growth of transnational rulemaking institutions, as well. Gulnaz Sharafutdinova and Karen Dawisha call this phenomenon “institutional arbitrage,” whereby well-resourced domestic actors select into and out of national rulemaking institutions. The authors present evidence that Russian oligarchs and commercial interests have taken their capital abroad in order to avoid local institutions and take advantage of British courts and international arbitration bodies like the London Court of International Arbitration and the ICC to settle disputes and enforce contracts.<sup>41</sup> The availability of these institutional exit options worsened the collective action problem facing Russian commercial interests—that had a history of advocating for liberal legal reform—when faced with an increasingly extortionate and illiberal state.<sup>42</sup> It became easier to simply rely on transnational contract enforcement institutions than to lobby for domestic reforms. Sharafutdinova and Dawish thus go one step further beyond what I argue here. They argue that the availability of high-quality, transnational contract enforcement institutions not only reduces political pressure for domestic reform but instead *increases* the incentives for local business elites to maintain the illiberal domestic status quo. As they write, “business elites take advantage of weak institutions at home to make profits, while using strong institutions abroad to safeguard them.”<sup>43</sup>

Another proposed causal pathway, emphasized by Rogers, is through the diffusion of norms and knowledge through elite actors that move between transnational and national settings.<sup>44</sup> For this to occur, professionals and experts in the private and public institutions must move between each site of authority, carrying with them “best practices” or higher expectations of local institutions that lead local elites to lobby for reform. Prior research on norm transfer has found that progressive standards tend to diffuse where actors with incentives to promote reform move between sites with

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Switzerland, tend to serve this role for most international arbitrations.

41. Sharafutdinova and Dawisha 2017, 369-71.

42. 364-5.

43. 363.

44. Rogers 2015.

		State Orchestration	
		High	Low
Professional Integration	High	Enhancement	Mixed
	Low	Mixed	Deterioration

Table 2: Theoretical Expectations

relatively “high” and “low” standards. For example, the work on the diffusion of womens’ rights through trade and foreign direct investment (FDI) argues that the diffusion of such norms happens because of the greater integration of women into a workforce increasingly defined by multinational firms with relatively more progressive gender policies.<sup>45</sup> Crucially, diffusion depends on women moving from the site of higher standards (the MNC) into sites with lower standards (local firms) and demanding change. Without movement and political demands, there is no mechanism of change. In the case of private governance, we need to identify bidirectional movement within and integration between the national and transnational professional class granted governing authority.

To summarize, institutions can be thought of as bundles of tasks and authorities. Increasing economic interdependence has put pressure on state institutions to delegate authority to more flexible, expert and, often, private transnational authorities. As private, transnational institutions develop to take over tasks that were previously bundled in more general public institutions, rule-making authority risks becoming more diffuse, decentralized and complex. Increased complexity risks entrenching the power of well-resourced actors,<sup>46</sup> while the export of governance authority risks subverting local political and legal development incentives.<sup>47</sup> The framework presented here highlights two aspects of the design of transnational institutions that influence the incidence of these outcomes. First, if the resulting public-private governing complex allows for state orchestration, then the quality of the unbundled local institutions is expected to be enhanced due to both the added capabilities from integrating with a transnational, private authority paired with

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45. Neumayer and de Soysa 2011.

46. Drezner 2009.

47. Ginsburg 2005; Sharafutdinova and Dawisha 2017.

the sustained political pressure from interest groups to maintain governing quality. An alternative possibility is that the private body offers an independent functional equivalent to the public institution that allows for only minimal or even no state oversight or direction. Because some subset of actors can then select out of the public institution into the private institution, the political and economic pressure to reform the public institutions decreases. The second factor is the degree of integration between transnational and national professionals. Professionals moving between the transnational and national realms may support the transfer of norms and knowledge from one realm to the other. This synthesis yields the expectations presented in Table 2. High orchestration and high professional integration between private and public bodies should have an *enhancing* effect on local rule of law institutions. Whereas I expect low orchestration and low professional integration to have a *deteriorating* effect. In the next section I apply this framework to the case of international commercial arbitration.

#### **IV. International Commercial Arbitration as an Unbundling Institution**

This study builds on the rich and growing literature on the interaction between intergovernmental organizations and domestic institutions by exploring the unique dynamics of private, transnational governance. Why focus on international commercial arbitration? Prior work testing the relationship between investor-state dispute settlement (ISDS) and legal development has found mixed results.<sup>48</sup> There are a few aspects of ISDS that limit its potential to substitute for local institutions. First, ISDS might be better described as a complement due to the frequent requirement to exhaust local remedies before an ISDS panel can grant itself jurisdiction over a dispute. Second, the influence of ISDS on domestic development incentives may be weak because it is not a very active international dispute resolution regime relative to ICA. In 2018, 56 cases were filed at the International Centre for Settlement of Investment Disputes (ICSID), a popular ISDS venue within the World Bank. Compare this to the 842 cases that were filed at just the International Chamber of Commerce the same year (141 of which involved a state-entity);<sup>49</sup> 301 cases at the London Court of International Arbitration; 152 cases at the Stockholm Chamber of Commerce; and 343 cases at

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48. Ginsburg 2005; Rogers and Drahozal, forthcoming.

49. An additional 2 cases involving state-entities were registered at the ICC that year, but the jurisdictional bases for these claims came from bilateral investment treaties so they are more likely to be classified as ISDS than ICA.

the Singapore International Arbitration Center. Figure 1 plots the yearly number of cases that have been registered at the ICC from its inception in 1921 against publicly known ISDS disputes registered with ICSID. Given the relatively small ISDS caseload, perhaps foreign and domestic firms may still feel the need to push for more neutral, expert, efficient and predictable local dispute resolution mechanisms in countries that are party to treaty-based arbitration clauses. Third and relatedly, ICA's larger caseload is driven by the wider jurisdictional scope of ICA relative to ISDS. ISDS only deals with international law violations while ICA is equipped to resolve any cross-border contract dispute (very broadly defined).<sup>50</sup> Any international contract can be shifted from a local court to an ICA panel.<sup>51</sup> ICA therefore provides a near complete substitute for a country's local contract enforcement institutions that applies between fully private as well as public-private disputes. The comparatively limited ambit and activity of ISDS may help explain the mixed findings to date. In sum, while there are many institutional similarities between ISDS and ICA, the increased activity, the broader jurisdictional scope, and, as Rogers argues, its deeper integration with local legal institutions suggest that ICA is more likely to influence the development of local legal institutions for better or for worse.<sup>52</sup>

In the rest of this section I briefly situate the international commercial arbitration regime within the analytical framework discussed above, evaluating how ICA fares on each of the relevant dimensions. I begin with a short discussion of the competition hypothesis. Then I argue that ICA admits minimal state orchestration and therefore creates few institutional dependencies that would retain simple lines of accountability and political pressure for reform. Finally, I examine the limited potential of ICA to promote professional interpenetration between transnational and national legal communities.

*Institutional competition and the “race to the top.”* One proposed benefit of unbundling is the creation of competition between the specialized and bundled institutions. This is the logic behind Franck's “race to the top” hypothesis.<sup>53</sup> For competition to produce a “race to the top,” however, there must be some mechanism by which competition creates costs that the public institution will seek to minimize or recoup. As the judiciary is not compensated on a per-case basis,

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50. Many jurisdictions allow the parties to a contract to define for themselves whether the subject matter is “international” or not.

51. And many countries opt to apply the ICA reforms to domestic arbitration, as well.

52. Rogers 2015.

53. Franck 2007, 367-368.

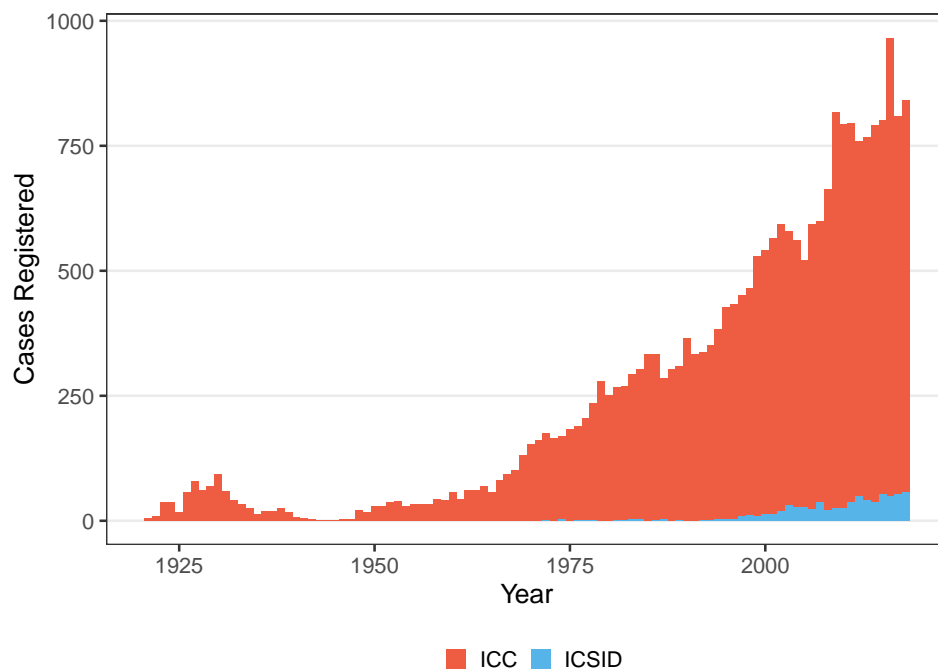


Figure 1: Comparison of ICC and ICSID Caseloads



it is unclear what those costs would be. Judges retain their salary and the judiciary as a whole retains its monopoly on the rest of its adjudicative task-set. To the extent that public institutions are insulated from competitive pressures we might see the opposite outcomes, that the state sees a *benefit* from a private alternative that provides an exit option for discontented actors.<sup>54</sup> This is especially true in in autocratic states, where the growth of a private judicial alternative would relieve pressure from commercial interests on the state to implement reforms promoting judicial neutrality, predictability, expertise and independence. Privatization therefore enables autocratic states to provide neutral, efficient judicial-like adjudication while maintaining a tight control over the judiciary in matters of public order.<sup>55</sup>

The growth of public international commercial courts suggests that rather than a “race to the top” we see states participating in the public unbundling of commercial and non-commercial judicial functions.<sup>56</sup> Notably, high-capacity autocratic states such as Qatar, Saudi Arabia, Singapore and China are actively developing and promoting their international commercial courts.<sup>57</sup> As Bookman argues, these states are not driven by competitive judicial forces to make “better” courts. Instead these countries consider the development of specialized courts for commercial actors as a means of competing for foreign capital.<sup>58</sup> There are thus few judicial competitive forces at work that might lead to a “race to the top” between public judiciaries and private arbitration institutions or their public offshoots. Where there is competitive pressure, we see states respond by further unbundling judicial work through the construction of commercial courts, further limiting the positive externalities of a bundled judiciary.

***Low levels of state orchestration.*** If the state is still involved in orchestrating a private authority, then the users of the private authority will remain invested in the quality of the state orchestrating institution too. As Susan Franck argues, “national courts provide critical support to the investment arbitration process. There are various points in the process where the integrity of local courts can impact the efficacy of the dispute resolution process.”<sup>59</sup> If this is true, then a private “exit option” will likely not have the effect of relieving pressure on bundled institutions to

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54. Gerring and Thacker 2004, 317-318.

55. Massoud 2014, 19-21.

56. Bookman 2020.

57. 21-45.

58. 40.

59. Franck 2007, 369.

invest in reform. Alternatively, low levels of orchestration can instead reduce pressure for reform. As I argue below, however, opportunities for state orchestration over ICA have been declining for decades. The two main opportunities for orchestration for ICA are in the design of domestic legislation governing ICA and in the judicial enforcement of arbitration agreements and awards. I deal with each of these factors in turn.

There are many ways a country can both promote ICA and orchestrate its practice. A country can grant the right to judicial review on the merits; require arbitrators to state the reasons for their decisions; require that awards be made public; etc. Few countries do so. Instead, most countries enacting ICA reforms today base those reforms on the UNCITRAL Model Law on International Commercial Arbitration, which expressly denies all of the potential orchestration mechanisms outlined above. The Model Law is considered the “gold standard” of the “modern” ICA regime. It is the standard against which all ICA reform is measured today. Pressure from UNCITRAL has thus been instrumental in harmonizing and increasing ICA protections around the world. While there is some variation in the enactment of these reforms, by and large the reforms are quite uniform across jurisdictions.<sup>60</sup> Because the pressure for reform typically comes from a desire to attract capital, rather than reform of the judiciary, countries have opted into adopting the Model Law with minimal revision. A second homogenizing force is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958), commonly referred to as the New York Convention (NYC). This convention allows for the enforcement of arbitration agreements and awards in any other signatory jurisdiction while at the same time (like the Model Law) prohibiting essentially any form of judicial oversight. Competition for trade and investment drive states towards focal standards such as the Model Law and New York Convention and incentivized states to limit the scope of orchestration over the practice. Outside of the major arbitration jurisdictions like the United States, France, United Kingdom and Switzerland, there is little room for less prominent countries to orchestrate arbitral practice.

Another avenue of orchestration is for courts to carve out certain areas of law over which they have exclusive jurisdiction. Arbitrators today have wide latitude to base decisions on their own interpretations of almost any relevant rules of law. Judiciaries in the major arbitration states have been gradually increasing the authority of arbitration to interpret and apply public law. For

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60. For an extensive cross-national analysis of the enactment of particular Model Law provisions see Binder 2010

example, through a series of interpretations of the Federal Arbitration Act, the United States Supreme Court has increased arbitrator's powers to rule on mandatory rules.<sup>61</sup> Andrew Guzman argues that this given actors an avenue to circumvent mandatory rules in areas like securities law and antitrust.<sup>62</sup> European courts have similarly granted increased authority to arbitration panels to root decisions in their own interpretations of mandatory EU law.<sup>63</sup> Alec Stone Sweet argues that this deference has led to the transnationalization of commercial law and its decoupling from domestic law.<sup>64</sup> Using both legal analysis and interviews with practitioners, Joshua Karton finds that the culture of ICA has led arbitrators to arrive at unique, though internally consistent, interpretations of domestic law.<sup>65</sup> If the legal reasoning of an arbitration award were reviewable by a court for errors in law, this would not pose any problem. But article 5 of the Model Law reads, "In matters governed by this Law, no court shall intervene except where so provided in this Law." And the Model Law bars courts from reviewing arbitral awards for mistakes of law, further limiting the opportunity for state orchestration through judicial oversight.

A final potential avenue for state orchestration written into both the New York Convention and the Model Law is an exception that allows courts to deny enforcement of awards that cut against "public policy." The scope of this exception is very narrow and appears to be shrinking.<sup>66</sup> In recent years, courts in major enforcement states have increasingly interpreted this to mean not domestic public policy but transnational public policy. Stone Sweet and Grisel find that courts in Italy, France and Switzerland have ruled that public policy challenges to international arbitration awards should be considering in light of *international*, not national, policy grounds, further limiting the extent of domestic authorities can orchestrate arbitration practice.<sup>67</sup>

***Minimal professional integration.*** Finally, in the absence of competitive pressures or institutional complementarities through state orchestration, rule-of-law norms may flow from ICA practice into local practice through a process of normative spillover. As discussed above, normative spillover requires social and professional interpenetration between the sites of normative export and

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61. Mandatory rules apply regardless of the parties' intents. They are meant to protect uninformed or under-resourced parties to a transaction.

62. Guzman 2000.

63. Stone Sweet and Grisel 2017, 178-185.

64. Stone Sweet 2006.

65. Karton 2013.

66. Redfern and Hunter 1999, 471-474.

67. Stone Sweet and Grisel 2017, 147-150.

import. But in the transnational and highly lucrative world international commercial arbitration, it is typically a one-way street from public judge to private arbitrator and lawyers in already weak rule-of-law states are often attracted to more lucrative careers in the transnational world of ICA. It is thus not uncommon instead for ICA to encourage the *export* of actors with strong credentials for independence and competence from the public to the private sector, not the other way around.

Nor is it clear that integration into the ICA regime will bring increased interpenetration between national and transnational sites of authority. Instead, it seems that ICA leads to a professional reorientation away from the local and towards more lucrative transnational practice. Yves Dezalay and Bryan Garth find that the burgeoning arbitration profession in Egypt typically shunned local professionals and institutions: “A state company lawyer underscored this point by referring to a list of fifteen top arbitrators who would be acceptable as the chair of an important arbitration—none were Egyptians.”<sup>68</sup> Second, the structure of the arbitral regime works against the diffusion of norms through lawyers working in local and transnational contexts. Instead, local professional may seek to take advantage of ICA as a means of escaping local practice. Dezalay and Garth find that the introduction of Model Law-based legislation in Egypt helped spur “many conferences, workshops, and training sessions...[for which] many leading figures in the world of arbitration are brought to Cairo, adding stature to the Cairo center, gaining attention to Cairo, and not incidentally letting Cairo have a look at the stars of the [ICC] core.” But they found little evidence of an increase in the number of arbitrations seated within the country.<sup>69</sup> This is likely because contractual parties tend to select seats in jurisdictions that have robust legal institutions out of fear that a court in a weak rule-of-law jurisdiction will annul an award adverse to a local firm or state entity. Because of this, even when states actively promote arbitration as a mechanism for dispute resolution, it is unclear what effect increasing arbitral practice by local firms would have on local courts outside of a decline in caseload and authority.

In sum, there is little reason to believe competitive pressures will nudge local courts to invest in costly reform; the modern ICA regime is designed to prevent orchestration and therefore remove the state from the regulation of commercial disputes; and rather than providing a mechanism for importing rule-of-law norms, ICA may instead encourage the export of local legal talent to more

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68. Dezalay and Garth 1996, 243.

69. 242-244.

lucrative opportunities abroad. These three factors together push the state into the background and minimize whatever incentives would otherwise exist to invest in costly and uncertain rule-of-law reforms. We should therefore expect to find a *negative* association between the promotion of ICA and legal development. In the next section I test this hypothesis on a cross-national panel of countries that have implemented UNCIRAL’s Model Law on ICA.

## V. Data and Methods

**Dependent Variable: Legal Development.** Legal development refers to the reform of governance institutions such that they adhere to contemporary rule-of-law norms. The “rule of law” is a notoriously slippery kind of concept. I make no pretension to contributing to the vast and interesting literature on the rule of law as a concept. Instead, I draw my operating definition from the growing field of rule-of-law development practitioners. This definition is particularly useful here because it represents the approach adopted by the very experts from whom public officials often seek advice and know-how when implementing rule-of-law reforms.<sup>70</sup> If there is reduced pressure for legal reform, then we should expect to see a reduction in legal development along the lines defined by the international development community actually involved in legal development efforts around the world. These practitioners deploy what Rachel Kleinfeld refers to as an “institutional approach” for promoting the rule of law.<sup>71</sup> They focus on a set of concrete institutional reforms. Kleinfeld notes three main features of such a definition:

- “**Laws**...which are publicly known and relatively settled;
- “A **judiciary** schooled in legal reasoning...efficient...[and] independent of political manipulation or corruption; and
- “A **force able to enforce laws**, execute judgements, and maintain public peace and safety.”<sup>72</sup>

Kleinfeld’s synthesis accords with common strategies adopted by rule-of-law development practitioners. The American Bar Association’s Rule of Law Initiative, for example, focuses on these very institutions through its legal development efforts supporting broad-based reform initiatives such as “drafting and implementing codes of judicial ethics; promot[ing] judicial education and training;

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70. Carothers 2006, 10-11.

71. Kleinfeld 2006, 47-54.

72. 47.

and help[ing] to enhance court administration and efficiency.”<sup>73</sup> Moreover, each aspect of this definition is tied to the interests of commercial actors seeking fair treatment and efficient, predictable contract enforcement. In the absence of an exit option, commercial actors would have an interest in pressuring the state to pursue goals that align with the “best practices” of the development community. This definition thus serves to capture both what is lost when commercial interest groups exit and the practices adopted by the kinds of actors to which states that do feel the pressure to invest in reform would turn.

I use the Rule of Law Index as coded by the Varieties of Democracy Project (V-Dem) to measure the quality of rule of law institutions cross-nationally and over time.<sup>74</sup> The V-Dem Rule of Law index is an aggregation of expert coded measures pertaining to both the independence and competence of multiple levels of each country’s judiciary along with other aspects of the rule of law including the openness and transparency of laws, judicial independence, access to justice, quality of public administration, and the predictability of enforcement.<sup>75</sup> Aside from the substantive similarity this index has to the definition of the rule of law adopted here, the index is ideal because it has very wide temporal and unit coverage. It allows for the inclusion of over 150 countries in the sample across the full length of the relevant time span (from 1985, the year the UN General Assembly adopted the Model Law, on). Other measures are either too substantively narrow (such as the Judicial Independence Index), unreliable (like the World Bank’s Contract Enforcement indicator in its Ease of Doing Business dataset), have missing data (such as the early years of the World Governance Indicators) or cover a limited timespan.

**Independent Variable: Protections for International Commercial Arbitration.** To proxy for integration into the transnational ICA regime I collected data on the enactment of domestic legislation based on the UNICTRAL Model Law on ICA. The Model Law is considered to be the “state-of-the-art” in permissive arbitration laws. By 2017 over 70 countries had enacted national legislation based on the Model Law (see Figure 2). The data were collected from the UNCITRAL’s yearly “Status of Conventions” reports. These reports update UNCITRAL members (and the international community at large) when a country is recognized by UNCITRAL for entering into force

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73. See [https://www.americanbar.org/advocacy/rule\\_of\\_law/what-we-do/governance-justice-system-strengthening/](https://www.americanbar.org/advocacy/rule_of_law/what-we-do/governance-justice-system-strengthening/)

74. Coppedge et al. 2018; Pemstein et al. 2018.

75. Coppedge et al. 2018, 235-236.

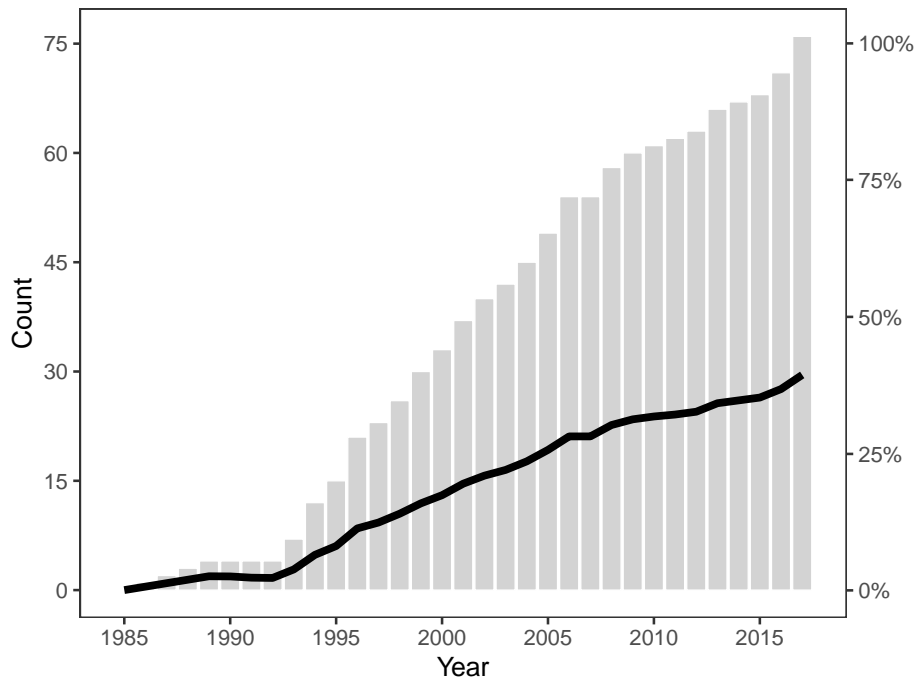


Figure 2: Rate of National Legislation based on UNCITRAL Model Law on International Commercial Arbitration, 1985-2017

**Note:** The grey bars represent total number of Model Law countries per year. The black line plots percentage of countries with Model Law-based legislation per year. The yearly denominator is derived from the Correlates of War State System Membership Dataset.

legislation based on the Model Law as well as all of UNCITRAL's other legal instruments.<sup>76</sup> Because of the flexibility built-in to all of UNCITRAL's legal instruments, it does not have an official and clear set of rules for inclusion in the reports. While UNCITRAL allows countries to shape local implementation as they see fit, transnational legal harmony is the ultimate goal.<sup>77</sup> This discretion does not mean that any country can win the approval of UNCITRAL, however. UNCITRAL has an interest in maintaining the value of its legal instruments as not only guides for commercial law reform, but also as heuristics for the international commercial community. One Senior Legal Officer at UNCITRAL described the classification of "Model Law countries" in this way:

...domestic arbitration statutes are considered to be enactments of the Model Law when...the legislator took the Model Law as a basis and made certain amendments and additions, but did not simply take the Model Law as one amongst various models or follow only 'its principles.' This also means also that the bulk of the provisions of the Model Law have been enacted and that the domestic statute does not contain any provision incompatible with the basic philosophy of the Model Law.<sup>78</sup>

Despite the flexibility afforded to countries by a model law, Faria later writes that there is a "high degree of substantive uniformity in the implementation of the [Model Law]."<sup>79</sup> UNCITRAL's assessment accords with Peter Binder's empirical analysis of the implementing legislation all Model Law countries through 2010.<sup>80</sup>

By using the Model Law as a proxy for a permissive ICA regime the analysis leaves out some jurisdictions that are arbitration-friendly but have not based their law on the Model Law. Many of the major enforcement jurisdictions are in this category such as the United States, United Kingdom, France, Switzerland, Sweden, and others.<sup>81</sup> The primary difference between these two groups is the publicity afforded Model Law countries when they win UNCITRAL recognition and the utility of that marker as a heuristic for outside actors considering doing business in the country. Given the amount of money at stake in international trade and investment, the arbitration community is expert, well-informed and sensitive to changes in domestic laws governing ICA around the world,

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76. Due to some inconsistencies in the yearly reports, I verified all dates of entry into force by examining the implementing legislation in all Model Law countries.

77. See Block-Lieb and Halliday 2007.

78. Faria 2005, 19-20.

79. 22.

80. Binder 2010.

81. It should be noted that some subnational units have enacted Model Law-based legislation including Scotland in the UK and Texas, California, Illinois and others in the USA.



so it is unlikely that UNCITRAL recognition would create material differences between Model Law and non-Model Law arbitration-friendly countries. Either way, this measurement error is mitigated in the analysis restricted to weak rule-of-law countries, as pro-arbitration, non-Model Law countries tend to be high-income countries with robust legal systems.

**Estimation Strategy.** I estimate the effect of enacting strong protections for ICA on the quality of local legal institutions using a semiparametric difference-in-differences (DiD) estimator with matching methods.<sup>82</sup> The goal of the procedure is to estimate change in the trajectory of the quality of a country’s legal institutions caused by enacting the Model Law. The problem is that we cannot observe what a country that did enact the Model Law would have looked like if it had not enacted the Model Law. To estimate that counterfactual, I construct a unique “control group” for each Model Law country made up of non-enacting countries (called a matched set,  $M_i$ ). To improve the comparability between each Model Law country and its matched set, I weight the observations within the matched set based on how similar each country is to its matched Model Law country. The weights are derived from propensity scores estimated for each country. So countries that did not enact the Model Law but are just as likely to have enacted the Model Law relative to the country that *did* enact the Model Law are given a greater weight than countries that are more or less likely to have done so. I then calculate the change in the weighted control group’s rule-of-law score beginning from the year the Model Law enters into force and subtract this from the change in the Model Law country’s rule-of-law score over the same duration. I average the difference-in-differences across all the the Model Law countries for each time period to yield an average effect of the Model Law on legal development for the year it enters into force and each of the following five years. The five year window was chosen in order to allow enough time for any effect of the Model Law to appear while also including a sizable set of countries in the analysis.<sup>83</sup>

The benefit of using this method is that it relaxes the linearity assumption. Problems would arise when using a parametric difference-in-differences approach if the decision to enact the Model Law and its subsequent effect of on legal development is related to some confounding variable such as, for example, how democratic a country is. While we could interact the treatment with a measure

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82. Imai, Kim and Wang, forthcoming. I use the authors’ PanelMatch R package for the estimation below. It can be found here: <https://github.com/insongkim/PanelMatch>

83. Any country that does not have at least five years of post-enactment data is dropped, so the data only include countries that enacted the Model Law on or prior to 2012. Expanding the window would therefore reduce the size of the Model Law sample. The results are robust to longer time windows. See Appendix B.

of democracy in order to account for this, one problem we may encounter is that democracy may not be the only factor moderating the relationship between the Model Law and domestic legal institutions. Adding an increasing number of interaction terms into the model to account for these dynamics will lead to the “curse of dimensionality” in which the researcher is left with more explanatory variables than what the data can support.<sup>84</sup> The semiparametric method used below circumvents this issue by relaxing the linearity assumption, allowing for heterogenous treatment effects as long as we account for any confounding covariates when estimating the propensity scores. Importantly, this method does make the additional common trends assumption that the difference between the trajectories of the treated and control units would have remained stable in the absence of treatment, conditional on a set of time varying covariates.<sup>85</sup> Below, I explain my choice of covariates used to estimate the propensity scores to help prevent violating this assumption. I now turn to an outline of the procedure.

First, I set a time-window for the analysis,  $F$ . The results reported below estimate the effect of the Model Law over a five-year period,  $F = [0, 5]$ . I then construct a matched set for each treated unit  $i$ ,  $M_i$ , which includes all countries that have the same treatment history as the treated unit for a given period of time (i.e. all countries that have not yet enacted legislation based on the Model Law). Any unit that enacts the Model Law between the time country  $i$  enacts the Model Law and five years thereafter is dropped from  $i$ 's matched set. This also means that any Model Law country with fewer than 11 years of observations (the year of entering into force plus 5 years on either side of that year) is dropped from the analysis.<sup>86</sup>

The next step is to refine each matched set to improve the comparability between the treated units and their matched sets. Typically, this is done by using logistic regression to estimate the propensity of each matched unit to have received the treatment. These propensity scores are used to identify a subset of the full matched set that is most similar to the treated unit. “Nearest neighbor” matching, for example, simply selects the matched unit that has an estimated propensity to receiving the treatment closest to that of the treated unit. The treatment effect on the treated is

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84. Persson and Tabellini 2007, 5.

85. Imai, Kim and Wang, forthcoming, 10-11.

86. A list of included Model Law countries can be found in Appendix A. This decision drops Russia and Ukraine from the analysis because they each enacted the Model Law fewer than five years after becoming independent countries (in 1993 and 1994, respectively). The results from an analysis in which I relax the pre-treatment history requirement by matching on pre-treatment missingness is presented in Appendix B. The results are consistent with those of the main analysis.

calculated as the change in the outcome for the treated unit minus the change for its nearest neighbor control unit. King and Nielson caution against using propensity scores for this style of matching because the resulting control group is highly dependent on the logit model used to estimate the propensity scores.<sup>87</sup> I mitigate the potential for model-dependence by weighting every country in the matched set rather than matching a treated unit to a limited (and equally weighted) subset of its matched set.<sup>88</sup> The weights used in the results reported below are calculated from either propensity scores (PS) and the covariate balancing propensity score (CBPS).<sup>89</sup> An important benefit of this method is that it allows for the simple evaluation of covariate balance.<sup>90</sup> We can use pre-treatment trends in this balance to assess the parallel trends assumption.<sup>91</sup> The results for this analysis are found in Appendix D.

The propensity scores are estimated by regressing the outcome variable, the V-Dem Rule of Law Index, on a set of covariates. I include two institutional covariates. First, I include V-Dem's Polyarchy index, which, like the Rule of Law index, is a composite measure running from 0 to 1 designed to measure the level of electoral democracy in a given country. Democracy is highly correlated with the Rule of Law and a relatively high percentage of democratic states have enacted legislation based on the Model Law. Including this variable should account for any bias caused by the interaction between democracy and the Model Law. Second, I include a count of currently in force BITs.<sup>92</sup> BITs provide access for foreign investors to international arbitration through ISDS. ISDS and ICA are highly interdependent systems with similar relationships to local courts, so it is possible that the effect of the Model Law might be amplified when a country is also integrated into the ISDS regime.<sup>93</sup>

Countries that are more integrated into the global economy face greater pressure to provide neutral dispute resolution services and therefore may be more likely to both invest in progressive legal reforms and transnational contract enforcement regimes like ICA. I therefore include a battery of economic variables that would influence both pressure for reform and access to legal development

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87. King and Nielson 2019.

88. 2.

89. Imai and Ratkovic 2014.

90. See Appendix C

91. See Imai, Kim and Wang, forthcoming, 15-18.

92. Due to the presence of 0s, I transform this count using the inverse hyperbolic sine function, see Burbidge, Magee and Robb 1988

93. Rogers and Drahozal, forthcoming.

assistance. I include measures of logged GDP, GDP per capital, GDP growth and population to account for any effects on of the market size and its development trajectory. Finally, I include a measure of total trade (imports + exports) as a percentage of GDP.

The final step of the procedure is to estimate the average effect of treatment on the treated (ATT) in the year of enactment of the Model Law ( $t_i$ ) and for each of the five years thereafter (F). I apply the following DiD estimator for each time period F across all countries in the sample that implemented the Model Law:

$$\widehat{ATT}_F = 1/N \times \sum_{i=1}^N \left( (Y_{it_i+F} - Y_{it_i-1}) - \sum_{i' \in M_i} \omega_i^{i'} (Y_{i't_i+F} - Y_{i't_i-1}) \right) \quad (1)$$

N is the number of countries within the sample that have enacted the Model Law.  $t_i$  is the year in which the Model Law enters into force for each country  $i$ .  $Y_{it}$  and  $Y_{i't}$  are the rule of law scores for Model Law and matched non-Model Law countries, respectively. The term  $\omega_i^{i'}$  refers to the normalized weight applied to the rule of law score for each unit  $i'$  in the matched set of Model Law-enacting state  $i$ . This equation yields an estimate of the change in the rule of law score from one year before the Model Law enters into force to years  $t_i + F$  for Model Law countries minus the weighted average of the change within each Model Law country's matched set over the same duration. I calculate this for each Model Law country then average the results for each time period. The  $\widehat{ATT}_F$  is therefore the estimated average effect of the Model Law entering into force for each year beginning from the year of enactment through each of the following five years.

## VI. Results

The results are reported in Table 3. The estimate in each cell represents the ATT of the Model Law on the rule of law score for each year relative to the year just before the Model Law entered into force. For example, the year 5 cell in column 1 indicates that five years after enacting the Model Law countries have, on average, a rule of law score .02 points below what they would have had if the country had not enacted the Model Law. Year 1 of column 1 estimates that there is no difference between the observed rule of law score and the counter-factual estimate (i.e. if the country had not enacted the Model Law), one year after entering into force.

Years in Force (F)	ATT			
	(1)	(2)	(3)	(4)
0	-0.00 (.00)	-0.00 (.00)	-0.00 (.00)	-0.00 (.00)
1	-0.00 (.00)	-0.01 (.01)	-0.01 (.01)	0.00 (.00)
2	-0.01 (.01)	-0.02 (.01)	-0.02 (.01)	0.00 (.00)
3	-0.02 (.01)	-0.02 (.01)	-0.02 (.01)	0.00 (.00)
4	-0.02 (.01)	-0.04 (.01)	-0.04 (.02)	0.00 (.00)
5	-0.02 (.01)	-0.04 (.02)	-0.04 (.02)	0.00 (.00)
Refinement	CBPS	CBPS	PS	CBPS
Sample	Full	Low Rule of Law	Low Rule of Law	High Rule of Law
Countries	58	38	38	20

**Note:** Bootstrapped standard errors reported in parentheses.

Table 3: Results

Column 1 reports the results when estimating the model using data from the full sample. While the Model Law and control groups are indistinguishable during the year of enactment, we see a gradual decrease in the Rule of Law score for Model Law countries that grows over time. The gradually increasing divergence between Model Law and non-Model Law countries is consistent with the framework presented above. We should not expect an immediate and “large” effect to manifest itself through a complex bundle of institutions like a legal system after the enactment of a single reform package. It can take some time for the legal and behavioral changes brought on by the Model Law to influence broader legal development in the country. Parties must opt-out of national judicial institutions by negotiating arbitration clauses into their contracts. Therefore, there should be some lag as firms shift their attention away from the judiciary and local rules and onto transnational arbitration centers. Exit by commercial parties from the local legal institutions lowers outside pressure on the state to invest in the progressive reforms like reforming archaic procedures, improving judicial training, increasing salaries, funding domestic law schools and legal training, and so on. This process leads to the gradual reduction in political pressure for investment in progressive rule-of-law reforms, which allows for problems in the legal system to persist and accumulate.

We are most interested, however, in the interaction between ICA and local institutions in countries that do not already enjoy a high quality, consolidated legal regime. The sample in column 1 includes enacting countries that have both high and low Rule of Law scores at the time of entering into force. The estimates in the Column 1 may be biasing the results downward for three reasons. First, there is little room for the rule of law score in high rule of law states to move as the index runs from 0 to 1. And, second, countries that enjoy robust legal systems may not be actively engaged in legal reform, so a reduction in pressure for reform would have little effect on legal development. Third, weak rule of law countries tend to have fewer resources to devote to different reform projects. Minimizing pressure in one area frees up resources for another area. High rule-of-law states tend to enjoy both greater material and expert resources in evaluating the quality of local institutions, so there may be less pressure to shift resources outside of the legal system as there would be in a state with fewer such resources. Normatively, we should be interested in how ICA interacts with legal institutions in weak rule-of-law countries because the Model Law is embedded within broader development efforts to promote the rule of law in developing countries. Practitioners advertise ICA

as mechanism for promoting good governance. As Rogers and Drahozal put it, there is “an implicit promise of investment arbitration...that it will not only provide protection of foreign investors, but also foster good governance in developing and emerging economies.”<sup>94</sup> Indeed, UNCITRAL understands its own efforts to promote commercial arbitration as part of the United Nation’s broader project to promote the rule of law around the world.

To examine the effect of the Model Law on weak rule of law countries, I drop all observations of strong rule of law countries that have enacted the Model Law from the dataset.<sup>95</sup> I use a cutoff of a Rule of Law Index less than .8 at the time of enactment of the Model Law.<sup>96</sup> As a frame of reference, Bulgaria, a Model Law country, has hovered around .75 for the last decade. Another Model Law country, Mexico, has fluctuated between .5 and .65 over the last decade. Just above the cut point is Greece, which had a score of .82 in 2017. The results for this subsample are reported in columns 2 and 3.<sup>97</sup> Comparing columns 1 and 2 we see that the ATT for Low Rule of Law countries is roughly double that of the full sample. We also see the same pattern of gradual degradation relative to the control group over time. The model estimates that, on average, five years after enacting the Model Law a country is around .04 points below where it would otherwise have been. This comes out to a cumulative effect over five years of a decrease of roughly 13% of a standard deviation of the Rule of Law score in the sample. The difference between weighting on propensity scores or covariate balancing propensity scores is negligible (compare columns 2 and 3).

Figure 3 plots the ATT for weak rule-of-law countries (i.e. Table 3, Column 2). As was the case with the full sample, the non-Model Law and Model Law groups are statistically indistinguishable for the first 2-3 years after enactment.<sup>98</sup> Whereas around the third year after implementation, the Model Law group becomes statistically distinguishable from the non-Model Law group (at the .05 level), with an estimated Rule of Law Index score of .02 less than that of the non-Model Law group. What is driving this divergence? There are two possibilities consistent with results

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94. Rogers and Drahozal, forthcoming, 1.

95. I do not drop the observations of these countries prior to enactment because those units would still provide important information for the control groups. Also, this sample departs somewhat from the quote in that I am interested in legal development in low rule of law countries, which tend to be emerging markets, but also includes high income autocracies like Saudi Arabia and Oman. The results hold when excluding these countries.

96. Lindberg 2015. The results are robust to alternative cutoff points. Countries, like Georgia, that are below the cutoff point at the time of enactment but move above it post-enactment are included in the weak rule of law group.

97. A full list and categorization of the Model Law countries included in the analysis can be found in Appendix A.

98. This imprecision is due to the country-year level of analysis. A country for which the Model Law entered into force on January 1 is coded exactly the same as a country for which the law entered into force on December 31 of the same year.

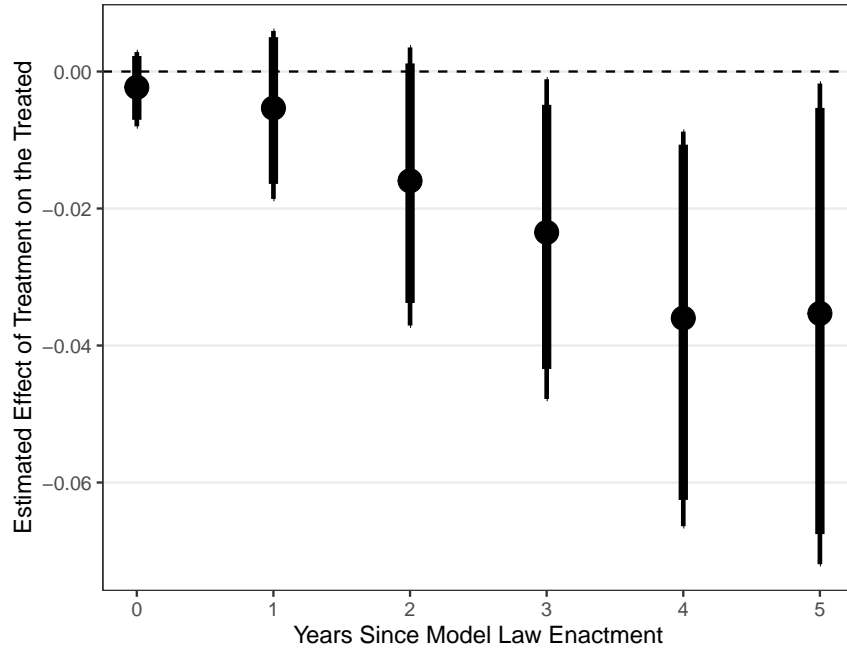


Figure 3: Estimated Change in Rule of Law Index After Enactment of the Model Law

**Note:** The thick and thin black bars plot the 90% and 95% confidence intervals, respectively.

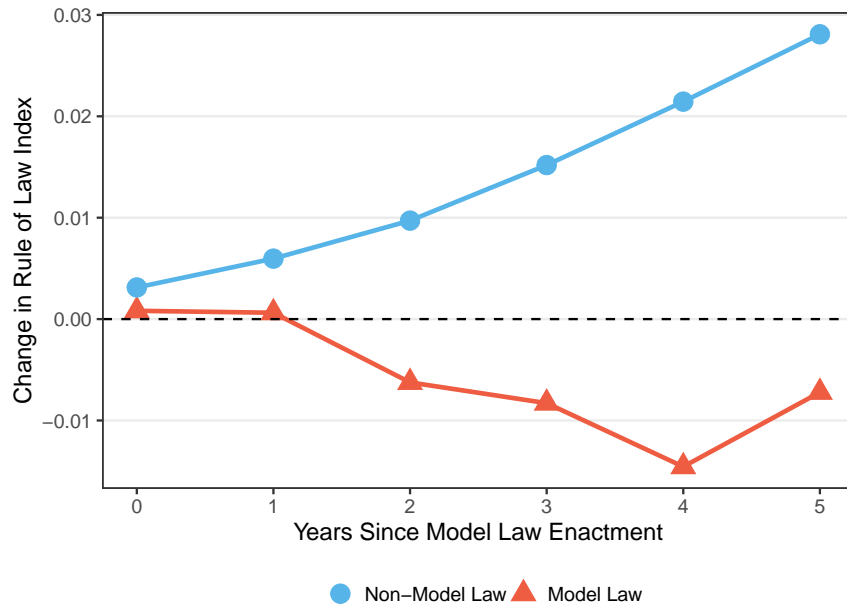


Figure 4: First Differences



presented in Table 3. Either legal institutions in Model Law countries are *deteriorating* from their pre-Model Law baseline faster than non-Model Law countries are or non-Model Law countries are *improving* at a faster rate than Model Law countries. One benefit of the DiD estimator is that we can disaggregate the second difference to see what is driving the growing divergence between Model Law and non-Model Law countries. Are legal institutions within recent Model Law countries getting worse or are they not developing at the rate they otherwise would have? Figure 4 plots the estimated trajectories of the Model Law and non-Model Law groups individually (as opposed to Figure 3 which plots the differences between these groups at each time  $t_i + F$ ).<sup>99</sup> This plots the average change in each group relative to the year prior to implementation. The upper, blue line reveals that the non-Model Law group experiences steady improvement over time. By contrast, the red line, representing the trajectory of the Model Law group, shows a very slight decline in the quality of local legal institutions. These results suggest that rather than degrading local institutions, promotion of ICA may instead be hindering legal development. This is consistent with the theory presented above in which the exit of international and local commercial actors from the domestic legal system are expected to lower the incentive for governments to invest in the difficult and costly reforms necessary to improve the neutrality and competence of local legal institutions.

Does the Model Law exert a similar effect on countries with already consolidated legal regimes? It appears not. Unlike with weak rule of law regimes, there appears to be no effect of the promotion of ICA on national legal institutions in already consolidated legal regimes. Column 4 reports the results for the portion of the sample that had high rule of law at the time of enacting the Model Law (i.e. a Rule of Law Index that is greater than or equal to .8 at the time of enactment). The estimated effect is positive, but, even over five years, the effect is highly insignificant and estimated to be less than .01 points on the V-Dem scale.

## VII. Conclusion

The findings presented here are in line with Ginsburg’s analysis of ISDS and domestic institutions.<sup>100</sup> Particularly in light of the competing findings within the literature across ISDS and now

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99. Estimates are based on model reported in Table 3, Column 2, in which the sample is restricted to countries that had a Rule of Law Index less than .8 at the time of enactment.

100. Ginsburg 2005.

ICA, extensions of the findings presented above should include greater empirical attention to the mechanisms of interaction between transnational and domestic institutions. I have attempted to set parameters around such an investigation by synthesizing the debate in a broader context of the growth of transnational private authority. The theoretical framework presented in this paper calls attention to two related phenomena: orchestration and professional integration. The former asks whether local institutions retain rulemaking authority.<sup>101</sup> The second mechanism, professional integration, demands a closer, cross-national examination of how ICA influences local professional incentives. The work of Dezalay and Garth and, more recently, by Florian Grisel provide a foundation for such an investigation.<sup>102</sup>

More broadly, the findings presented here lend support to Ginsburg’s plea for scholarship of emerging trends in global economic governance to consider not just first-order effects (i.e. does this regime promote cooperation in this specific issue area?) but potentially unexpected second-order effects as well. Before declaring international arbitration a “success” for the rule of law because of the incredible ease by which international commercial actors can enforce contracts and protect their rights abroad, we need to evaluate the downstream effects that are likely to hit developing countries hardest. The findings reported here fit, for example, with the work of Cristina Bodea and Fanjin Ye, who find that the international investment regime is also harming human rights practices abroad by limiting state’s ability to implement progressive political, economic and social reforms that an arbitrator might deem harmful to the rights of foreign investors.<sup>103</sup>

The emergence of transnational, private authority in global economic governance comes with risks. Transnational authorities haven proven to be effective actors in the promotion of human rights as well as higher labor, environmental and product standards.<sup>104</sup> But transnational authorities, like their national counterparts, are subject to capture from interest groups or myopic experts.<sup>105</sup> And much work remains to be done to better understand not just the effectiveness of transnational authorities themselves, but how the interaction between transnational and national authorities influences domestic governance outcomes outside of the narrow domain of any given

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101. This is the focus of my other job market paper currently under review, “Substitute or Complement? International Commercial Arbitration and the Diminishing Authority of Domestic Courts.”

102. Dezalay and Garth 1996; Grisel 2017.

103. Bodea and Ye 2018.

104. E.g. Vogel 2008; Abbott and Snidal 2009; Meidinger 2009.

105. E.g. Nelson 2014; Sending 2015; Kennedy 2016; Lienau 2016.

transnational governance scheme. Progressive rule-of-law reform is most likely to succeed when foreign commercial actors and local civil rights groups have a *joint* interest in pressuring the state to invest in such reforms. The growth of substitutive global governance institutions risks undermining efforts in low income and developing countries to invest in broad-based legal reforms by giving commercial actors an exit option unavailable to others. This emerging trend is especially important given the complexity of political accountability in global governance regimes. Simple lines of accountability channeled through visible, bundled domestic institutions facilitate coalitions for reform by clarifying the causal connections between governing institutions, tasks and outcomes. But the nebulous, decentralized world of specialized, transnational authority diffuses accountability across an ever-growing array of overlapping authorities and shrouds political decision-making behind a veil of expertise. The theory and empirical findings presented here suggest that the design of transnational institutions is key and that we should focus on both the institutional and sociological dimensions of transnationalization. My results suggest that transnational institutions that are not designed to lock-in both interdependence between transnational and national authorities and the interpenetration of professionals between transnational and national sites of authority may have the unintended consequence of causing local institutions to atrophy.

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## A List of Included Model Law Countries

Weak Rule of Law						High Rule of Law		
Country	$t_i$	Rule of Law	Country	$t_i$	Rule of Law	Country	$t_i$	Rule of Law
Armenia	2006	.26	Mauritius	2008	.73	Australia	1989	.99
Azerbaijan	1999	.04	Mexico	1993	.37	Austria	2006	.95
Bahrain	1994	.24	Nicaragua	2005	.38	Canada	1986	.98
Bangladesh	2001	.31	Nigeria	1988	.13	Chile	2004	.88
Belarus	1999	.26	Oman	1997	.57	Costa Rica	2011	.91
Bulgaria	2002	.75	Paraguay	2002	.40	Cyprus	1987	.85
Cambodia	2006	.14	Peru	1996	.14	Denmark	2005	1
Croatia	2001	.79	Philippines	2004	.50	Estonia	2006	.98
Dom. Rep.	2008	.32	Russia*	1993	.26	Germany	1998	1
Egypt	1994	.25	Rwanda	2008	.63	Greece	1999	.81
Georgia	2009	.79	Saudi Ara.	2012	.30	Hungary	1994	.92
Guatamala	1995	.28	Sri Lanka	1995	.57	Ireland	1999	.97
Honduras	2000	.28	Thailand	2002	.52	Japan	2003	.98
India	1996	.71	Tunisia	1993	.20	Lithuania	1996	.92
Iran	1997	.40	Turkey	2001	.79	Norway	2004	.99
Jordan	2001	.62	Uganda	2000	.42	New Zeal.	1996	.99
Kenya	1995	.20	Ukraine*	1994	.29	Poland	2005	.94
Macedonia	2006	.65	Venezuela	1998	.52	Singapore	1994	.97
Madagascar	1998	.30	Zambia	2000	.61	Slovenia	2008	.90
Malaysia	2005	.40	Zimbabwe	1996	.64	Spain	2003	.99

Table A1: List of High and Low Rule of Law Countries

\*Ukraine and Russia not included in main analysis due to missing data. See Figure B1 for results with these countries included.



# B Alternative Specifications

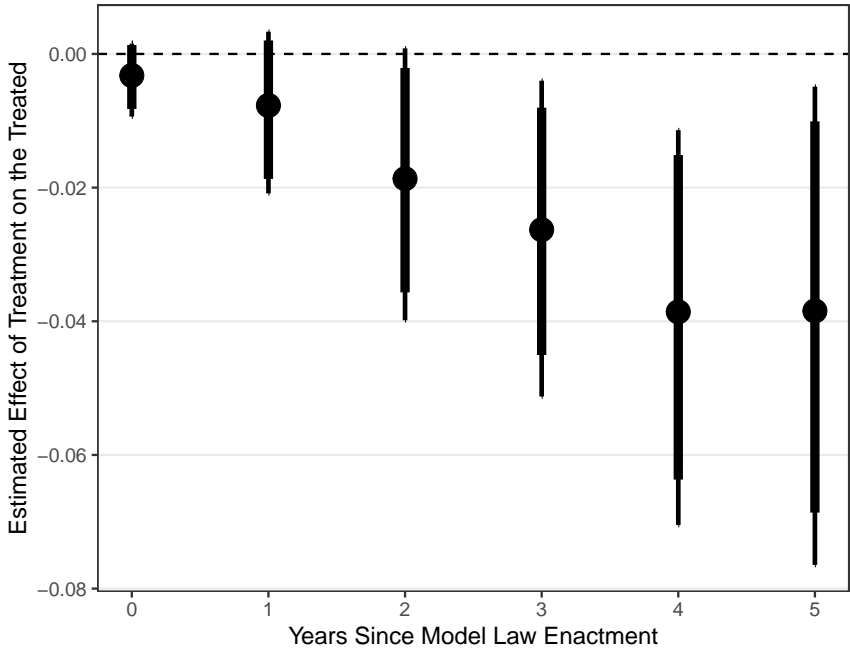
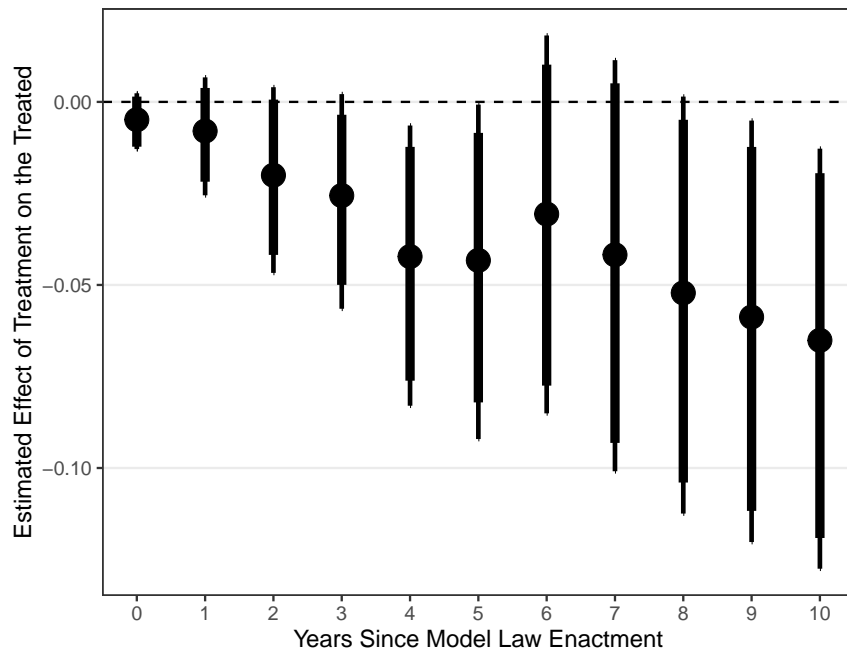
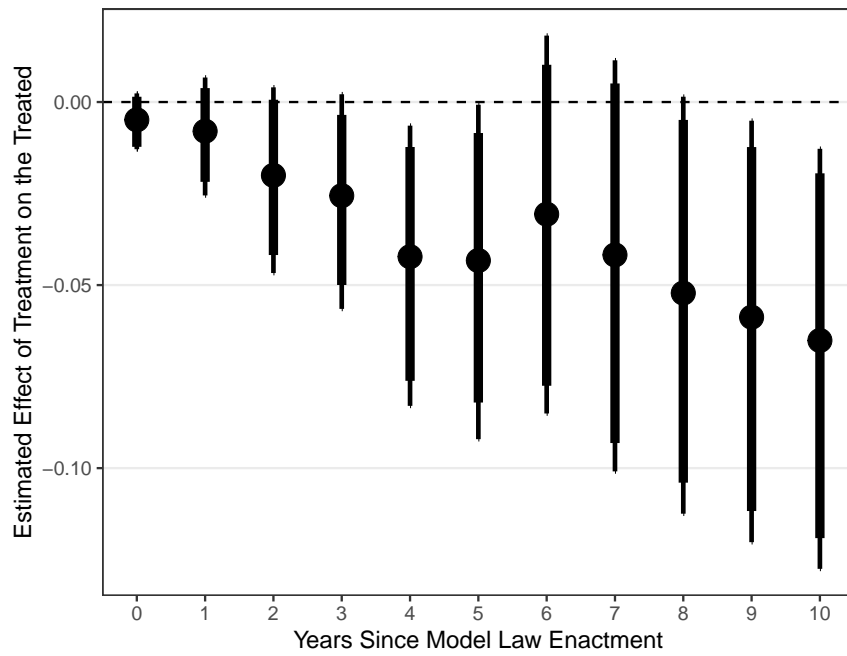


Figure B1: ATT with Missing Data Allowed

**Note:** Only low rule of law countries included. Matching on missing data adds Russia and Ukraine into analysis. The thick and thin black bars plot the 90% and 95% confidence intervals, respectively.



(a) Low Rule of Law Sample



(b) Low Rule of Law Sample, Inc. Russia and Ukraine

Figure B2: ATT, Low Rule of Law Sample, Ten Year Lead ( $F = 10$ )

## C Covariate Balance Pre- and Post-Refinement

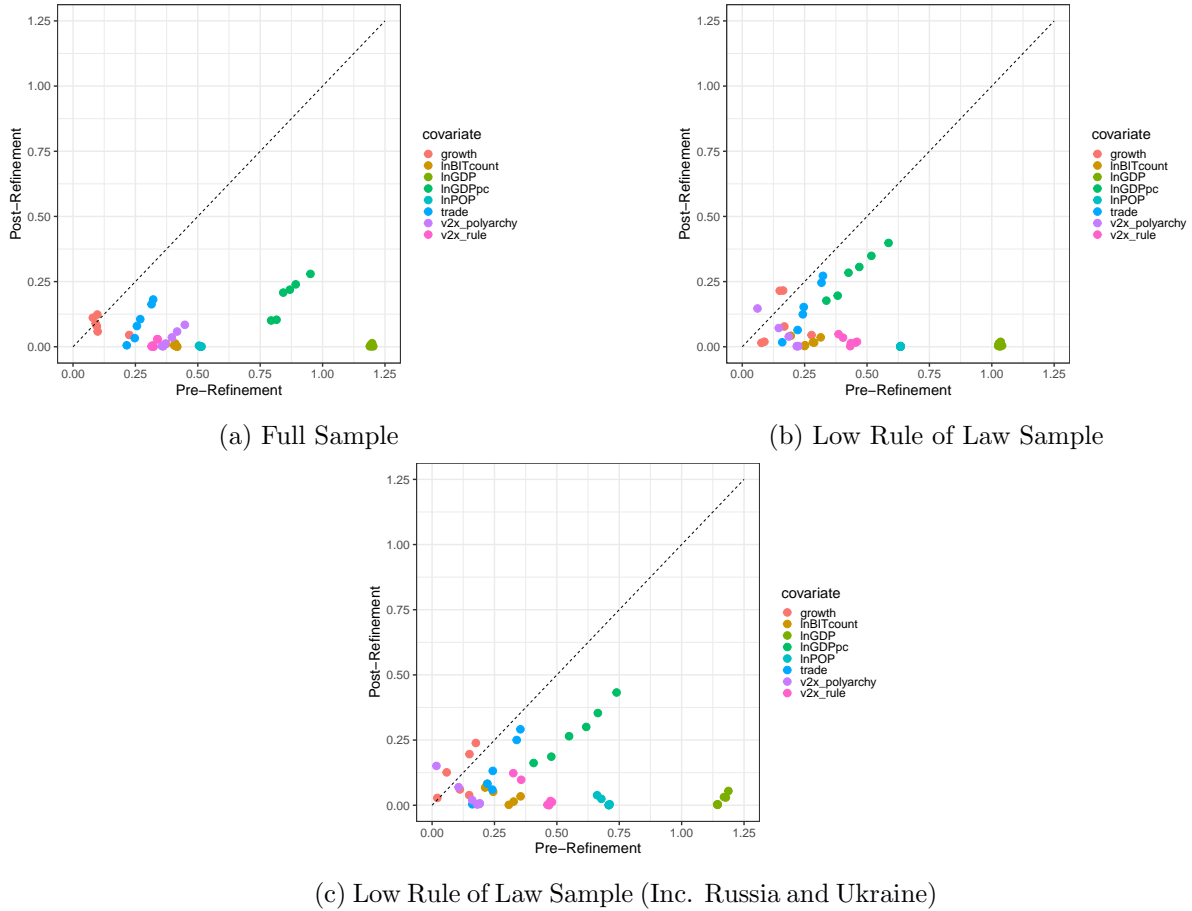


Figure C1: Covariate Balance

**Note:** Each figure plots the absolute value of the standardized mean difference (pre- and post-refinement) of covariates across all matched sets and in each time period. Points below the dashed reference line indicate improvement of covariate balance post-refinement.

## D Assessing the Parallel Trends Assumption

Following the recommendations of Imai, Kim and Wang, I use pre-treatment trends in the covariate balance between treated and weighted control groups to assess potential violations of the parallel trends assumption.<sup>106</sup> In Figure D1 below, I plot the normalized mean difference in pre-treatment covariate balance for each of the 5 years prior to Model Law enactment (this is based on Column 2 in Table 3 in the main text). The left panel plots balance for the *unweighted* control groups, while the right panel plots balance for the *weighted* control groups. This shows weighting improves covariate balance dramatically. Prior to refinement, the trend on Rule of Law is relatively flat, though (unweighted) control countries tend to have higher rule of law scores on average. Post-refinement, however, the balance is improved greatly and the treatment group has very slightly higher rule of law scores. Importantly, the trend on rule of law is quite flat, indicating that the parallel trends assumptions holds.

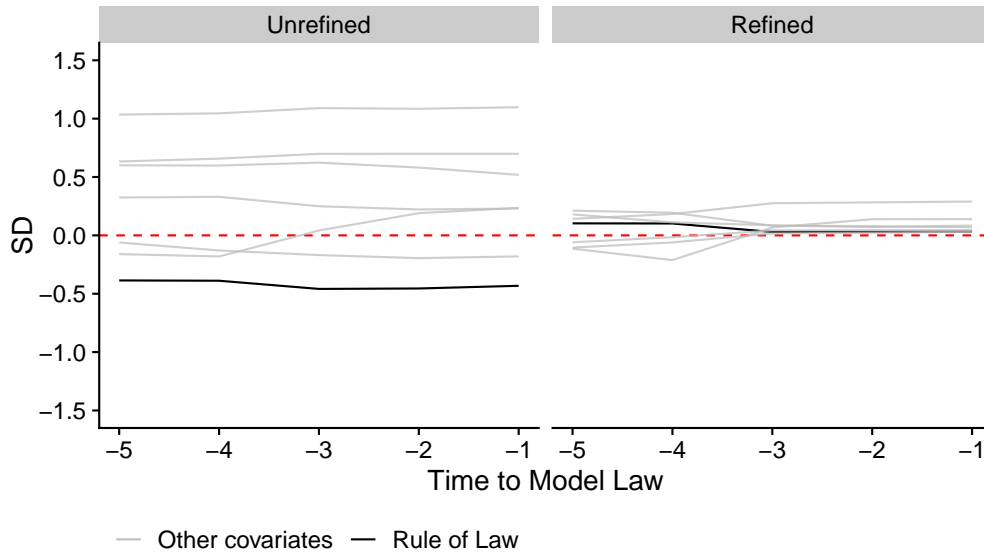


Figure D1: Pre-treatment Covariate Balance between Treated and Control Groups

106. See Imai, Kim and Wang, forthcoming, 18.