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Introduction

At the beginning of the medieval era it would have been difficult to guess that Venice, a muddy archipelago in the northwest Adriatic, would become the dominant trading power of the Renaissance. It had limited access to fertile land until it was strong enough to impose suzerainty over the eastern Po river valley. It faced the lucrative trade routes of the eastern Mediterranean, but contemporary seafaring technology also put these in reach of rivals like Genoa, Pisa, and Amalfi. It achieved a string of early military victories, but these were as much a product of luck as prowess in combat (Crowley 2012).

Venetian prosperity sprang, instead, from a less tangible source – its institutions. Unencumbered by feudal practices, the city developed one of the most inclusive political systems of its time, with a broad base of *citadini orignarii* and noble families represented in government (Finer 1997). Without strong feudal hierarchies to order social relations, and with a somewhat tenuous connection to the Church, the Venetians turned to a different source of authority: law (Ikins Stern 2004). This commitment can be seen today in the statue of Justice, with her sword and scales, which stands atop the *Porta della Carta*, the ceremonial entrance to the ducal palace on St. Mark's Square.

Venice's strong rule of law nearly killed the eponymous character of Shakespeare's *The Merchant of Venice*. Antonio wanted to help finance his friend Bassanio's courtship of the lovely heiress Portia. But Antonio's wealth, though substantial, was tied up in a number of foreign trading expeditions. He therefore borrowed 3000 ducats from Shylock, a Jewish moneylender, offering a pound of his own flesh as collateral. Antonio obviously hoped this was a noncredible commitment. After all, who would demand such a forfeiture, much less enforce it? This proved a mistake. Antonio's ships were lost at sea, and Shylock, driven mad with grief when his only daughter ran off with a Christian (Bassanio's friend, it turned out), demanded payment. The dispute thus came before the ducal court,

with the Doge himself presiding before an assembly of angry Venetians. Shylock was adamant,

> The pound of flesh, which I demand of him,
> Is dearly bought; 'tis mine and I will have it.
> If you deny me, fie upon your law!
> There is no force in the decrees of Venice.
> I stand for judgment: answer; shall I have it?

The Doge was at a loss. If he refused Shylock's claim, he would undermine Venetian law and thus the source of its prosperity. But upholding the bond would endorse Shylock's grim vengeance and outrage his constituents, who wanted the city's judiciary to protect their own. As many courts have done, the Doge decided to refer this vexing question to a private legal expert, an individual we might today call an arbitrator. Conveniently, one had just arrived from Padua.

The arbitrator, "a young and learned doctor," knew that the law must not be ignored:

> It must not be; there is no power in Venice
> Can alter a decree established:
> 'Twill be recorded for a precedent,
> And many an error by the same example
> Will rush into the state: it cannot be.

And so the arbitrator bade Shylock claim his gory award. But fortunately for Antonio, the contract only specified a pound of *flesh* as collateral. It said nothing about blood. The young doctor interpreted this language literally:

> Take then thy bond, take thou thy pound of flesh;
> But, in the cutting it, if thou dost shed
> One drop of Christian blood, thy lands and goods
> Are, by the laws of Venice, confiscate
> Unto the state of Venice.

In this way the young arbitrator – who was actually, in typical Shakespearean fashion, the newlywed Portia dressed as a man – elided the difficulty before the court by finding a solution somewhere between law and politics.[1]

Shakespeare's story bears the prejudices of its day, but it highlights a very contemporary issue. Shylock's claim dramatized a quotidian but

[1] For a discussion of the play's jurisprudence and the surrounding social issues, see Posner, R. (2013). *Shylock on Trial: The Appellate Briefs*. Chicago, Chicago University Press.

essential problem that Venice had to solve as its trading empire expanded across the Mediterranean world. How could disputes between different communities be resolved? As Shylock saw, the courts of the Venetian state could be biased against outsiders. But as the Doge knew, blatant partiality would undermine the ability of Venetian merchants to make credible contracts. Contract enforcement within the city-state was difficult enough, but how could the rule of law be imposed on commercial relations that ranged from Cadiz to Alexandria? On an even broader scale, how can this foundational public good, the rule of law, be extended to today's global economy?

1.1 Dispute resolution as a laboratory for shifts in global governance

There is perhaps no greater consensus in political economy than on the importance of the rule of law for economic exchange. Merchants need a way to make their deals credible, and the laws of the state are regarded as the most effective guarantors of that fidelity. For this reason, economists – following Shakespeare's Venetians – have argued that "the creation of the state in the millennia following the first economic revolution was the necessary condition for all subsequent economic development" (North 1981, 24; see also Greif 2006; Acemoglu and Robinson 2012). But if the rule of law is essential for economic exchange, how is it possible to sustain a global economy where both "rule" and "law" are divided between nearly 200 sovereign states?

This dilemma applies not only to commerce but also to an increasing number of the problems societies confront in a globalizing world: financial regulation, environmental degradation, disease, crime, basic security, and so on. Given that our preeminent political institution remains the territorial state, how can we manage situations of interdependence (Keohane and Nye 1977), in which problems span borders, and policies in one part of the world have repercussions for distant people and places?

Most policy makers and scholars of international relations have a ready answer to this dilemma: the international institution. Since the nineteenth century, countries have increasingly managed interdependence by cooperating through formal treaties and law-based intergovernmental organizations. In our highly interdependent world, state-to-state bodies like the United Nations or the World Trade Organization (WTO) rank among the most important political institutions alongside the countries that create them. And their weight is growing. In 1909, 37

intergovernmental organizations existed; in 2013, the number of organizations and their outgrowths had grown to 7710 (Union of International Associations 2014). The study of these institutions has become a dominant strand of international relations (IR) scholarship.

So does intergovernmental cooperation solve the dilemma of managing interdependence in the world economy? The parallel to the domestic context is appealing. Just as a state provides the rule of law needed for national economies to prosper, so international cooperation between states allows our globalized economy to function.

This book shows that the truth is, as in a Shakespearean play, more complex. It examines a core institution of the global economy, the regime for transborder commercial dispute resolution, which gives companies from different parts of the world a way to settle conflicts between them. This regime includes "traditional" intergovernmental agreements, but it functions chiefly through thousands of private arbitration tribunals, linked to domestic courts both in formal law and through networks of private lawyers. We could not have a global economy without some way of ensuring cross-border dispute resolution between traders, but the regime that performs this function bears little resemblance to the public intergovernmental institutions envisioned in established theories of international institutions.

There is much at stake in this discrepancy. Intergovernmental institutions are increasingly challenged by shifting power relations between states and the profound deepening of interdependence that multilateral institutions themselves have helped to engender. A flurry of books has identified a general state of "gridlock" in multilateralism (see, e.g., Hale *et al.* 2013). But we also live in a period of enormous innovation in global governance. In recent decades, there has been a proliferation of so-called transnational institutions (Hale and Held 2011) that include a far wider variety of actors, public and private, and take a multiplicity of forms. These include "transgovernmental" networks of bureaucrats, mayors, judges, and legislators (Nye and Keohane 1971; Slaughter 2004; Slaughter and Hale 2010); "multistakeholder initiatives"; and "public–private partnerships" that bring together coalitions of actors to tackle some common problem (Benner *et al.* 2003; Schäferhoff *et al.* 2009); and private regulations that solve collective action problems with little or no state intervention (Büthe 2010; Abbott and Snidal 2000; Pattberg 2007; Vogel 2008; Green 2013).

Scholarly understanding of formal intergovernmental organizations is now relatively sophisticated, but academic theories are still catching up with the proliferation of newer institutional elements in global

governance.[2] Most existing IR scholarship on the topic has focused on the environment, human rights, public health, and finance, because these are particularly dynamic spheres of institutional innovation. This work is important but suffers a key limitation. Because any form of global governance in these areas is relatively recent, and because transnational governance in those spheres is even more recent, it is difficult to explain these new institutions. Under a short time scale, general dynamics cannot be parsed from historically contingent factors. Moreover, many of the new transnational institutions confront issues like environmental degradation or social rights that can be seen (wrongly, in my view) as secondary policy concerns and therefore not central to the study of world politics.

This book, instead, looks at one of the oldest and most fundamental areas of global governance: how traders solve disputes with other traders when they buy and sell across borders. Centuries before the nation-state took its modern form, merchant tribunals were providing the rule of law for economic exchanges between different communities. Today, private arbitral institutions fulfill the same task for vast swaths of global trade, although public courts also play this role. Adding further complexity, governments in all major trading nations have made the decisions of private arbitral tribunals enforceable in public courts. This policy has been adopted in many countries through national laws and judicial decisions but has also been institutionalized through an array of bilateral, regional, and multilateral treaties, the most important being the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (NYC). This sprawling regime for transnational commercial dispute resolution is therefore best thought of as a hybrid, plural, institutional ecosystem in which transnational tribunals, intergovernmental commitments, and domestic courts all play a role. Given the

[2] This is not necessarily surprising. It took until the 1970s before IR theorists first articulated what is today considered the most plausible explanation for postwar international organization. The theory remained contested until after the Cold War, a half-century after the principal institutions it sought to explain were created. Nonmultilateral forms of global governance were recognized by political scientists in the 1970s as well, but then largely overlooked until the 1990s. Key works from the 1970s include Kaiser, K. (1971). "Transnational Politics: Toward a Theory of Multinational Politics." *International Organization* 25: 790–817; Mansbach, R., Y. H. Ferguson *et al.* (1976). *The Web of World Politics: Nonstate Actors in the Global System.* Englewood Cliffs, NJ: Prentice Hall. A key volume restoring interest in transnational politics in the 1990s was Risse, T. (1995). *Bringing Transnational Relations Back In: Non-State Actors, Domestic Structures and International Institutions.* Cambridge: Cambridge University Press, which was built on by Keck, M. E. and K. Sikkink (1998). *Activists beyond Borders.* Ithaca, NY: Cornell University Press. For a discussion of this intellectual history, see Hale and Held (2011, 8).

prominence of private arbitration in this arrangement, this book refers to the regime for "transnational commercial arbitration" (TCA).

Commercial dispute resolution offers a fascinating laboratory in which to study the general question of institutional variation in global governance. Its centuries of history provide a vast empirical record for analysis. It is also fundamental to contemporary political economy; without a mechanism for credible deal making across borders, our economies would look far different. This "real-world" importance is matched by its relevance to theories of the state; few functions are more fundamental to the concept of the modern state than the rule of law. And finally, the regime for commercial dispute resolution *works*. In a world where many global problems seem mired in gridlock, it provides a strikingly successful example of global public good provision. The chief goal of this book, therefore, is to explain the evolution of the TCA regime as way to learn something broader about the conditions under which institutions to manage transboundary problems vary and how they can succeed.

1.2 Law and politics

The substantive importance of commercial dispute resolution underlines the second goal of this book to: to bridge the political science and legal literatures on this topic. This requires, in the first instance, bringing commercial dispute resolution fully into the domain of mainstream international political economy (IPE). This subfield of political science, which seeks to understand the politics and institutions that shape the world economy, has produced reams of studies on state-to-state disputes (such as those in the WTO or in preferential trade agreements [PTAs]) and disputes between states and private investors, which also rely on arbitration under bilateral investment treaties (BITs) or other agreements. But just a handful of IPE studies (see later) have considered commercial disputes between a buyer and a seller in different jurisdictions, even though such transactions are arguably the atomic unit of the global economy.

That is not to say that nothing is written on the topic. Legal scholars, particularly those involved in the practice of arbitration, have produced a vast and sophisticated literature on commercial dispute resolution. And a number of scholars have recognized the TCA regime as indicative of broader trends in global governance and the relationship between public and private authority (Wai 2002, 2005, 2008; Calliess and Zumbansen 2010; Watt 2011). The topic has also attracted significant attention from sociolegal scholars, including Dezalay and Garth's seminal 1997 *Dealing*

in Virtue. A recent volume edited by Mattli and Dietz (2014) gathers various perspectives on arbitration as a form of global governance.

For these scholars, the book instead aims to demonstrate the utility of a social-scientific approach that explains institutional outcomes by empirically testing falsifiable hypotheses derived from theory. This approach allows us to say how economic and political forces shape institutional outcomes, including the very laws and legal processes that legal scholars take as their subject.[3] The book's empirical analysis also brings to light new evidence from quantitative, qualitative, historical, and archival sources that even veteran arbitration practitioners may find revelatory.

Inevitably, in bridging these two literatures, the book explores the theoretical relationship between politics and law in global governance, again using commercial dispute resolution as a testing ground. For the political scientist, policy outcomes are explained by contestation between different interests and vary by the constellation of power and preferences that surround an issue area. Law is largely the outcome of this process. For the legal scholar, in turn, the rules laid down by political institutions are merely a starting point. They must be implemented and interpreted in the context of a body of rules, practices, norms, and procedures, and it is this process that shapes outcomes. The relationship between these dynamics is complicated even within the context of a nation-state and has been much discussed in both legal and political literatures (Dworkin 1986; Slaughter Burley 1993; Whittington *et al.* 2010). Transborder commercial dispute resolution offers a perspective on these issues from a rather different context in which (1) no overarching state exists, (2) public law is contingent on voluntary cooperation among sovereign entities, and (3) private actors can create, apply, and enforce law themselves.

1.3 The question: institutional variation in transborder commercial dispute resolution

With these larger goals in mind, consider the problem that vexed Shakespeare's Venetians, the creation of trust in commercial relations. Exchange depends on the ability to make credible deals, or, as Hume put it, "the freedom and extent of human commerce depend entirely on a fidelity

[3] As the editors of a prominent handbook of the field of law and politics put it, "the starting point for the study of law and politics is that politics matters and that considerable analytical and empirical leverage over our understanding of law and legal institutions can be gained by placing politics in the foreground" (Whittington *et al.*, 2010, 2).

with regard to promises."[4] Achieving this trust is straightforward for basic, face-to-face transactions: a deal is negotiated, the two goods (or their monetary equivalents) are presented, and each party hands his good to the other.

But few exchanges are so simple. Imagine that one party is much stronger than the other. The strong party may, after agreeing to certain terms of exchange, later break her promise. When this occurs, the weaker party will be left without recourse and may thus refrain from trading in the first place. Both parties will be worse off. Alternatively, consider an exchange that occurs across time or space, so that neither party can verify that the other will uphold his part of the bargain. Put another way, each knows she could cheat and get away with it. Again, this risk may scare both parties into forgoing an otherwise beneficial exchange.

The solution to these and other credibility problems, which characterize the vast majority of commercial exchanges, particularly those that cross borders, is an institution. Many are possible. At the most basic end of the spectrum, a contract enforcement institution could be something as simple as a shared understanding that those who cheat will not be bargained with in the future. Alternatively, we could imagine something as formal as a legal contract that gives an aggrieved party recourse to a public court of law that can adjudicate claims and rely on the power of a state to enforce decisions. Whatever the arrangement, dispute resolution – a process through which parties can raise disagreements, determine a solution, and enforce it – is a key function. Creating and maintaining an institution to provide this function is a collective action problem that all traders must solve.

Many different institutional solutions have arisen across time and space (a historical overview is given in Chapter 2). For much of Chinese history, the state eschewed involvement in commercial dispute resolution, leaving the matter almost entirely to private merchant guilds (Ma 2004; Hamilton 2006). Similar arrangements could be found in the emergent City of London, among the Hanse merchant groups in the Baltic, and elsewhere in premodern Europe. Foreshadowing the current hybrid system, some of these private bodies operated with the explicit permission of governmental authorities. For example, Milgrom *et al.*'s (1990) seminal article on the Champagne fairs has been widely recognized in the political economy literature as a quintessential example of a private ordering.

[4] This quote serves as an epigraph for McMillan, J. and C. Woodruff (2000). "Private Order under Dysfunctional Public Order." *Michigan Law Review* 98(8): 2421–58.

Interestingly, however, these fairs operated with the explicit permission of local authorities and depended on their goodwill (Sachs 2005).[5]

In other parts of Europe, such as Shylock's Venice, public authority was more direct, and state courts provided the principal tools of commercial dispute resolution (González de Lara 2008). Indeed, the Serene Republic imposed its own laws on its trading partners via military force (if needed). In the nineteenth century, European powers, as well as the United States and Japan, imposed a similar system of extraterritorial jurisdiction on trading ports ranging from the Ottoman Empire to the East China Sea. In Latin America, the dominant powers frequently eschewed institutions altogether and simply resolved disputes with gunboats.

How can we explain variation in arrangements for transborder commercial dispute resolution? And how can we explain the evolution of the present hybrid regime?

The book aims to answer this question by developing and testing theories of institutional variation. Following Keohane (1982), I break this research question into two parts. First, why do actors *demand* certain institutions? When firms sign a contract, they typically choose what form of dispute resolution will be employed. Why do they choose one or another? Second, why are different institutional alternatives *supplied*? This second part can itself be split in two. Why do private actors form institutions to supply dispute resolution, and why do states back private tribunals with public authority? A comprehensive account of variation, like the ones summarized here and developed in more detail in Chapter 3, should answer all these questions.

1.4 The argument: market power, legal networks, and their interaction

This book considers two very different explanations for institutional variation in commercial dispute resolution, which roughly fall under the opposing banners of politics and law.

The first explains private dispute resolution as the product of self-interested economic actors seeking material advantage. In 1936 the political scientist Harold Lasswell wrote a book titled *Politics: Who Gets What, When, How*, and the subtitle remains a valid précis for the field's approach to this day. Very few political scientists would dispute the idea that, on

[5] For a more wide-ranging critique, see Kadens, E. (2012). "The Myth of the Customary Law Merchant." *Texas Law Review* 90: 1153–1206.

average, states create international institutions to advance their interests (which are themselves influenced by domestic interest groups) and that global institutions reflect the constellation of interests and power that surround them. Scholars advance similar arguments for transnational governance arrangements in which nonstate actors negotiate over institutions to achieve benefits from cooperation just as states do (Abbott and Snidal 2000). Such theories would not expect the TCA regime to be any different.

In this vein, the book develops a rationalist, materialist argument for the TCA regime based on market power. A trader's position in the market – its ability or inability to compel its counterparties should a dispute arise – determines its preferences over (or "demand for") dispute resolution institutions, I argue. When a firm is dominant, it can compel a weaker firm to accept an institution that favors the strong, or force the weaker firm out of the market. When, instead, firms are roughly equal in power, or when the market is so uncertain that firms cannot know what their future position will be, more neutral institutions are preferred. Depending on where they sit, firms then push for the institutional arrangement that serves them best, arbitraging across different spheres of authority – domestic, intergovernmental, and private – to get what they want. Their ability to succeed in any given locus of political contestation is determined by the attendant constellation of power and interests, which determines the "supply" of institutional outcomes. I term this rationalist theory the "market power" explanation. Note that this explanation does not require all firms to always maximize their options at all times; it simply argues that we can parsimoniously explain institutional outcomes as if firms act this way on average.

The second explanation, which builds on the existing sociolegal literature on commercial dispute resolution, instead attributes the rise of commercial arbitration to sociolegal processes. It recognizes the social field of law as an active force that shapes actors' behavior and, thus, institutional outcomes. I argue that firms and policy makers often defer to legal expertise, meaning that both the "demand" and "supply" of dispute resolution institutions follow trends in legal opinion. I also note how transnational networks of legal experts can transmit norms across legal fields through a process of legal contestation. In this "legal networks" explanation, institutional variation follows shifting patterns of legal norms and practices across the globe.

These theories, market power and legal networks, offer two alternative explanations for institutional variation. The analysis thus considers the