

CAN STATES BE BUILT USING COMMERCIAL LAW?

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In the new era of international relations ushered in by the end of the Cold War, nation building has become all the rage. In a burst of Wilsonian optimism, western countries have sought to recreate failed states in their own image, fashioning new governmental institutions from the ashes of war or civil collapse. These projects have become possible in a fresh environment of international consensus that has prevailed since the middle of the 1990s, and they have been driven by legions of international experts employed by multilateral and bilateral development institutions, from the World Bank and USAID to a myriad array of UN agencies and private contractors. Developing improved legal institutions has been considered a particularly important component of any state building project, and has been a primary focus of almost all such efforts. A new label has been created to describe exercises in developing legal institutions: the rubric describes them as “rule of law” or “legal and judicial reform” projects. The aim of these exercises is to fashion the legal system of the target country along principles found in the legal systems of developed western states: promoting judicial independence, legal transparency, civil rights and market freedoms. This, it is said, will promote three goals: economic development, political stability, and reconciliation after conflict.

Of those three goals, this paper discusses the first. It will turn out to be a multi-faceted investigation, to which this article can serve only as an introduction. The paper begins in a theoretical vein, by asking how rule of law can promote economic development, and what it must encompass to achieve that goal. It then focuses upon the models used by practitioners of legal and judicial reform projects to build effective systems of commercial law, and how they hope to promote domestic commerce, foreign investment, and economic growth in an impoverished country. It will then turn to a series of generic problems such projects have encountered, and explain why rule of law is so hard a goal to pursue by international intervention in a post-conflict “new” state. It concludes by setting

out some lessons to be learned for future rule of law projects. While this paper will not seek to give exhaustive answers to each of the issues it raises, it hopes to engage the principal issues and to act as a discussion guide for those involved in future state building attempts. The overarching theme will be that state building in general, and development of commercial law in particular, is a science in its infancy, one about which we know remarkably little. Vastly more needs to be learned and committed in resources. Until that happens, the exercise of trying to create effective commercial law, and thus promote economic development in new states, will be a tricky and elusive goal.

A modern theory of economic development

The role of commercial law in post-war nation building is not an issue that can be considered in isolation. It is a comparatively small part of a rich tapestry of research and theories of how to promote economic development in poor countries.¹ This criss-crossing array of academic inquiries is commonly called development economics, and one of the aims of this essay is to locate the topic within a set of broader inter-disciplinary themes. The thought that institutional quality is a key component to a country's political and economic success may to the contemporary reader seem obvious, but it has not always been so. It is worth beginning with a brief survey of the recent history of development economics, to understand how we reached the current view.

Before World War II, the problem of economic underdevelopment was relatively unexplored within international relations literature or practice, because the bulk of what we now call the developing world was colonized in one form or another by the European powers. Styles and motives for colonization varied. Some colonies had been established for economic purposes, generally extraction of natural resources. Some had been established to facilitate a trading network. Some had geo-political rationales: keeping the influence of other colonizing powers at bay. In some instances there was a desire to

¹ See generally Fukuyama (2004), which sets out a clear statement of the “state building” agenda, of which promoting rule of law is one component.

improve of the quality of life of the subject people, often in the name of advancing “civilization”, but in few cases was that the overriding purpose of maintaining colonial possessions. Thus the broad problem of why large tracts of the world were much poorer than the west was not so commonly asked.

The process of decolonization after World War II and the rise of multilateral development agencies (starting with the Bretton Woods institutions)² shone new light on a hitherto relatively unexplored range of development issues. As colonies became independent, many faced social and economic collapse and high degrees of poverty. Initially it was easy to blame these failures upon latent problems inherited from their former colonial overlords, but with the passage of time this explanation became increasingly implausible as a justification for dictatorial systems of government, flat economic growth, and rampant corruption. At the same time, organizations such as the World Bank, originally established to oversee post-war reconstruction of Europe, found themselves in need of new and broader mandates as Europe’s reconstruction was completed, and they started to focus on the development problems apparent in the rest of the world. Thus the science of development economics was formed.

Initially development economics did not focus upon client countries’ political or legal institutions. The reason was that in the midst of decolonization and in the politically polarised environment of the Cold War, any sort of development assistance that might be characterized as political interference or ideologically driven was unacceptable. The World Bank could not advocate free markets or democracy, or it would be excluded from participation in countries under the influence of the Soviet Union and China and its multilateral status would be compromised. So the theory came to fit the practice. The first theory prevalent within development economics was the comparatively simplistic thought that countries are poor because they lack (financial) capital. With capital injections, their economies would receive a Keynesian boost and development would occur naturally

² The World Bank and the IMF. They were followed by a plethora of other multi-national development banks (e.g. the European Bank for Reconstruction and Development, the African Development Bank, the Asian Development Bank and the Inter-American Development Bank) and a tradition of establishing bilateral development agencies within western governments (e.g. USAID, the UK’s DfID, Sweden’s SIDA).

thereafter. This model fitted well with the desire by the international development banks to lend money. But it didn't work. The money loaned was wasted in many cases and growth remained negligible. The next theory to replace it was thus that the capital had to be directed into projects that facilitated industrial production. The emphasis was on infrastructure: development agencies funded roads, airports, power stations, telecommunications and railways. Again the results were very mixed, but projects of these kinds were all that could be realistically achieved in the Cold War world of international relations without courting excessive political controversy.³

With the collapse of the Soviet Union and the capitalization of China, a politically more ambitious range of development projects could be initiated. So the theory went, just as businesses need roads, railways and ports, likewise they need light regulation, low and transparent taxes, and fast and effective legal systems. There was no longer a powerful communist ideology to preclude multilateral interventions focusing upon advancement of western economic and political goals. A new discipline within economics emerged, calling itself "neo-institutional economics".⁴ Its central thesis was that the quality of political and legal institutions is a direct determinant of a country's economic growth. Successful businesses are the principal engines of economic development, and they suffocate under the weight of bad government. If government is slow, incompetent or corrupt, businesses waste their resources interacting with the administration instead of creating jobs and money. Foreign investors are deterred from investing in a country in which they cannot engage effectively with its public institutions. The most important component of a country's institutional framework is its legal system, for two reasons. First, the law can be used to hold public institutions accountable. Where legal standards are set, and there are consequences for violating them, public institutions will have incentives for raising their game that may not otherwise exist. True, there may be electoral accountability mechanisms: where governments are guilty of maladministration

³ This brief survey of themes in development economics since the end of World War II owes a great deal to Kenneth Dam. See Dam (2006).

⁴ Perhaps the seminal text applying neo-institutional economics to development is North (1990); see also Eggertsson (1990).

the voters may eject them from office. But developing countries may have highly imperfect democratic procedures, in which voting patterns do not reflect perceptions of administrative competence to any significant degree.

Second, reliance on legal institutions enables commercial partners to engage in sophisticated transactions. Where two private individuals (or corporations) want to do business, they rely upon the concept of enforceable promises. In virtually every developing country worldwide, contract law is poorly developed. If two business partners have no confidence that a court will enforce the terms of an agreement they reach, the incentives to observe that contract will be greatly diminished. They will not necessarily be zero, for there may be reputational consequences to contractual default.⁵ But there are certain recurring features of economies with poor rule of law. One is the prevalence of “point transactions”: economic activity tends to be confined to interactions in which no trust is necessary, or there is the prospect of enforcement by immediate violence. I want to buy a book. You have a book for sale. I can meet you, look at the book in your presence, and pay you money in exchange for it, even where there is no effective legal system. There will never be any need for either of us to sue the other, for I can inspect the book before I accede to the exchange and if I attempt to abscond without payment you can take immediate action against me. However, without a court system I would not buy the book from you via mail order, because if I send the money first before delivery I have no legal recourse against you if you do not send the book back to me. A society without rule of law cannot fully develop mail order, because mail order is not a point transaction.

Another recurring feature of societies with poor rule of law is a culture of family and personal connections in business transactions. People cannot trust strangers, because there is no enforcement mechanism. So they only trust people with whom they otherwise have close personal connections, in the hope that those personal bonds will keep people to their commercial promises. In much of the developing world, personal relationships

⁵ Incentives to observe contractual promises may also be created in “repeat play” situations, in which contractual counterparts may have future opportunities to engage, but will do so only where prior contractual commitments have been honored: see North (1990).

are far more important in business than they are in the west. Personal relationships of trust take the place of impartial and enforceable dispute resolution mechanisms. But this is deleterious to the economy, because it significantly limits the set of people with whom any one individual can do business. The American consumer thinks nothing of contracting over the Internet to purchase something from a person thousands of miles away about whom he or she knows nothing. A consumer in Cairo may not buy anything unless sourced from a shop belonging to his friend or relative, for lack of recourse should he turn out to be defrauded. The American consumer has far greater choice, and thus prices are lower for the same goods. And the American entrepreneur has a far greater market for his products, because he is not confined to his personal contacts in his marketing efforts. Economic growth is severely fettered by bad or unenforceable contract law, and it is an imperative component to any plan for economic growth to take measures to improve commercial law. It expands markets, dissolves business cultures based upon personal relationships, opens opportunities to strangers and foreigners, and allows for sophisticated temporally extended transactions using loans, deferred payments, and future commitments. All this is foreclosed for the participant in a commercial culture without rule of law: all he or she can use as a locus for commercial activity is point transactions, involving immediate cash payments in exchange for immediate goods or services and without any future commitment by either party.

Yet another component of societies without developed rule of law is the lack of faith in marketing and advertising by either vendor or consumer. In developing countries, consumers of a product do not generally trust any representations made about the product they are buying. This is because there are no legal repercussions for a vendor should they make false or misleading statements. Everybody knows this, and therefore they do not believe what they are told in the course of a business transaction, save that they can observe for themselves at the “point”. Vendors also realise this, and thus they spend comparatively little time or money conducting sophisticated advertising which is unlikely to be believed. Similarly, within international business circles, some countries have reputations for their businessmen economical with the truth. Those countries generally have poor rule of law. The reason businessmen in some countries do not tell the truth is

that there is no incentive for them to do so. No bad consequences follow from their lies. In their home countries, nobody believes unenforceable commercial representations. In countries with high standards of honesty, such representations may be relied upon. Conventions of business honesty are created by the institutions in the society from which one hails. The reason the United States has high cultural standards of honesty in business is that sophisticated criminal and civil penalties have been developed to penalize liars and compensate the victims of it. Where those safeguards do not exist or do not work, such conventions never have an opportunity to take root and be developed into strong social rules. This inability of parties to a commercial transaction to rely upon representations they make to one another diminishes the commercial space within countries with poor rule of law. Competition is harmed, as vendors of products cannot effectively distinguish their competing wares by advertising and marketing. Transactions are slowed down by excessive due diligence, as every representation must be individually verified. Provision of professional services is undermined, as one cannot trust what one's professional adviser says. The ability to make legally binding and enforceable pre-contractual representations is vital for business. Living in western societies, we may despair of the ceaseless daily bombardment of our senses with consumer advertising, but we ought not to complain too vociferously: sophisticated consumer marketing is the badge of our happy economic situation, and when we travel to countries in which advertising is primitive we know this to be a reliable indicator of a deep undercurrent of economic malaise.

These are some of the most important reasons why an effective commercial law is important. These ideas have been developed in the course of the debates about law and economic development. This essay is about commercial law in new states. That may seem to be a distinct topic, but one that is intimately related. To appreciate the close link between the two topics, we must also say something about the recent rise of nation building and where development economics fits into it.

The notion that we can build new states, developing fresh new institutions where troubled countries or regions existed before, is a product of global political opportunity. During

the Cold War, every trouble zone became a proxy battle between the Superpowers. Since its end, a degree of commonality of interests has been more often found in keeping a region of the world politically stable by international intervention. If the United States decides to actively influence the affairs of a troubled country like Bosnia or Afghanistan, there is no longer in the Soviet Union an automatic opposition. Instead a series of more or less cooperative partners – the EU, Japan, Russia and China – may support the intervention politically, financially and even militarily. These interventions in new states have given the science of development economics a boost, because it allows western countries extraordinary leverage over domestic institutions in a post-conflict *tabula rasa* political environment, where they can impose their new ideas afresh and free of many domestic political restraints.

The most challenging feature of the practice of development economics is the following: achieving results requires compliance by a client country's political leaders, and if a project's reforms threaten their position, they are unlikely to support it. For capital injections or infrastructure improvements, such problems are comparatively rare. A new road network financed by the World Bank is (usually) unlikely to undermine the political hegemony of a ruling class. But where the international community promotes institutional reforms in developing world countries, there is a real threat to a client country's entrenched political elites, who may have strong vested interests in preserving an ineffective status quo in which the Judiciary is complicit in suppression of political freedoms, or exhibits bias towards politically preferred commercial interests. Thus applying the lessons of neo-institutional economics turns out to be very difficult in practice. The World Bank has established numerous departments to pursue legal and judicial reform and public sector administration reform, but those departments lie to a great extent idle because they cannot find willing partners in sovereign states prepared to embrace such reforms in good faith. Their positions or benefits might be jeopardized if a country's judiciary really became independent or were public sector corruption actually eliminated. But when engaging in nation building in a post-conflict context, the inconvenience of finding a willing client state counterpart with whom to cooperate can be easily disposed of. Where the international community decides to intervene in a failed or

new state, its role is inevitably far more comprehensive than for a regular development project. It may come into the country after a war, or after foreign military intervention. The country's new rulers may be hand picked by the international community, as in Iraq or Afghanistan. Compliance with a state building agenda, including practical application of the lessons of neo-institutional economics, may be a condition of their holding office. UN agencies may have formal powers in international law (as in Bosnia and Kosovo),⁶ and the level of post-war reconstruction funds and tangible foreign military presence may give the international community formidable lobbying powers. And so it is in the context of peace operations and the construction of new states that the pursuit of rule of law projects has been most pro-actively pursued, and the most significant attempts to re-craft commercial law in line with the theories of neo-institutional economics have been found.

This completes a brief survey of the latest brand of academic thinking about economic development and the role of commercial law within it.⁷ For the purposes of the argument in this essay, it is important to recognize that this thinking has not developed in a vacuum. It is a style of academic theory about economic development born of the political opportunities to practice it, and the desires of practitioners of international development to reinvent their jobs when the conventional roles of the UN and the international development agencies are under attack in the post Cold War world. This school of thinking is born not of a trial and error process of learning from prior theories, but from a desire to meet a new growth industry of state building within international relations. It will turn out that notwithstanding the beguiling simplicity of the theory, the practice of successfully applying it is far harder than one might at first instance imagine. To investigate just how difficult it is, we shall now turn to the question of what makes a system of commercial law a good one. We will then ask how people have so far gone about trying to create such a system within new states.

⁶ For an overview of the powers of Bosnia's High Representative (including the powers to dismiss officials and impose legislation), see Parish (2007). The leading UN official in Kosovo has similar *de facto* powers (although the use of such powers has not been sanctioned by the UN Security Council), as did the head of the Coalition Provisional Authority in Iraq from 2003-2004.

⁷ For more details see Dam (2006), that undertakes an analysis of a number of key themes in the rule of law that promote economic development, including contracts, the Judiciary, property relations, corporations and insolvency.

Commercial law in the developing world

The complaints made by foreign investors in emerging markets about the domestic legal systems in which they have to operate are remarkably consistent across the developing world.⁸ Some include:

- (a) abnormal litigation delay (even simple cases may take years, involving multiple procedural steps that continue without end);
- (b) excessive procedural complexity in simple interactions with the government (registering companies and land transfers, and procuring urban planning consents, being some of the most common problem areas experienced);
- (c) accompanying corruption in legal transactions (procedural complexity can be overcome only when irregular payments are made);
- (d) corruption in the courts (both amongst Judges, who may take money to decide cases, and amongst lower court staff, who may be persuaded to lose court files or certain papers within them, or place them to the back of the pile for listing hearings);
- (e) lack of familiarity by Judges and lawyers with concepts prevalent in international commercial transactions, and lack of experience of complex commercial disputes;
- (f) excessive legal formalism, entailing a preference by Judges to decide cases on the basis of technicalities rather than substance, and a habit in legislative drafting of focusing on procedural steps but ignoring declarations on substantive issues of law;
- (g) judicial bias against foreigners or in favor of those with political connections;

⁸ Hay et al (1996) describes many of the characteristics of a dysfunctional legal system, using Russia as a case study.

- (h) poor enforcement of court decisions (the process is often slow and procedurally confusing, giving a debtor ample opportunity to move assets to evade enforcement);
- (i) immaturity of legislation (laws are often drafted vaguely, being impossible to interpret definitively and making even simple business decisions based upon a clear understanding of the legislation difficult);
- (j) poor legal training (lawyers are incapable of clear legal analysis or practical advice);
- (k) corruption or other unethical behavior within the legal profession (a party's lawyers may be taking payments from other parties to a transaction or a dispute behind the client's back, or may draw a party into a transaction only to create excessive fee demands that the client must satisfy or be left stranded);
- (l) burdensome business regulation (for example environmental, banking or employment regulation). This places a foreign investor at a competitive disadvantage with local companies, who pay bribes to those who would otherwise enforce it. But such evasion techniques may not be available to foreign investors, who may not have the personal contacts to know how to pay the necessary bribes, and may be prohibited by the legislation of their home countries from making corrupt payments.⁹

It is worth making an extra comment about banking regulation: often the rules companies are forced to obey in undertaking domestic banking transactions are extremely restrictive, ostensibly as methods of tax enforcement. In many transition economy countries with Communist heritages, full documentary evidence of the purpose of a payment out of a business account is required, and the transaction must be approved in advance by the bank manager or other senior official. Local businessmen know how to manipulate this system with sophisticated fraudulent accounting; foreigners may find it virtually unusable.

⁹ The United States Foreign Corrupt Practices Act of 1977 (15 U.S.C. §§ 78dd-1, et seq.) is the most widely known piece of legislation, but many OECD member states have enacted similar laws pursuant to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the OECD Anti-Bribery Convention).

These legal problems besetting business people exist to differing degrees in almost every emerging market. They tend to be particularly acute in the context of “new states”, that have recently emerged from destructive civil conflicts and painful separations from broader unions. Such countries have typically inherited a legal system from a prior imperial or federal power. But the process of separation may have left the legal system defunct, as it may have been run by a social or ethnic group or political elite that is no longer dominant within the new state. Expertise and political stability within the system may thus have been lost. Moreover, in post-conflict environments corruption tends to be particularly rife. In the course of a civil war, the entire social fabric will typically break down. The omnipresent danger in day-to-day life causes people to ignore legal rules save to extent that there is immediate enforcement down the barrel of a gun. Legal institutions thus simply collapse: even the most basic norms of property ownership and civil liberties are ignored, never mind more sophisticated legal principles governing commercial transactions. At the same time, during civil war a new political and commercial elite may arise. This class will incorporate militia leaders, profiteers and others who in no way feel bound by the constraints of law. Huge and illegal fortunes are amassed in the course of virtually every civil war. At the end of the war, the position of the previous educated middle class elites has been undermined. Many have fled the country, and those who remain have had to compromise with the criminal classes that have taken over. This disease affects the legal system in particular, with corruption and political pressures dominating the courts and other legal institutions.¹⁰ Civil conflict is devastating to the rule of law in general and the orderly conduct of commerce in particular.

One should also note that many of the problems listed above also exist in highly developed legal systems associated with the western world: a foreigner who has experienced the full gamut of satellite and appellate litigation possible in complex commercial disputes in the U.S. or English legal systems may have plenty of cause to complain about inordinate delay. It is also important to note that these problems have

¹⁰ For detail on the Bosnia context, see ICG (1999) and ICG (2002); in the Kosovo context, see ICG (2002a).

beset legal systems in western nations in the course of their historical development. The history of American law is replete with examples of courts that suffered from home state bias, judicial corruption and partial application of business regulation. It seems that in most cases the evolution from an immature legal system to a developed modern system of legal institutions was a gradual one that accompanied economic growth and to a great extent was driven by it.¹¹ This point is worth emphasizing, for it presents the “legal and judicial reform” project advanced by neo-institutional economics with a significant theoretical challenge. Development economics has identified a correlation between maturity of legal institutions and economic development. But in advancing their methodology of improving legal institutions as an engine to economic growth, have development economists placed the relationship of cause and effect the right way round? A contrary hypothesis might be that economic growth is the driver of improvements in legal institutions, because the growth creates a politically influential business class that has a vested interest in seeing those institutions improve. If this is the principal determinant of the improvement in a country’s legal system, then is development economics placing the cart before the horse in seeking to create improvements in a country’s legal system that predate the economic growth that will make those improvements sustainable?

As with many such paradoxes, the truth may be symbiotic: the direction of causation flows both ways. We shall return to this thought a little later in this essay. But we should now turn to the solutions to the failures in the rule of law that have been used. Within the practice of development economics, a distinct sub-discipline has emerged, focusing on what is called “legal and judicial reform”. Practitioners of this art work by identifying a series of very practical problems with a legal system that typically make it ineffective in resolving civil disputes between private individuals. The faults perceived are often much the same in whichever country the practitioner operates, and the practice of legal and

¹¹ See Walsh (1995).

judicial reform has become somewhat standardised. The usual model consists of the following components.¹²

- (a) Delays are often ascribed to a lack of courts with basic equipment. There may not be enough courthouses, or courtrooms. The facilities there are may be inadequate. Projects thus construct courts and equip them adequately.
- (b) Connected with this thought, it has sometimes been proposed to establish a separate commercial court within a country's legal architecture, with standards of efficiency and independence with relatively few connections to the broader judicial system (e.g. Tanzania).¹³ This way, the wheels of commerce may be oiled by an effective commercial dispute resolution system even while the rest of the country's court structure seeks to catch up.¹⁴
- (c) Efforts are often made to reform the methods by which case disposal rates are counted. Judges have an interest in appearing busy, and therefore typically count their caseloads using metrics such as the number of hearings completed rather than the number of cases concluded. This creates an incentive for repeated adjournments (something to which inquisitorial systems of litigation may in any event be prone) and thus creates delays. Once a more rational data collection system is adopted, these perverse incentives disappear. Benign incentives can also be created by measuring and publishing mean case disposal time (writ to settlement or judgment) per Judge.

¹² For considerably more detail on international legal and judicial reform project models, see Bergling (2006) which undertakes a comprehensive overview of the components typical to such a project.

¹³ Tanzania's commercial court was established in 1999 as a subdivision of its High Court but with distinct procedures and Judges. See Finnegan (2004) for a discussion.

¹⁴ The establishment of separate commercial courts has been the subject of some criticism. Where one part of a country's court system is significantly better than the others, litigants fight to get into that court, creating satellite jurisdictional litigation, creating pressures to distort the jurisdictional rules (something found in the US with federal diversity jurisdiction), and overloading the commercial court so undermining its effectiveness. The extraction of the best Judges and court staff into a commercial court may also erode the quality of the remaining judicial system. For a review of the arguments for and against specialist courts by a World Bank legal and judicial reform specialist, with comments on several cases in which specialized courts have been attempted, see Reiling (2006).

- (d) Once more rational case management data is available, it often becomes apparent that the organizational structure of the courts is lop-sided, with uneven distribution of resources in proportion to demand. One court may have a high concentration of cases, whereas another court in a neighboring administrative division may have very few. But the number of Judges and other staff assigned to the Court may be the same in each case. The solution in such cases is to reorganize the administrative structure of the courts, and allow transfer of cases, to permit more even distribution of work.
- (e) Courts are often beset with time management problems: the system by which hearings are allocated time slots may not work effectively. Judicial case management systems are thus introduced, for example to provide that a hearing date is listed as soon as a writ or other originating process is issued. Lawyers may be required to introduce time estimates for hearings. Judges may be given clerks, to assist them with their caseloads. Case files may be computerized, as may hearing timetables.
- (f) Judges and other court staff are given training on efficient case management. The salary and incentive structures for judicial staff are analyzed and improved. Judges are taught to undertake management roles. A President of a Court should measure the productivity of his Judges and other court staff using the revised efficiency metrics.
- (g) An attempt is made to grant judges political independence through reform of the system of judicial appointments, introduction of judicial tenure (i.e. providing that judicial appointments are permanent until retirement, and judicial salaries may not be reduced) and insulating the budgets of courts and other legal institutions from the broader political processes of setting public budgets.
- (h) Legal training is introduced for law students, legal practitioners and parliamentarians. They are taught skills of legal drafting, professional ethics, and legal analysis, with the aim that legislation becomes clearer, more transparent and easier to apply.

- (i) Modern commercial legislation is drafted, improving commercial laws, civil procedure rules, and codes of professional ethics.
- (j) Simple bureaucratic tasks are made easier, by removing the number of steps required to register a company, open a bank account, or register a transfer of title to real estate. Punitive taxes, that may be imposed upon types of government interaction (particularly transfers of real estate), are reduced or removed.

These are the building blocks of legal and judicial reform of the commercial law of developing states. There are a variety of potential ways projects of this kind may be funded. In some cases the funding comes from development loans from one of the multi-lateral development banks. But in fact this is a relatively rare form of funding for legal and judicial reform projects, because client countries do not wish to incur sovereign debt to achieve a result as long-term and intangible as legal and judicial reform. Infrastructure projects are the most common subject of development loans, because politicians want to show off major construction as the fruits of their borrowing commitments. For the most part, therefore, legal and judicial reform projects must be funded by donors rather than loans. And donor money being in relatively short supply, it is hard to attract the interest of donors for such projects when other uses for donor funds may provide more concrete results. It is hard for the casual observer to see the immediate benefits to an impoverished nation of spending money on developing an already elite legal profession. Moreover, the level of political accommodation required for international experts to go into a client country and execute legal and judicial reform projects is substantial. Judges are invariably conservative people, hard to persuade of the need for change. There are always vested political interests in a legal system staying as it is, and overcoming those interests to pursue root and branch reform is extremely difficult. Lawyers are usually a powerful class, and this applies just as in emerging markets as it does in the developed world. A country's legal system reflects many features of its political institutions and culture, and its features are often heavily ingrained. The idea that a country would abrogate its sovereignty and legal and political traditions to allow foreigners to impose their ideas upon it from the outside is often a very difficult notion for a Minister of Justice to

swallow. For all these reasons legal and judicial reform projects are rare throughout the developing world, because they are not domestically politically attractive and because international donors are not easily persuaded of their benefits. Although development economists have opined that development of commercial law is an imperative component of economic growth, it is remarkably hard for the idea to achieve traction. The legions of legal and judicial reform experts hired by the major development institutions in the last few years for the most part remain under-utilized.

There are however two areas in which legal and judicial reform projects have been embraced. One is the case of accession candidates for the European Union; the other is “new states” that have been subject to unusually intensive levels of international intervention. Most substantial legal and judicial reform projects have fallen into one of these two categories. For EU accession candidates, the countries have no choice. The EU requires every candidate country for membership to sign a “stabilization and association agreement” (SAA) at an early stage of membership negotiations, essentially a checklist of institutional reforms that must predate a formal decision on membership. Teams of inspectors will visit the country regularly throughout the accession process, which may take several years. During that time, they will report to the European Commission upon the pace of institutional reforms that have been completed. Legal and judicial reforms are an integral component of the SAA: joining members must have a dynamic market economy with legal institutions adequate to secure that and to enforce the dictates of EU law. This requires a domestic legal system with some sophistication, for EU law is a complex federal system of jurisprudence that cannot sit atop an immature domestic legal system if Judges and lawyers do not have a sound grasp of international, federal and constitutional legal principles. So far, the political imperative within the countries of Eastern Europe to join the EU has been so strong that it has overridden vested interests within the domestic legal systems, and the type of large-scale external interference that legal and judicial reform requires has been tolerated. The funding to do this has, in general, been provided by EU grants. This process has been undertaken everywhere as the EU has expanded eastward, but the most notable recent examples have been Romania and Bulgaria, that saw extraordinary reforms to backward systems within only a few

years. There is evidence that Macedonia is now in the midst of similar progress in its path to EU membership.¹⁵

The other category of countries for which substantial legal and judicial reform projects have been implemented is “post-conflict” countries, or new states. These states have been subject to such heavy degrees of international intervention that reform projects have been imposed upon them. In Bosnia, Cambodia, Kosovo, Afghanistan and Iraq, large quantities of new domestic legislation has been written by foreigners. International contractors have restructured the court system, appointed Judges, and changed the legal system radically. One of the aims of doing this has been to create a completely new commercial environment within which businesses can operate, to encourage economic growth in these previously devastated countries. Domestic politicians and judges have had no practical choice but to accept this forced assistance, because the client country is awash with foreign troops, foreign money and forceful diplomatic presence. These exercises in nation building have been full-blooded in their neo-institutional ambitions. Now we turn to examine the extent to which they have been successful.

Problems with legal and judicial reform projects

The view advanced in the remainder of this article is that where comprehensive legal and judicial reform projects have been pursued in post-conflict states, they have not been particularly successful. This is a broad hypothesis, and it is acknowledged that there are some exceptions. It would be impossible to attempt to justify such an assertion in a relatively short paper, for it would require a comprehensive survey of every significant attempt, and that should be, but has not yet been, undertaken. However, some significant research critical of individual projects has been undertaken. This article will not attempt to recreate that research,¹⁶ but some general themes will be set out below exemplifying

¹⁵ Anderson and Gray (2007) discuss the legal reforms in Romania, Bulgaria and Macedonia on their paths to EU membership.

¹⁶ For some of the more interesting recent reviews of the successes and failures of legal and judicial reform projects, see Stromseth et al (2006); Paris (2004). Also worthy of review is Armytage (2006), one of the

the challenges for legal and judicial reform projects in new states, and to explain why these projects have not achieved the successes one might have hoped for.

First, it is important to consider the incentives of the officials who undertake law reform projects. Typically they are employees of one or more private development contractors specializing in such work, working to a budget set by an international development institution such as USAID or an international development bank. These contracts are generally relatively short-term contracts (typically with a time scale of one to four years), whereas the desired results of such a project are inevitably longer-term. The contractors therefore work to identifiable deliverable results by which their performance may be assessed. There is therefore much emphasis upon constructing new court buildings and equipping them, arranging training courses, and drafting legislation, for these results are tangible. But some of the more politically difficult tasks facing any legal and judicial reform project – achieving the political consensus necessary to pursue far-ranging reforms, changing the way judges are appointed, addressing corruption and bias, severing the court system from politics, and radical restructuring of the court procedure and administration – often go unaddressed. It is difficult to make international contractors address such problems, because resolving them is difficult to measure, whereas the successful completion of a new court building is a blazing accomplishment easy to present in an annual contractor's report. Progress must be easily demonstrated to international diplomatic officials whose opinions may be pertinent to renewal of the contractor's mandate or securing a follow-on contract or a project in another country. This problem is compounded in many cases because legal and judicial reform projects are undertaken as a sign of progress and development of a political agenda that the donor country finds desirable. Perceived success of the project then becomes a political imperative irrespective of actual results, and failing projects are often hailed as successes even when they are not because the political climate makes the independence of the Judiciary a frustratingly hard goal to pursue. Both Bosnia and Georgia are telling recent examples of this trend. In Georgia several major US- and EU-sponsored rule of law

comparatively few occasions in which a practitioner of legal and judicial reform projects expresses skepticism about their effectiveness and calls for a more thoroughgoing review process to establish what works in such projects and what does not.

projects have been underway notwithstanding the near-complete subservience of the Judiciary to an authoritarian Executive;¹⁷ in Bosnia a new institution of a “state court” was created by the international community but persists only with enormous injections of foreign manpower (including foreign Judges) and capital that are unsustainable in the long term.

In the context of new states, in which international intervention is intense, there is a further challenge facing legal and judicial reform: the difficulties of effective coordination and management. Legal reform projects have been largely successful in the EU accession candidates of Eastern Europe because they have been managed by pre-existing national government institutions. Government ministers at the most senior levels want the project to work, because they have a direct political interest in securing a positive report from the EU. But this direct incentive does not apply in the context of a wide-ranging international mission of the sort found in Bosnia, Kosovo or Afghanistan. In such cases, the domestic officials play second tier to a government strategy created by international officials such as Bosnia’s High Representative or Kosovo’s SRSG (Special Representative of the Secretary General).¹⁸ The biggest single problem for international intervention missions is their lack of legal or political accountability. Nobody elects UN officials of the kind that run such missions. They write their own reports, evaluating their own successes. Difficult questions are rarely asked. Diplomatic imperatives thus take over. A plethora of international organizations compete for the same political space. Probably the most ambitious legal reform efforts were undertaken in post-war Bosnia. In developing the country’s post-war legal and institutional framework, OSCE, USAID, the World Bank, OHR (the Office of the High Representative), the Norwegian, American,

¹⁷ See ICG (2007) for an account of some of the problems with legal authoritarianism in the country. The New York based NGO Human Rights Watch also lists an extensive catalogue of problems with the Georgian justice system, including torture and prison abuses: see <http://www.hrw.org/doc?t=europe&c=georgi>. Notwithstanding these problems Georgia’s legal and judicial reform projects have been hailed as a great success, with a plethora of international agencies involved in rule of law projects there, including the EU, OSCE, USAID, ABA-CEELI and UNDP.

¹⁸ The SRSG is the head of UNMIK, the United Nations Mission in Kosovo. Although he is given no formal legal powers under the UN Security Council Resolution (1244 of 1999) that creates UNMIK, in fact the SRSG has played the lead role in establishing domestic public institutions in Kosovo since 1999, and issues *de facto* binding decrees that have effect as if they were domestic legislation.

German and Austrian governments, the EU, and countless other government and non-governmental organizations have played various different roles. Domestic commercial actors and foreign investors were rarely consulted. International officials talk to one-another, rather than people who are ostensibly to benefit from the reforms to be executed. The result is that there are too many people managing the process, creating myriad overlapping and sometimes inconsistent policy initiatives.¹⁹ So prevalent are problems of this kind in every country in which state building is attempted, it is tempting to conclude that they are an inevitable externality of employing international organizations.

Third, the mandates of international officials are inevitably short-term. It is normal for international contractors only to stay in any one country for a relatively short period – a few years maximum. Hardship involved living in a developing world country – particularly a post conflict “failed state” – means that there is a regular turnover of staff. Often not long after a contractor acquires knowledge of the local political and legal culture, he or she departs the country. This lack of country-specific experience amongst the implementers of legal reform projects inevitably hinders project execution. If one does not understand the politics of the judiciary, one will never understand the limits of what can be achieved and how to achieve it. Without comprehensive understanding of the domestic legal culture, including drafting styles, methods of legal argument, legal traditions and hierarchy, the practice and strategy involved in civil procedure, domestic business conventions, relationships between lawyers and their clients, the interaction between business and politics, and the ways commercial people deal with problems of bureaucracy and corruption, the amount one can achieve will be limited. One can spend a lifetime learning about another culture’s legal system. Efforts at institutional tailoring will be subject to manipulation by domestic actors with their own vested interests,

¹⁹ See Karnavas (2003), talking of legal and judicial reform in post-war Bosnia: “The lack of any overall strategy, coordination and cooperation within the OHR is the single greatest contributor to the lack of any meaningful or sustainable legal and judicial reform in Bosnia and Herzegovina. By outsourcing to international organizations or depending on nongovernmental organizations to produce a coherent and consistent body of legislation, the OHR has, in essence, subcontracted its mandate, and, as a result, placed itself at the mercy of these international and nongovernmental organizations, which, far too often, disagree with one another or are engaged in pursuing their own agendas. It should not be surprising that what is often produced is a hodge-podge of drafts that are usually met with skepticism at best and disdain at worst by national experts.”

because they will understand the complexities of the domestic system far better than the inexperienced international intervener. It is a common experience of international officials that while certain types of reform are easy to push through, others are frustratingly hard, or even impossible, to achieve, and still others, when adopted, are rapidly subverted to preserve the status quo *ante*.²⁰ This is often because international officials do not understand the underlying political considerations motivating the local actors. The temptation for those executing legal and judicial reform projects are to assume that the problems, and the solutions, are the same in each country they address. To a superficial observer, the problems with emerging market legal systems often appear very similar. But to a person with detailed knowledge of the legal culture, the difference appears in the balance of political powers within which one needs to work to execute effective change, which are always subtly different.

Lack of detailed local knowledge often encourages off-the-shelf solutions to legal and judicial reform. This is best illustrated in the use of what are called “legal transplants”: taking foreign laws as the basis for new legislation in a client state. Although much decried in the literature,²¹ it is a persistent practice nonetheless, because it is the most natural thing in the world for a lawyer to use precedents with which (s)he is most familiar. When international contractors draft domestic legislation, they have an unnervingly common habit of using models from their home countries. The Constitution of Bosnia and Herzegovina was drafted by American lawyers and exhibits a drafting style remarkably similar to that of the US Constitution. The same is true of Iraq’s Oil Law.²²

²⁰ This is a particularly common feature of attempts to redraft civil procedure rules from scratch, with a philosophy very different to that which went before. The new philosophy does not stick, no matter how well drafted the new rules are, and they end up being drastically distorted in their interpretation to mirror the old rules and philosophy. This was particularly evident in the work of the Brcko Law Revision Commission in northern Bosnia, that sought to create an adversarial court procedure where an inquisitorial model had existed before, discussed in the subsequent paragraphs below; for more detail see Parish 2008.

²¹ See Galinou (2005), Mattei (1994) and Berkowitz et al (2001) for some of the academic commentary on legal transplants.

²² Iraq’s draft Oil and Gas Law (at the time of writing available on the website of the Kurdish Regional Government in Iraq – see http://www.krg.org/uploads/documents/Draft%20Iraq%20Oil%20and%20Gas%20Law%20English_2007_03_10_h23m31s47.pdf) was prepared by US development contractors Bearingpoint. It reads very much like a piece of US legislation. Aside from its drafting style, its content is controversial due to the degree of

When the new criminal procedure code of the Brcko District of Bosnia and Herzegovina (an autonomous region of northern Bosnia subject to special international oversight after the end of the Bosnian war due to its strategic significance) was drafted from scratch, it was copied from the Criminal Procedure Code of Alaska. This was the home state of the international official charged with its development. All this is nothing new; it is a tradition as old as colonialism. Probably the most influential French export ever was its Civil Code, adopted in various forms through colonial imposition in Spain, Latin America, Francophone Africa, Germany, Prussia and beyond. The English Common Law became similarly pervasive throughout the British colonies, replacing pre-existing domestic legal systems in their entirety. Legal transplants are attractive, because they require far less effort than getting to know another country's legal system: something that can take a lifetime. And once drafted and adopted, they can be hailed as a quick success.

But legal transplants assume a clean legal slate from which to begin, rather than a highly developed pre-existing legal tradition. Where such a tradition already exists, the new transplant is always a poor fit with what went before, and assumes an entirely different system of training and method of practice. Transplants imply unfamiliarity with domestic legislative drafting styles and techniques of interpretation,²³ which when applied to the transplant draft may produce a result quite different to that intended. Once international contractors depart and domestic lawyers are left to their own devices, the old habits will re-emerge. Legal transplants are rapidly rejected by their hosts, often with detrimental consequences worse than had the intervention never been begun. In Brcko District, the "Alaskan" attempt to introduce adversarial litigation procedures degenerated shortly after the departure of the scheme's progenitor. The subsequent roll-out of adversarial litigation practices throughout Bosnia precipitated a collapse in the quality of civil and criminal

long-term access it provides to foreign oil companies for investment in Iraq's oil fields, and the Iraqi Parliament has failed to pass it as of the end of December 2007.

²³ It is common for foreign legal officials to perceive in domestically drafted legislation ambiguities that do not exist in the mind of a domestically trained lawyer. The reason they do not perceive ambiguities where foreign officials do is often that western legal systems generally have a tradition of literalism lacking in the rest of the world. This leads one to believe that if the answer is not in the text, it is ambiguous. But in many so-called "less developed" legal systems, the answer to an ambiguity is obvious by the political context: it is clear what is intended, because the law is a tool to achieve a certain (unstated) political end.

trials, because parties' lawyers were not prepared for the vastly increased responsibilities imposed upon them, and Judges were not prepared to deal with problems of inequality of arms, where one side's lawyers are of superior quality to the other's. In the worst case, in an environment where traditions of legal interpretation are significantly different, Judges and lawyers simply ignore the transplanted legislation, or misinterpret it to achieve a political goal. The Bosnian constitution has suffered terribly from this malaise, seldom being referred to other than by lawyers in the international community or Judges on the country's Constitutional Court.²⁴ The most successful instances of international participation in legislative drafting have been ones where the process has been driven by local experts who invite international guidance on their own terms in an extended consultation process,²⁵ rather than the transplant model in which legislative reform is driven by outsiders with only cursory participation by domestic parties.

The assumption is frequently made that the problem with client countries' legal systems is a form of primitivism: they are simply unsophisticated, their lawyers are incompetent, their Judges are badly trained, and so forth. This is rarely true. "New" states do not emerge from a vacuum. In every country, developed and underdeveloped, even a new one or one recently emerged from the ashes of civil war, lawyers form an elite class of highly educated and intelligent people. If there is no tradition of legal analysis in a country, it is usually because analytical skills matter relatively little in the practice of law there: other things, such as perception of political connections and knowledge of how to work a corrupt system, matter far more. If legislation is ambiguously drafted, it is not usually due to poverty of legal training. It is deliberate, because it allows Judges and other legal decision-makers discretion to bend rules to political goals, depending upon the influences that are brought to bear upon them. Legal and judicial reform projects have a theoretical

²⁴ Bosnia is a good example of how not to draft a constitution. It was prepared in English only by American lawyers and agreed to under extreme diplomatic pressure at the peace negotiations hosted by the US Government at Dayton air force base in November 1995. It has never been ratified by any of Bosnia's many legislatures. The sense of local ownership over the document is virtually zero. For a discussion of the process by which the Bosnian constitution was prepared, see Holbrooke (1999). For a discussion of the anomalous political system established by the Constitution, see Chandler (1999) Chapters 2 and 3.

²⁵ Horowitz (1999) provides an interesting narrative of his own participation in a domestic commission charged with preparation of the electoral system for Fiji.

underpinning which is incorrect. They assume that the problem is an absence of technical competence. The reason there are heavy delays in the court system is that Judges have not thought about how properly to arrange their court systems. The reason laws are ambiguous is that teaching in law schools is inadequate. The reason Judges make poor decisions is that they have bad laws and bad training. This assumption betrays a whiff of arrogance; it is the attitude of the colonial official to his possessions. It is wrong. There is a sophisticated logic to the dysfunctionality of developing world court systems; the legal system serves very different purposes in a developing country. In the west, modern commercial legal systems exist to serve the interests of a powerful independent commercial class who desires to be free of the influence of politics and government. But such a class does not exist in developing countries. Their legal systems exist to serve the interest of a powerful political class with strong commercial connections, who see capture of political and legal institutions for their own ends as a tool to promote their own pursuit of wealth and to prevent the influence of competitors, including foreign investors. In countries where the dividing line between politics and business is far hazier than in the west, particularly where there is a recent history of communism, legal systems have evolved with very different goals in mind. A mere technical effort can never hope to reverse the philosophical differences that have developed within the legal profession in such a country. More than any other type of development assistance, legal and judicial reform is a political project.

Where do we go from here?

The themes developed in the course of this paper are that creation of a science of legal reform has been the product of political incentives in donor countries and spare capacity within international organizations. The way these projects have been structured so far has been flawed, because the project models used have motivated simplistic metrics of success. A belief by the international officials in charge of intervention projects, that the domestic legal systems they are coming to are simplistic or deficient, has caused them to overlook highly sophisticated systems, albeit ones that serve the interests of political and

commercial elites who wish to control the system to pursue their own ends, rather than the interests of politically neutral business people (a class which in emerging markets often does not exist).

All that does not however mean that legal reform projects are unimportant or impossible. This paper began with a brief exposition of neo-institutional economics. The neo-institutionalists remain right: the accessibility of an impartial legal system is most important to economic development, because without it business will inevitably remain localized, closely associated with politics and purely national. Foreign investors will not come to a country in large numbers if they cannot rely in the legal system and are thus liable to lose their investments should their political connections turn sour. If one wants to develop a country's political system, it is important to separate commercial and political interests. Modern western democratic principles rely upon a general proposition of impartiality before the law. Bias and partiality within public institutions condemns those without special connections to become second-class citizens, and denies a greater part of the population of the benefits of commercial freedom and economic growth. The proper objective of a legal and judicial reform project is therefore a judiciary independent of politics and answerable instead to a constituency of independent commercial people. This is more than a purely technical matter of changing rules and laws and the structure of court administration. It requires a sea change in political attitudes, of the kind found in transition from communism to EU membership in the accession states of Eastern Europe. There must be a real political will at the highest level to achieve that; EU membership is a good method of creating that will.

This suggests that the sorts of wide-ranging legal reforms sought in many post-conflict "new" states, such as Bosnia, Kosovo, Iraq and Cambodia may be unrealistic in the short-term. Legal reform is desperately important in a post-conflict country. One of the gravest scars of a civil war is the absence of almost all rule of law, after the society has been ravaged by corruption and commercial resources captured by a wartime political elite. International contractors cannot hope to come in and renovate such a country's legal system in just a few years, and thereby rapidly push open the doors to commercial

development and foreign investment. Legal transplants almost never work. Legal reform is a project that must be home-grown, by lawyers trained in the details of the pre-existing system and familiar with the political complexities of the model one seeks to reform. Moreover senior politicians with ideological commitment to promoting a market economy must stand behind the project. They must understand the importance of pursuing these reforms, they must state they are behind it publicly, and they must get involved. Likewise, business people, both domestic and international, should be invited to participate. The process must be undertaken gradually, by those with a long-term interest in the country's economic development. Earlier in this paper it was stated that in western countries development of commercial law has been a response to the demands made by the commercial sector rather than something undertaken in advance of the development of the commercial sector. This lesson is in danger of being lost upon the modern gurus of legal reform. Sustainable legal development is something for which there must be long-term domestic political imperatives drawn from the private sector. So far, the operational models necessary for this type of intervention have not been developed. Legal and judicial reform has been confined to the rarefied circles and ivory towers of international officials and development institutions.

This paper has not sought to set out a blueprint for future reform of commercial law in post-conflict states. Its goal has been far more modest: merely to highlight some of the problems in such projects in the past, and to explain why those problems have come about. Its intention is not to strike a purely skeptical note; for it has also argued that development of commercial law is desperately important in new states whose institutional weaknesses will leave them impoverished and unstable if the rule of law necessary for economic development is neglected. We still do not fully understand how best to achieve the goals we seek in such countries, but a significant rethink is required, and this paper has sought to set out some pointers for the future.

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