Appendix A APPENDIX

ONLINE APPENDIX

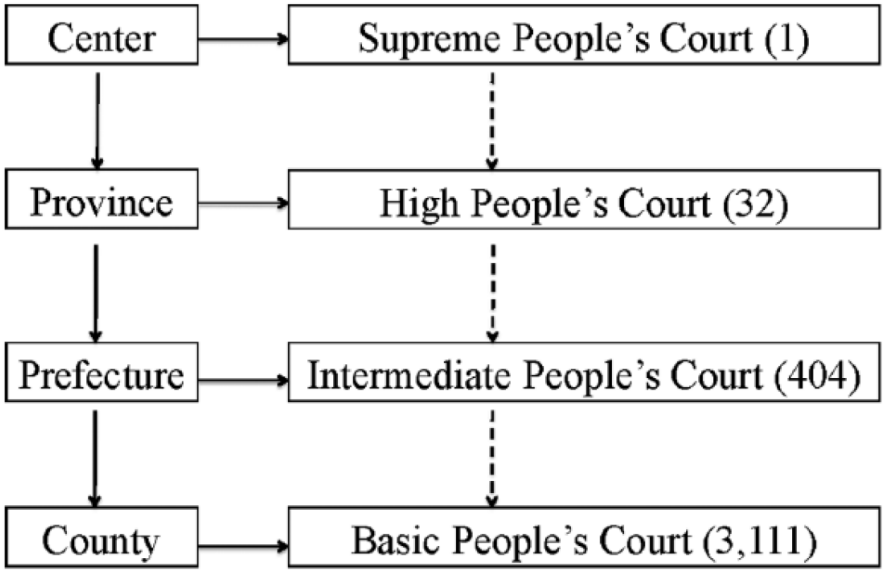
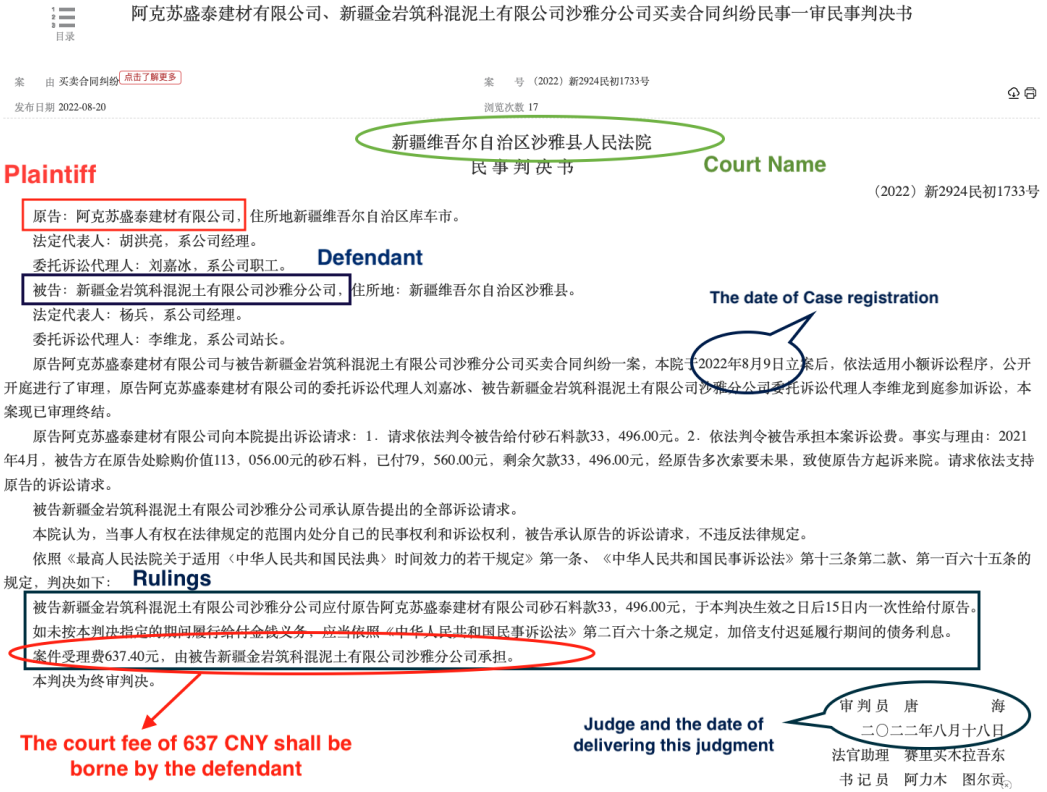


Figure A.1: Structure of China's Judicial System

Notes: Reprinted from Wang (2018).

(a) Frontpage of the China Judgements Online Website



(b) Sample Court Judgement

Figure A.2: China Judgements Online Website and An Example of Court Judgement

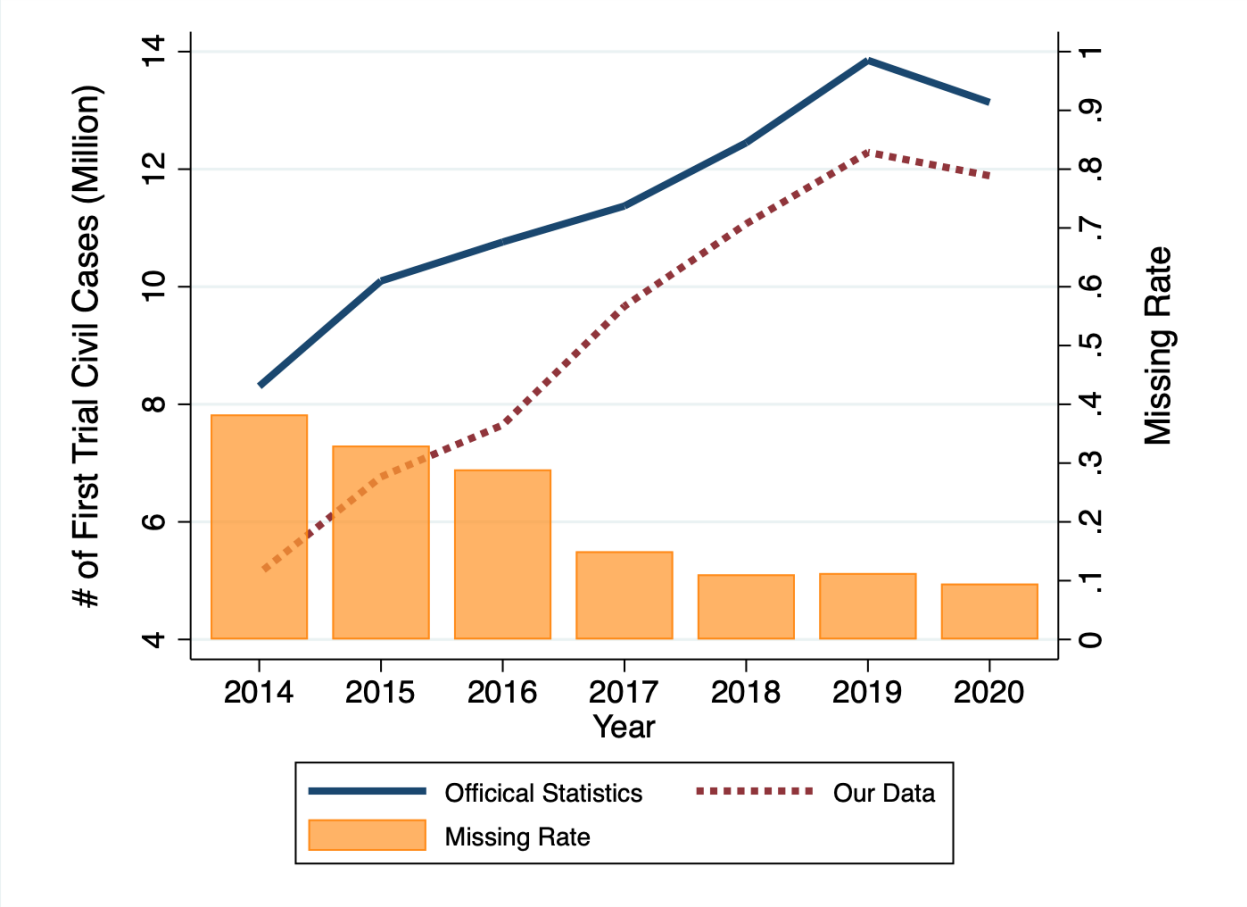
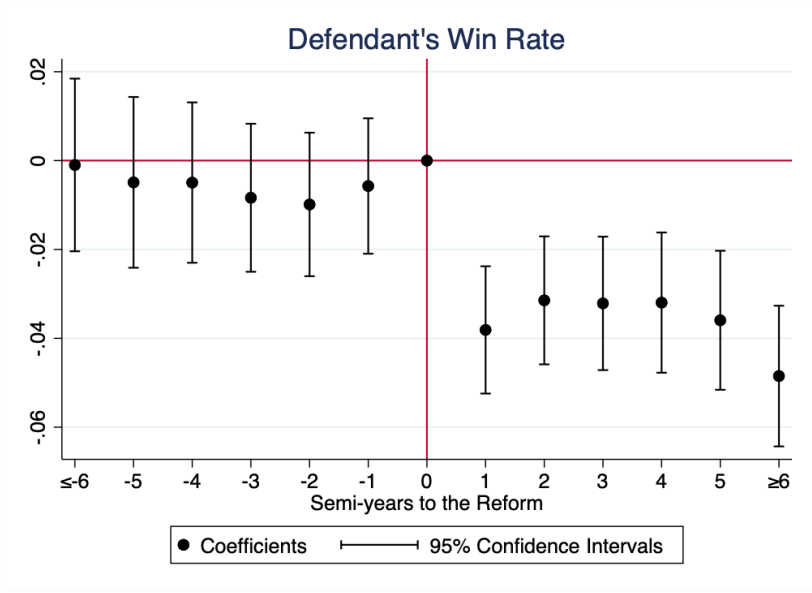


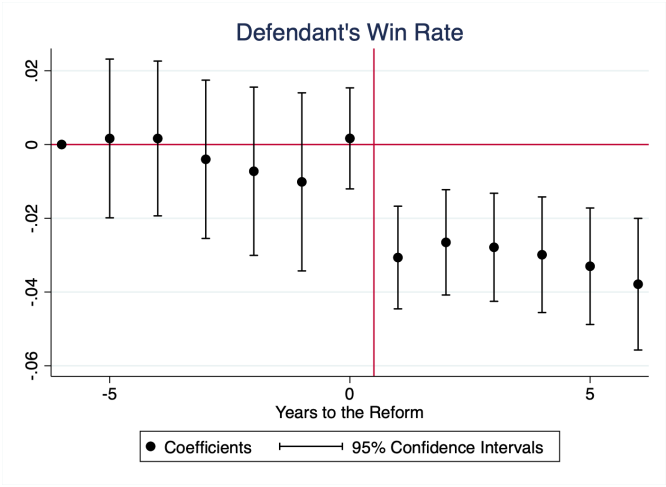
Figure A.3: Missing Rate of First Trial Court Verdicts

Notes: The official number of first trial civil cases is retrieved from *China Statistical Yearbook* published by National Bureau of Statistics between 2015 to 2021, while the number of first trial civil cases in our data is calculated using verdicts that were trialed between 2014 and 2020 and released by *China Judgements Online* before August, 2022.

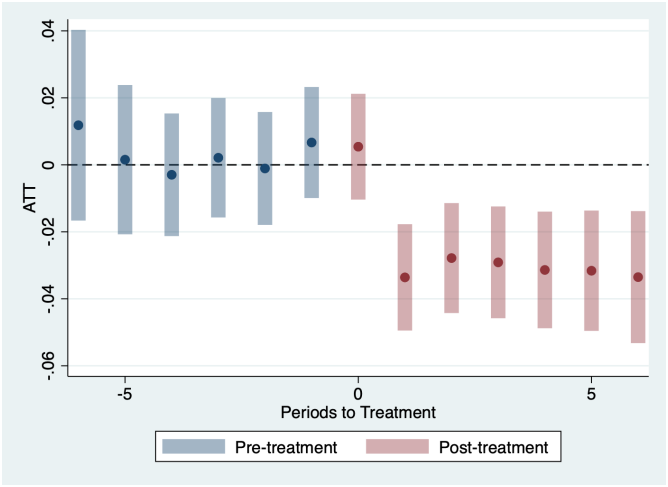
Figure A.4: Frontpage of the Tianyancha.com



(a) Unadjusted Event Study



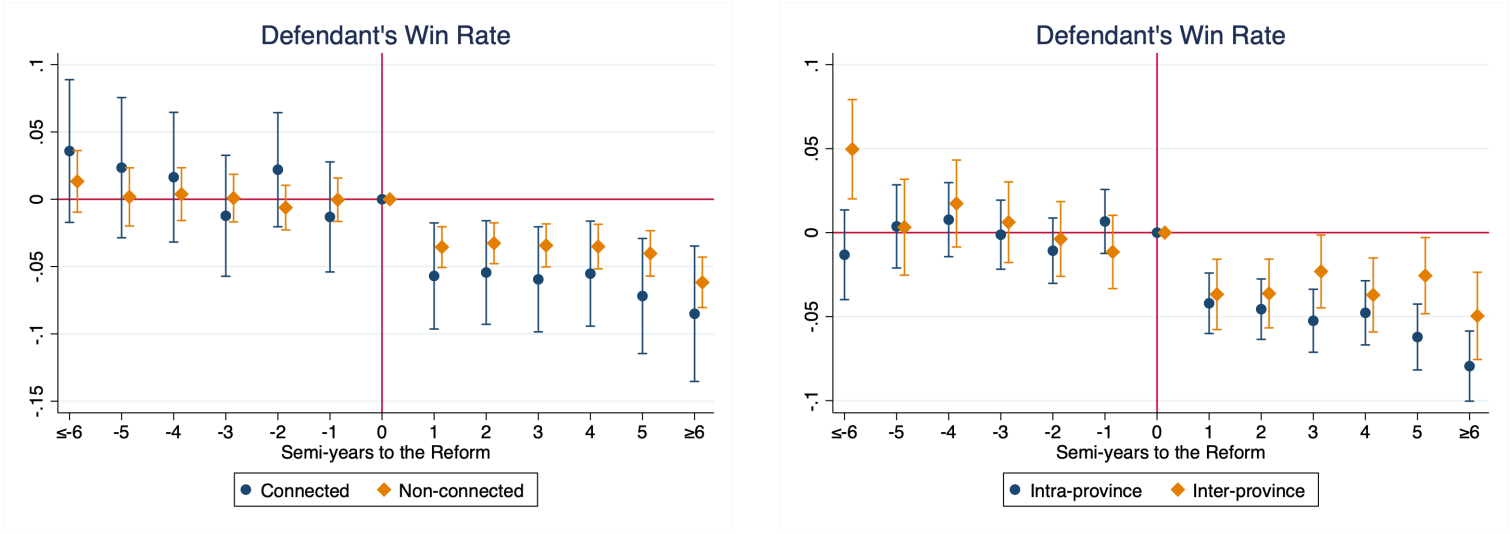
(b) Adjusted following Borusyak et al., 2021



(c) Adjusted following Callaway and Sant'Anna, 2021

Figure A.5: Judicial Independence Reform and Judicial Impacts - Alternative Estimators

Notes: Panel (a) plots the baseline event study coefficients (as well as 95% confidence intervals), with no additional adjustments. Panel (a) plots the baseline event study coefficients (as well as 95% confidence intervals), following the approach suggested by Borusyak et al. (2021). Panel (c) plots the baseline event study coefficients (as well as 95% confidence intervals), following the approach suggested by Callaway and Sant'Anna (2021).



(a) Connected v.s.Non-Connected Local Defendant

(b) Intra-province v.s Inter-province

Figure A.6: Judicial Independence Reform and Judicial Impacts - Heterogeneity

Notes: Panel (a) plots the event study estimates corresponding to Columns (2) and (3) of Table 2, Panel (b) plots the event study estimates corresponding to Columns (4) and (5) of Table 2. All event studies are estimated following the approach suggested by Sun and Abraham (2021).

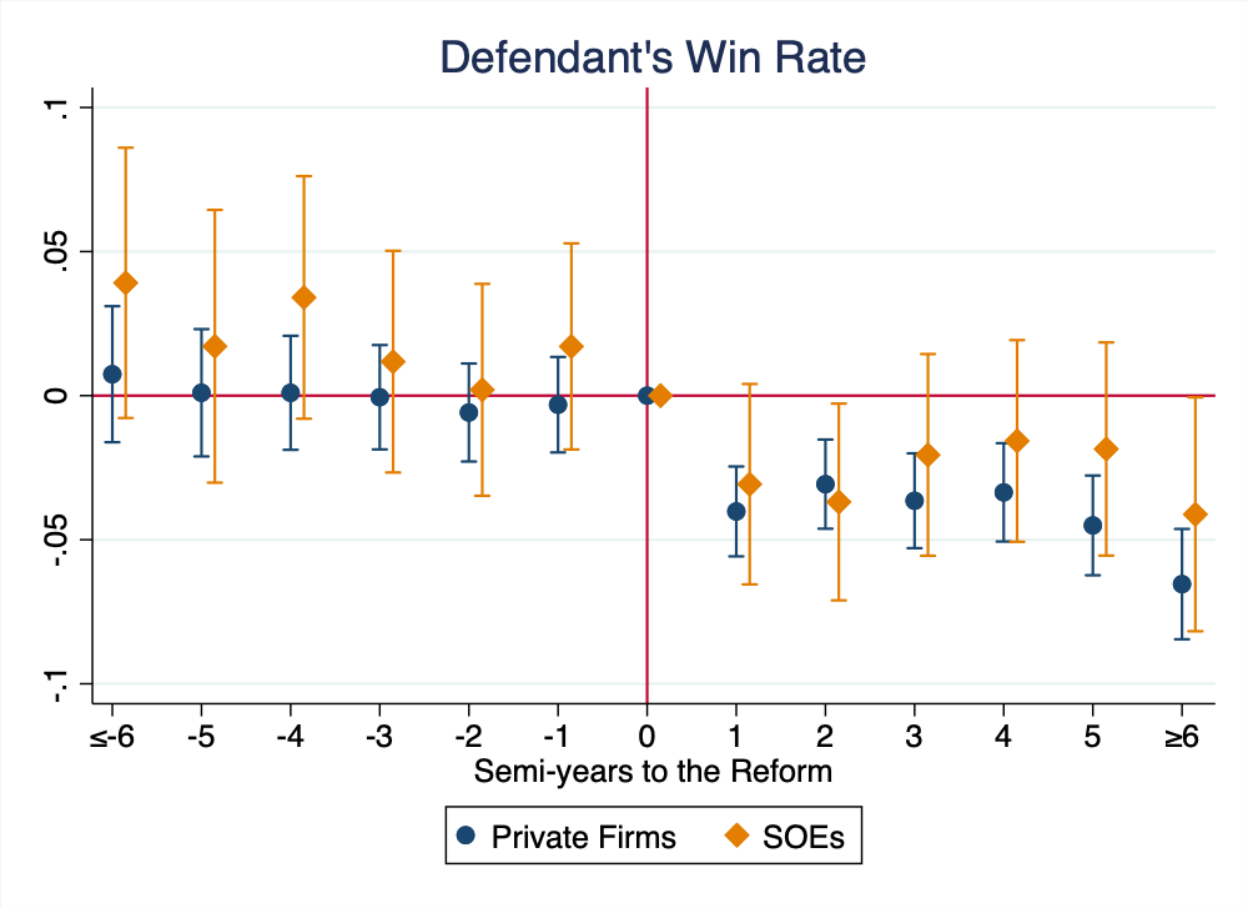


Figure A.7: Judicial Independence Reform and Judicial Impacts - Heterogeneity

Notes: This figure plots the event study coefficients (as well as 95% confidence intervals) corresponding to Columns (1) and (2) of Table A.5 following Sun and Abraham (2021).

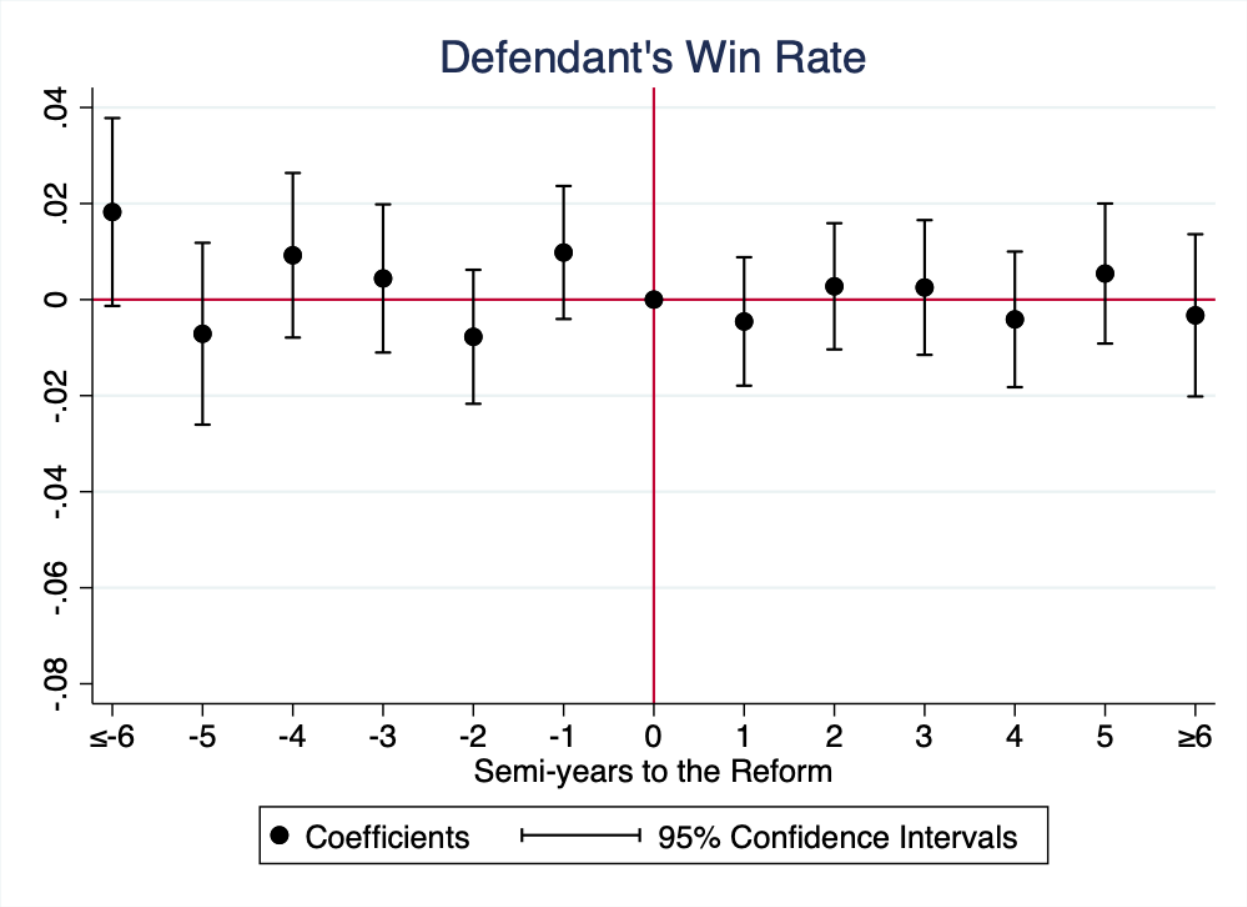


Figure A.8: Placebo Test Using Civil Lawsuits Between Local Firms

Notes: This figure plots the event study coefficients (as well as 95% confidence intervals) corresponding to Column (1) of Table A.4 following Sun and Abraham (2021).

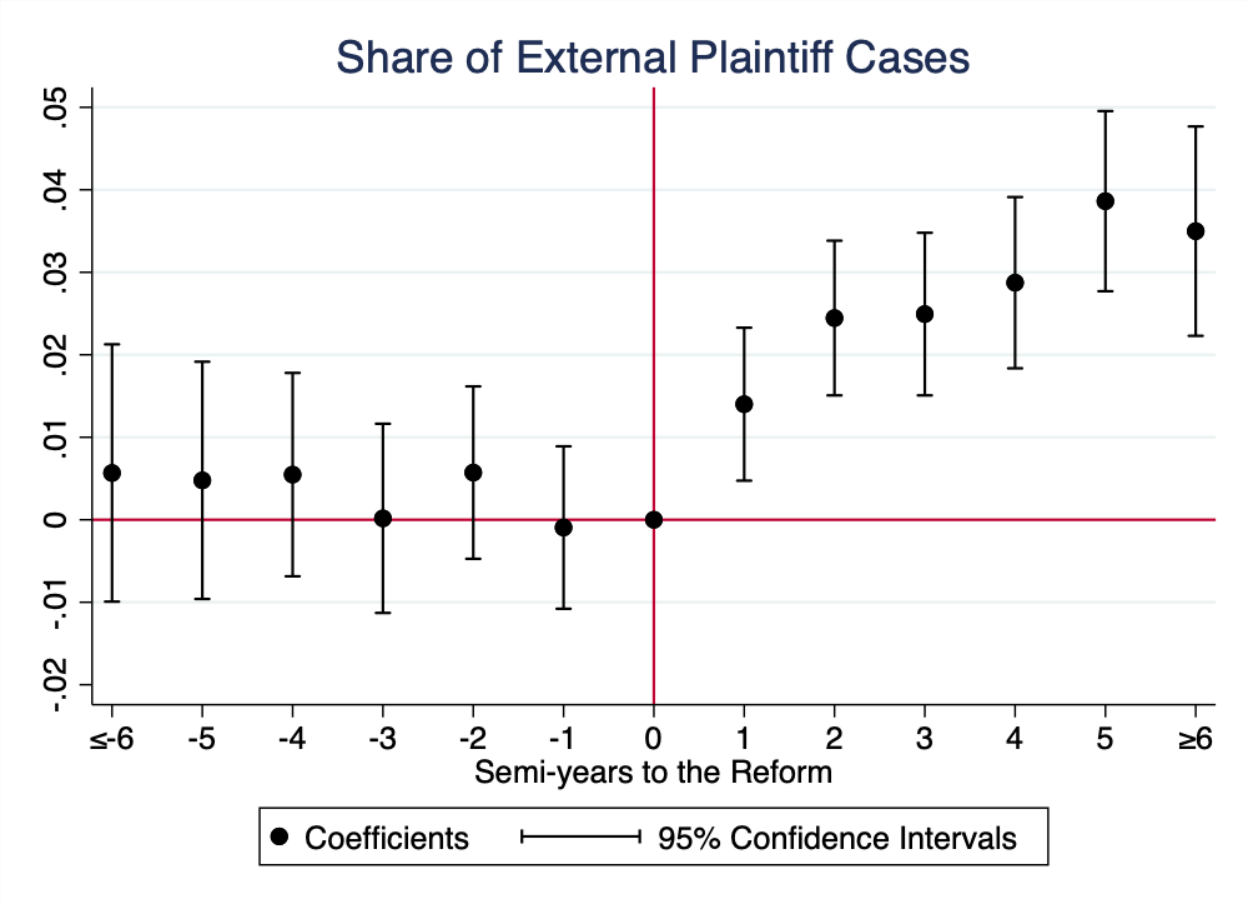
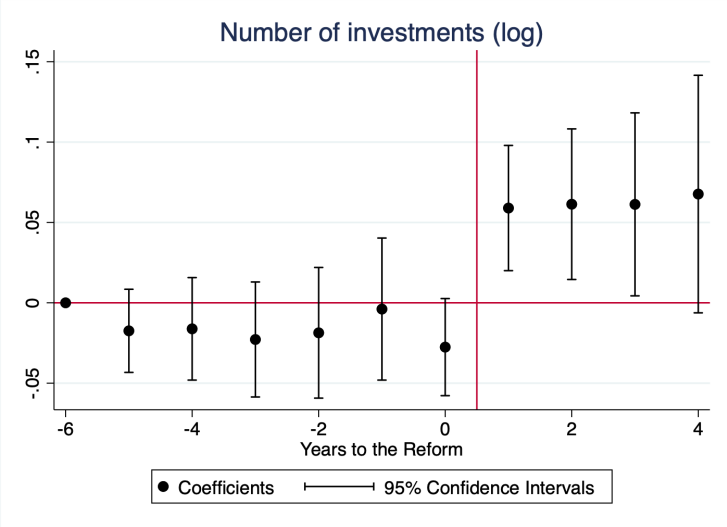
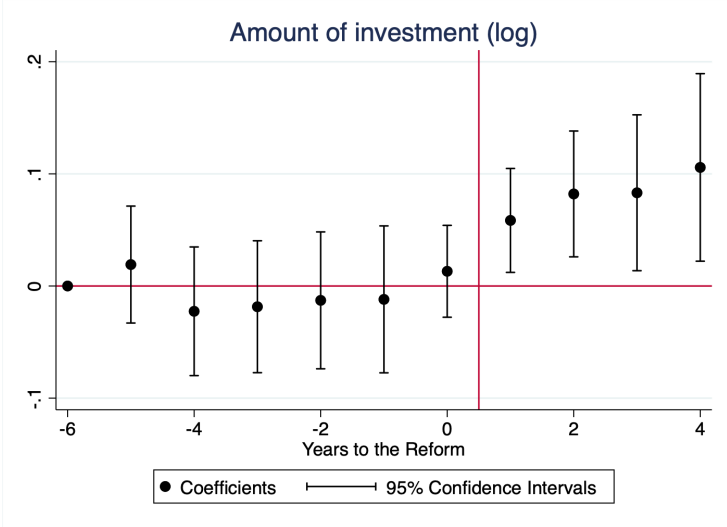


Figure A.9: Judicial Independence Reform and Share of External Plaintiff v.s. Local Defendant Cases

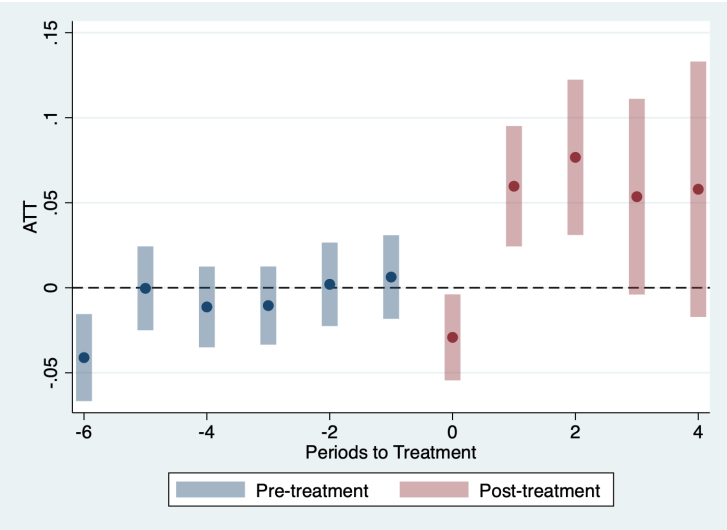
Notes: This figure plots the event study coefficients (as well as 95% confidence intervals) using share of outcome external plaintiff against local defendant cases over all cases between companies as outcome variable following Sun and Abraham (2021).



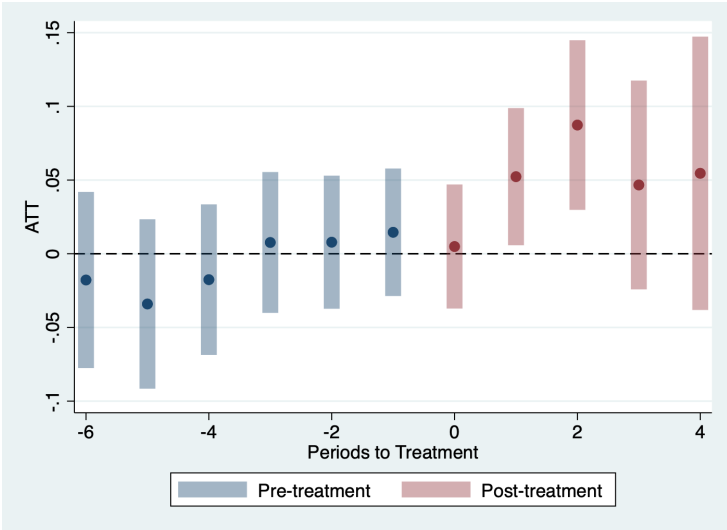
(a) Number of External Investments



(b) Amount of External Investment



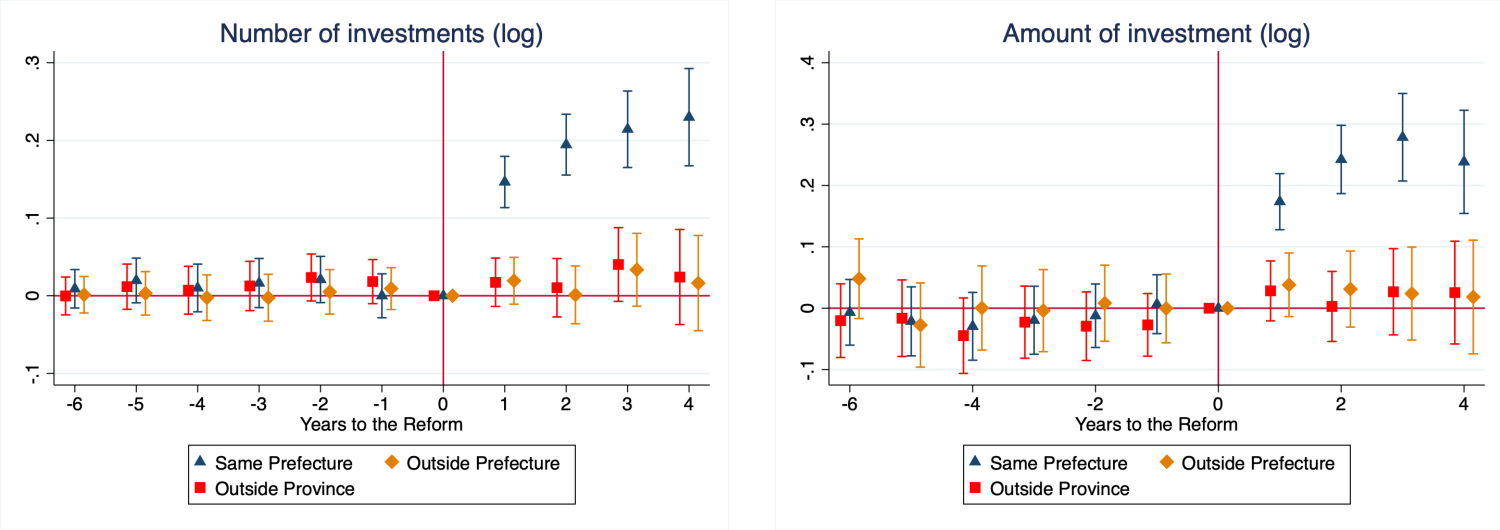
(c) Number of External Investments



(d) Amount of External Investment

Figure A.10: Judicial Independence Reform and External Investment

Notes: Panels (a) and (b) plot the event study estimates corresponding to Table 6, following the approach suggested by Borusyak et al. (2021). Panels (c) and (d) plot the event study estimates corresponding to Table 6, following the approach suggested by Callaway and Sant'Anna (2021).

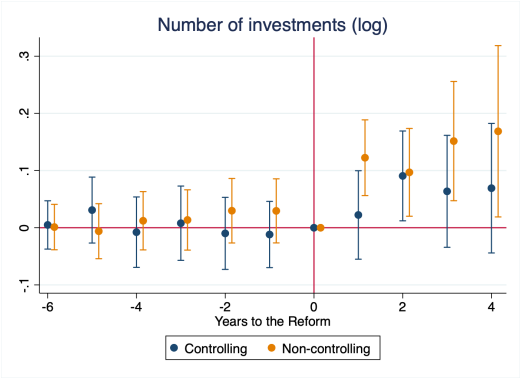


(a) Number of External Investments

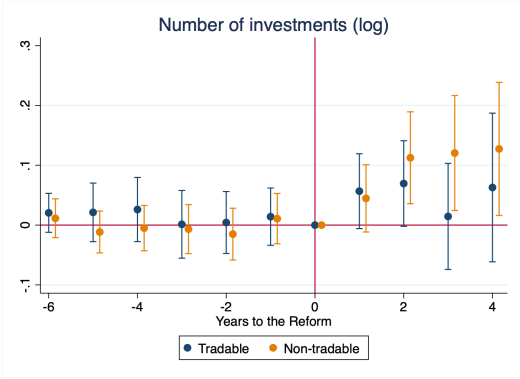
(b) Amount of External Investment

Figure A.11: Judicial Independence Reform and External Investment

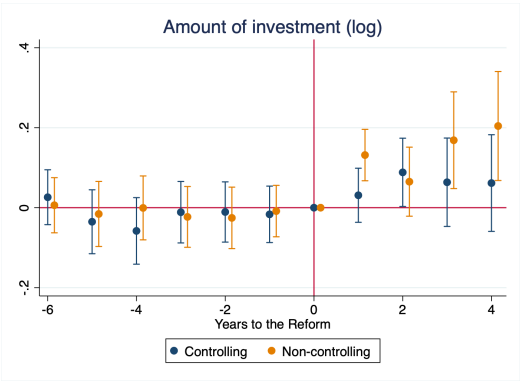
Notes: Panel (a) plots the event study estimates corresponding to Columns (1) to (3) in Panel A of Table 7, following the approach suggested by Sun and Abraham (2021). Panel (b) plots the event study estimates corresponding to Columns (1) to (3) in Panel B of Table 7 , following the approach suggested by Sun and Abraham (2021).



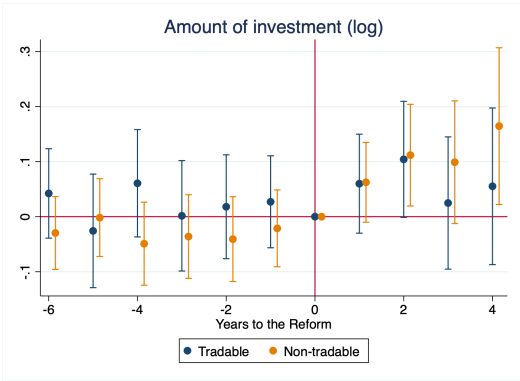
(a) Controlling v.s. Non-controlling



(b) Tradable v.s. Non-tradable



(c) Controlling v.s. Non-controlling



(d) Tradable v.s. Non-tradable

Figure A.12: Judicial Independence Reform and External Investment - Heterogeneity

Notes: Panels (a) and (b) plot the event study estimates corresponding to Columns (1) and (3) of Table A.8, following the approach suggested by Sun and Abraham (2021). Panels (c) and (d) plot the event study estimates corresponding to Columns (2) and (4) of Table A.8, following the approach suggested by Sun and Abraham (2021).

Table A.1: Judicial Independence Reform and Missing Rate of Court Verdicts

	Missing Rate	Missing Rate
	(1)	(2)
Post Reform	0.017	0.017
	(0.026)	(0.029)
Mean of Outcome	0.21	0.21
Province FE	Y	Y
Year FE	Y	Y
Observations	217	217
R-Squared	0.817	0.817

Notes: This table reports the impacts of the judicial independence reform on missing rate of court verdicts. We first calculate the number of civil cases in our database using verdicts that were trialed between 2014 and 2020 and released by the *China Judgements Online* before August, 2022, and then aggregate this information at province-year level. Second, we collect the official statistics using several sources, including provincial statistics yearbooks, the annual work reports of provincial high courts, and news reports from provincial high courts' official websites. Finally, we construct the missing rate for each province in each year using the gap between the number of cases in our dataset and the official statistics. Standard errors are reported below the coefficients. Column (1) reports the results with robust standard errors. Column (2) presents the results with standard errors clustered at province level. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.2: Judicial Independence Reform and Local Defendants Win Rate (Case-level Analysis)

	All Cases	Connected	Non-connected	Intra-Province	Inter-Province
	(1)	(2)	(3)	(4)	(5)
Panel A					
Post Reform	-0.040***	-0.053***	-0.039***	-0.058***	-0.013
	(0.008)	(0.014)	(0.008)	(0.010)	(0.011)
Court FE	Y	Y	Y	Y	Y
Year-Month FE	Y	Y	Y	Y	Y
Observations	1,191,854	101,727	1,089,773	596,261	595,498
R-Squared	0.080	0.116	0.083	0.069	0.114
Panel B					
Post Reform	-0.031***	-0.039***	-0.030***	-0.049***	-0.004
	(0.006)	(0.014)	(0.006)	(0.008)	(0.010)
Judge FE	Y	Y	Y	Y	Y
Year-Month FE	Y	Y	Y	Y	Y
Observations	1,166,520	86,895	1,064,423	571,043	572,419
R-Squared	0.258	0.393	0.267	0.268	0.321
Mean of Outcome	0.44	0.49	0.43	0.40	0.47

Notes: This table replicates Table 2 using case-level data. In Panel A, we control for court FE and year-month FE; in Panel B, we replace court FE with a more demanding judge FE. Standard errors clustered at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.3: Judicial Independence Reform and Local Defendants Win Rate (Semi-parametric DiD estimators)

	All Cases	Connected	Non-connected	Intra-Province	Inter-Province
	(1)	(2)	(3)	(4)	(5)
Post Reform	-0.030***	-0.037***	-0.030***	-0.049***	-0.015*
	(0.007)	(0.007)	(0.007)	(0.008)	(0.009)
Mean of Outcome	0.44	0.49	0.43	0.40	0.47
Court FE	Y	Y	Y	Y	Y
Seimi-year FE	Y	Y	Y	Y	Y

Notes: This table replicates Table 2 by estimating the two-way fixed effect model (Equation 1) following the approach suggested by Callaway and Sant'Anna, 2021. Standard errors clustered at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.4: Placebo Test Using Civil Lawsuits Between Local Firms

	All Cases	Connected	Non-connected
	(1)	(2)	(3)
Post Reform	0.007	-0.018**	0.007
	(0.005)	(0.009)	(0.005)
Mean of Outcome	0.39	0.45	0.38
Court FE	Y	Y	Y
Seimi-year FE	Y	Y	Y
Observations	51,393	25,396	51,076
R-Squared	0.243	0.250	0.242

Notes: This table replicates Table 2 using the civil lawsuits between local firms. Standard errors clustered at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.5: Judicial Independence Reform and Local Defendants Win Rate- Heterogeneity

	SOEs	Priviate Firms	Central SOEs	Big SOEs	Small SOEs
	(1)	(2)	(3)	(4)	(5)
Post Reform	-0.025**	-0.030***	0.004	-0.034**	-0.029**
	(0.010)	(0.005)	(0.030)	(0.017)	(0.012)
Mean of Outcome	0.47	0.44	0.57	0.55	0.43
Court FE	Y	Y	Y	Y	Y
Seimi-year FE	Y	Y	Y	Y	Y
Observations	23,456	46,192	5,276	12,859	18,058
R-Squared	0.238	0.209	0.430	0.292	0.261

Notes: This table reports the baseline DiD estimates on judicial outcomes in inter-regional commercial lawsuits, with data aggregated to court-semiyear level. Column (1) focuses on the average win rates of local defendants that are SOEs. Columns (2) investigate the average win rates of local defendants that are privately-owned firms. Columns (3) investigate the average win rates of SOE defendants that are centrally-owned. Columns (4) and (5) investigate the local defendants' average win rates for SOEs with registered capital above and below the mean, respectively. Number of observations change across columns since there are singletons for certain court-semiyear observations (e.g., some local courts do not have any SOE defendants in some semiyears). Standard errors clustered at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.6: Judicial Independence Reform and Ruling Enforcement

	Non-compliance Rate	Complete Non-compliance	Partial Non-compliance
	(1)	(2)	(3)
Post Reform	0.001	0.001	-0.000
	(0.001)	(0.001)	(0.001)
Mean of Outcome	0.024	0.020	0.006
Court FE	Y	Y	Y
Seimi-year FE	Y	Y	Y
Observations	46,907	46,893	46,830
R-Squared	0.178	0.158	0.129

Notes: This table reports the impacts of the judicial independence reform on judicial enforcement. Columns (1) presents the DiD estimates for all types of "non-compliance". Columns (2) and (3) present the DiD estimates for "complete non-compliance" and "partial non-compliance" respectively. Standard errors clustered at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.7: Intensive Margin - Changes of Plaintiffs and Defendants in Cases Received Rulings Before and After Reform

	Regis. Capital (Million CNY)		# of Employees		Age	
	Plaintiff	Defendant	Plaintiff	Defendant	Plaintiff	Defendant
	(1)	(2)	(3)	(4)	(5)	(6)
Received Rulings After Reform	-5.355	-34.526	75.438	-233.305	-0.398	0.295
	(26.597)	(21.765)	(84.187)	(327.923)	(0.331)	(0.282)
Mean of Outcome	246.17	241.14	501.27	677.71	10.74	10.63
Court FE	Y	Y	Y	Y	Y	Y
Seimi-year FE	Y	Y	Y	Y	Y	Y
Observations	24,935	34,163	21,004	22,770	31,981	43,373
R-Squared	0.149	0.126	0.369	0.185	0.140	0.120

Notes: This table test the changes in characteristics of the plaintiffs and defendants in cases that received rulings before and after the reform. Columns (1), (3), and (5) present the DiD estimates on external plaintiffs' registered capital, number of employees, and firm age. Columns (2), (4), and (6) repeat the same exercises for local defendants. Clustered standard errors at the court level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Table A.8: Judicial Independence Reform and External Investment - Heterogeneity

	(1)	(2)	(3)	(4)
Panel A				
	Number of Investment (log)			
	Controlling	Non-controlling	Tradable	Non-tradable
Post Reform	0.049	0.131***	0.042	0.078**
	(0.037)	(0.037)	(0.034)	(0.034)
Mean of Outcome	4.613	4.661	2.908	3.657
Observations	43,711	43,530	40,764	42,252
R-Squared	0.850	0.847	0.822	0.887
Panel B				
	Amount of Investment (log)			
	Controlling	Non-controlling	Tradable	Non-tradable
Post Reform	0.051	0.135***	0.049	0.078**
	(0.032)	(0.036)	(0.044)	(0.037)
Mean of Outcome	10.141	9.304	8.260	8.385
Observations	43,711	43,530	40,764	42,252
R-Squared	0.770	0.752	0.604	0.758
County FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y

Notes: This table reports the heterogeneous impacts of the reform on different types of investments. Panels A and B focus on the number and total amount of investments, respectively. Columns (1) and (2) investigate investments that fully control or partially control the invested firm, respetively. Columns (3) and (4) investigate investments in tradable and non-tradable sectors, respectively. Standard errors clustered at the county level are reported below the coefficients. * significant at 10% ** significant at 5% *** significant at 1%.

Appendix B Model Appendix

Appendix B.1 Derivations of Results in the Main Text

We first solve for the equilibrium.

Pricing. Given consumer demand (11), all firms charge a constant markup $\frac{\epsilon}{\epsilon-1}$. Equilibrium prices, quantities, and variable profits follow

$$p(\varphi) = \frac{\epsilon}{\epsilon-1}\tau\varphi, \qquad q(\varphi) = \left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{-\epsilon}, \qquad \pi(\varphi) = \frac{\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}}{\epsilon}.$$

Entry. A firm with cost index φ chooses to enter iff the variable profit $\pi(\varphi)$ exceeds the fixed cost of entry f. All firms with cost indices below $\bar{\varphi} \equiv \frac{\epsilon-1}{\epsilon}(\epsilon f)^{1/(1-\epsilon)}/\tau$ will enter. For notational simplicity, let $\kappa \equiv \frac{\epsilon-1}{\epsilon}(\epsilon f)^{1/(1-\epsilon)}$.

Expected Net Profit. The expected profit net of entry cost by a firm choosing location i is

$$\begin{aligned}
\Pi &= \int_0^{\bar{\varphi}} \frac{\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}}{\epsilon} - f\,\mathrm{d}F(\varphi) \\
&= \int_0^{\kappa/\tau} \gamma\epsilon^{-\epsilon}(\epsilon-1)^{\epsilon-1}\left(\tau^{1-\epsilon}\varphi^{\gamma-\epsilon} - \kappa^{1-\epsilon}\varphi^{\gamma-1}\right)\mathrm{d}\varphi \qquad (8) \\
&= \frac{\epsilon^{-\epsilon}(\epsilon-1)^{\epsilon}}{\gamma-\epsilon+1}\tau^{-\gamma}\kappa^{\gamma-\epsilon+1} \qquad (9)
\end{aligned}$$

Consumer Surplus. The consumer surplus derived from each variety is

$$u^*(\varphi) \equiv u(\varphi) - p(\varphi)q(\varphi) = \frac{\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}}{\epsilon-1}.$$

The total consumer surplus derived from all nonlocal firms is

$$\begin{aligned}
U &= \int_0^{\bar{\varphi}} u(\varphi) - p(\varphi)q(\varphi)\,\mathrm{d}F(\varphi) \\
&= \left(\frac{\epsilon}{\epsilon-1}\right)^{1-\epsilon}\int_0^{\kappa/\tau}\frac{(\tau\varphi)^{1-\epsilon}}{\epsilon-1}\gamma\varphi^{\gamma-1}\,\mathrm{d}\varphi \\
&= \frac{\left(\frac{\epsilon}{\epsilon-1}\right)^{1-\epsilon}\gamma\kappa^{\gamma-\epsilon+1}}{(\epsilon-1)(\gamma-\epsilon+1)}\tau^{-\gamma}
\end{aligned}$$

Total Revenue. The total revenue of nonlocal firms is

$$\begin{aligned} R &\equiv \left(\frac{\epsilon}{\epsilon-1}\right)^{1-\epsilon}\int_0^{\bar{\varphi}}(\tau\varphi)^{1-\epsilon}\,\mathrm{d}F(\varphi) \\ &= \frac{\left(\frac{\epsilon}{\epsilon-1}\right)^{1-\epsilon}\gamma\kappa^{\gamma-\epsilon+1}}{(\gamma-\epsilon+1)}\tau^{-\gamma} \end{aligned}$$

Judicial Reform. The response of consumer surplus to a change in τ is

$$\begin{aligned} \frac{\mathrm{d}\ln U}{\mathrm{d}\ln\tau} &= \frac{1}{U}\left(\int_0^{\bar{\varphi}}\frac{\mathrm{d}u(\varphi)}{\mathrm{d}\ln\tau}\mathrm{d}F(\varphi)+\frac{\mathrm{d}\int_0^{\bar{\varphi}}u(\varphi)\,\mathrm{d}F(\varphi)}{\mathrm{d}\bar{\varphi}}\frac{\mathrm{d}\bar{\varphi}}{\mathrm{d}\ln\tau}\right) \\ &= \frac{1}{U}\left((1-\epsilon)\int_0^{\bar{\varphi}}u(\varphi)\,\mathrm{d}F(\varphi)-\frac{\left(\frac{\epsilon}{\epsilon-1}\tau\right)^{1-\epsilon}}{\epsilon-1}\gamma\bar{\varphi}^{\gamma-\epsilon+1}\right) \\ &= -(\epsilon-1)-(\gamma-\epsilon+1) \\ &= -\gamma \end{aligned}$$

The response of producer surplus is

$$\begin{aligned} \frac{\mathrm{d}\ln\Pi}{\mathrm{d}\ln\tau} &= \frac{1}{\Pi}\left(\int_0^{\bar{\varphi}}\frac{\mathrm{d}\frac{\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}}{\epsilon}}{\mathrm{d}\ln\tau}\mathrm{d}F(\varphi)+\frac{\mathrm{d}\int_0^{\bar{\varphi}}\frac{\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}}{\epsilon}-f\,\mathrm{d}F(\varphi)}{\mathrm{d}\bar{\varphi}}\frac{\mathrm{d}\bar{\varphi}}{\mathrm{d}\ln\tau}\right) \\ &= \frac{1}{\Pi}\left((1-\epsilon)\int_0^{\bar{\varphi}}\left(\frac{\epsilon}{\epsilon-1}\tau\varphi\right)^{1-\epsilon}\mathrm{d}F(\varphi)-\left(\frac{\left(\frac{\epsilon}{\epsilon-1}\tau\bar{\varphi}\right)^{1-\epsilon}}{\epsilon}-f\right)\gamma\bar{\varphi}^{\gamma}\right) \\ &= \frac{1}{\Pi}\left((1-\epsilon)\Pi+(1-\epsilon+\gamma)f\bar{\varphi}^{\gamma}-\frac{\left(\frac{\epsilon}{\epsilon-1}\tau\right)^{1-\epsilon}}{\epsilon}\gamma\bar{\varphi}^{\gamma-\epsilon+1}\right) \\ &= -(\epsilon-1)-(\gamma-\epsilon+1) \\ &= -\gamma \end{aligned}$$

Because the revenue from each variety is proportional to the consumer surplus $u^*(\varphi)$, we know $\frac{\mathrm{d}\ln R}{\mathrm{d}\ln\tau}$ has the same decomposition as $\frac{\mathrm{d}\ln U}{\mathrm{d}\ln\tau}$.

Finally, the response of the mass of entrants $\mu \equiv F(\bar{\varphi})$ is

$$\begin{aligned} \frac{\mathrm{d}\ln\mu}{\mathrm{d}\ln\tau} &= \frac{\mathrm{d}\ln\bar{\varphi}^{\gamma}}{\mathrm{d}\ln\tau} \\ &= \frac{\mathrm{d}\ln\left(\frac{\epsilon-1}{\epsilon}(\epsilon f)^{1/(1-\epsilon)}/\tau\right)^{\gamma}}{\mathrm{d}\ln\tau} \\ &= -\gamma, \end{aligned}$$

thereby proving Proposition 1.

Appendix B.2 Model Extensions: Endogenous Location Choice

In this appendix, we extend the baseline model model in the main text to incorporate entrepreneur's endogenous location choice. We discuss how our reduced-form evidence show this margin not to be empirically relevant, that there is little substitution of investments from control to treated locations affected by the judicial reform or from investing locally to externally.

Consider an economy with N locations. A unit mass of nonlocal entrepreneurs can choose a location to enter and serve the local consumers. The consumer in each location has separable preferences over products from nonlocal firms:

$$U_n = \int_{\varphi \in \Phi_n} u\left(q_n\left(\varphi\right)\right) - p_n\left(\varphi\right) q_n\left(\varphi\right) \, \mathrm{d}F\left(\varphi\right), \tag{10}$$

where Φ_n is the set of nonlocal entrepreneurs (index by φ) that serve location n, $u\left(q\right) \equiv \frac{\epsilon}{\epsilon-1} q^{\frac{\epsilon-1}{\epsilon}}$ is utility derived from each firm φ. The consumer preferences (10) imply the following demand function for each firm:

$$q^*\left(p\right) = \arg\max_q \left\{u\left(q\right) - pq\right\} = p^{-\epsilon}. \tag{11}$$

Firms make location, entry, and pricing decisions. First, each nonlocal entrepreneur decides on a target location n based on expected profitability $\bar{\pi}_n$ and idiosyncratic preferences $\{\xi_n\}_n$. The entrepreneur then draws a cost index $\varphi \leq 1$ from distrubtion $F\left(\varphi\right) = \varphi^\gamma$ and decides whether to pay the fixed entry cost f to produce in location n with marginal cost $c_n\left(\varphi\right)$. After entry, firms engage in monopolistic pricing, choosing prices that maximizes variable profits.

Formally, an entrepreneur with preferences $\{\xi_n\}$ first chooses the target location that delivers the highest expected profit net of entry costs:

$$\max_n \xi_n \bar{\pi}_n, \qquad \bar{\pi}_n \equiv \int_0^1 \max\left\{\pi_n\left(\varphi\right) - f, 0\right\} \, \mathrm{d}F\left(\varphi\right), \tag{12}$$

where the maximization inside the integral of (12) indicates entry decision after drawing the cost index φ, and $\pi_n\left(\varphi\right)$ is the variable profits:

$$\pi_n\left(\varphi\right) \equiv \max_p \left(p - c_n\left(\varphi\right)\right) q^*\left(p\right). \tag{13}$$

Equilibrium price $p_n(\varphi)$ is the maximizer of (13).

Define $\bar{\varphi}$ as the cost index for which $\pi_n(\bar{\varphi}) = f$. Because of the fixed entry cost f, only entrepreneurs with sufficiently costs ($\varphi \leq \bar{\varphi}$) will enter.

We parametrize the marginal cost as $c_n(\varphi) \equiv \tau_n \varphi$, where $\tau_n \geq 1$ is a location-specific marginal cost shifter that depends on judicial fairness; a more locally biased justice system in location n raises the cost of production through higher τ_n.

We parametrize the idiosyncratic locational preferences ξ_n of entrepreneurs as being drawn independently from the Fréchet distribution (equivalent to $\ln \xi_n$ drawn from Gumbel):

$$G_n(\xi) = e^{-z_n \xi^{-\theta}},$$

where the Fréchet scale parameter (z_n) controls the average preference for target location n, which depend for example on the physical, cultural, or political factors in n. The Fréchet shape parameter θ controls the dispersion of prospects and regulates the sensitivity of location choice to economic variables (in particular the expected profits) relative to idiosyncratic factors. Specifically, let ω_n denote the share of nonlocal entrepreneurs choosing location n. The Fréchet distribution of idiosyncratic shocks imply a constant elasticity of substitution in the location choice shares with respect to relative ex-ante net profits $\frac{\mathrm{d}\ln(\omega_n/\omega_m)}{\mathrm{d}\ln(\bar{\pi}_n/\bar{\pi}_m)} = \theta$.

Given entrepreneurial preferences $\{\xi_n\}$ and the degree of local protection $\{\tau_n\}$, an equilibrium is the collection of firms' location choices $\{\omega_n\}$, entry decisions, prices $\{p_n(\varphi)\}$, quantities $\{q_n(\varphi)\}$, and variable profits $\{\pi_n(\varphi)\}$, such that a firm chooses location n iff n is the maximizer of (12) and enters iff $\pi_n(\varphi) \geq f$, $\pi_n(\varphi)$ solves (13), prices are the maximizers of (13), and quantities are consistent with the consumer demand function $q_n(\varphi) = q^*(p_n(\varphi))$.

Relative to the model in the main text, a judicial reform that reduces local protection τ_n and can now affect consumer and producer surplus through an additional channel: a reform in location n raises the ex-ante net profits $\bar{\pi}_n$ in that location, thereby attracting other nonlocal firms to choose location n and substitute away from other locations.

The response of consumer surplus (as in equation 10) to judicial reform (a decline in

τ_n) can be decomposed as

$$
\begin{aligned}
-\frac{\mathrm{d}\ln U_n}{\mathrm{d}\ln \tau_n} &= \frac{-1}{\int_0^{\bar{\varphi}} u_n(\varphi) F(\varphi)} \left(\underbrace{\int_0^{\bar{\varphi}} \frac{\mathrm{d}u_n(\varphi)}{\mathrm{d}\ln \tau_n} \mathrm{d}F(\varphi)}_{\substack{\text{lower production} \\ \text{costs among entrants}}} + \underbrace{\frac{\mathrm{d}\int_0^{\bar{\varphi}} u_n(\varphi)\, \mathrm{d}F(\varphi)}{\mathrm{d}\bar{\varphi}} \frac{\mathrm{d}\bar{\varphi}}{\mathrm{d}\ln \tau_n}}_{\substack{\text{entry of marginal firms given} \\ \text{a higher cutoff cost index}}} \right) - \underbrace{\frac{\mathrm{d}\ln \omega_n}{\mathrm{d}\ln \tau_n}}_{\substack{\text{more entrepreneurs} \\ \text{choose location } n}} \quad (14) \\
&= \underbrace{(\epsilon - 1)}_{\substack{\text{lower production} \\ \text{costs among entrants}}} + \underbrace{(\gamma - \epsilon + 1)}_{\text{new entrants}} + \underbrace{\theta\gamma(1 - \omega_n)}_{\substack{\text{more entrepreneurs} \\ \text{choose location } n}} \\
&= \gamma(1 + \theta(1 - \omega_n)),
\end{aligned}
$$

where $u_n(\varphi)$ is the equilibrium consumer surplus derived from a nonlocal firm with cost index φ (the maximand of 11).

Besides the two key elasticities (ϵ and γ) in the main text, the shape parameter θ in entrepreneur's preference distribution serves as the elasticity of substitution in entrepreneurs' location choice in response to higher expected net profits $\bar{\pi}_n$ after the reform.

We make two conceptual points using this model extension. First, we can still use the empirical measure of how the number of nonlocal firms operating in location n changes after the reform to assess the impact of the judicial reform on consumer and producer surplus and overall economic activity. Formally, let $\mu_n \equiv \omega_n F(\bar{\varphi}_n)$ denote the mass of nonlocal firms that enter location n; $\Pi_n \equiv \omega_n \bar{\pi}_n$ is the total net profits in location n; $R_n \equiv \int_{\varphi \in \Phi_n} p_n(\varphi) q_n(\varphi)\, \mathrm{d}F(\varphi)$ is the total revenue in location n. It can be shown that, just as in the baseline model in the main text, $\mathrm{d}\ln \mu_n$ is a sufficient statistic for $\mathrm{d}\ln U_n$, $\mathrm{d}\ln \Pi_n$, and $\mathrm{d}\ln R_n$:

$$
\frac{\mathrm{d}\ln \mu_n}{\mathrm{d}\ln \tau_n} = \frac{\mathrm{d}\ln U_n}{\mathrm{d}\ln \tau_n} = \frac{\mathrm{d}\ln \Pi_n}{\mathrm{d}\ln \tau_n} = \frac{\mathrm{d}\ln R_n}{\mathrm{d}\ln \tau_n}. \quad (15)
$$

Second, we comment on interpreting the difference-in-difference estimator, which compares the before-after changes in the number of outside investors to a location n that has gone through a judicial reform, to a location m, which did not experience a reform ($\beta^{DiD} = \mathrm{d}\ln \mu_n - \mathrm{d}\ln \mu_m$). A standard drawback of the DiD estimator is that, because the reform in location n may attract potential entrants to substitute away from m towards

n ($\mathrm{d}\ln\mu_m \neq 0$), the DiD estimator does not recover $\mathrm{d}\ln\mu_n$.

Our extended model provides guidance on how to interpret β^{DiD}. Specifically, the degree of substitution across locations by potential entrepreneurs can be expressed as $\frac{\mathrm{d}\ln\mu_m}{\mathrm{d}\ln\tau_n} = \gamma\theta\omega_n$, where θ is the elasticity of substitution across locations, and ω_n is the pre-reform mass of entrepreneurs who choose location n. Hence, the bias in the DiD estimator is

$$\text{bias} \equiv \frac{\beta^{DiD} - \mathrm{d}\ln\mu_n}{\beta^{DiD}} = \frac{\theta}{1+\theta}\omega_n.$$

When $\theta = 0$, there is no substitution across locations, and the bias is zero.

The judicial reforms that we exploit are rolled-out at the prefecture level; there is no within-prefecture, cross-county variation in the roll-out. The evidence in Table 7, columns (1)–(3) shows that relative to counties in non-treated prefectures, counties in treated prefectures experienced (1) significantly more external investments from external counties within the prefecture; (2) no more investments from external prefectures. This is evidence for $\theta \approx 0$, meaning the increase in economic integration in prefectures that has undergone the reform is mainly driven by net creation of new investments across counties within the treated prefecture, and not by the substitution of investments away from non-treated to treated prefectures.

Along the same lines, column (4) of Table 7 shows that treated prefectures experience no statistically different number of local, within-county investments relative to non-treated prefectures. This shows that the investment response we find corresponds to net creation of new investments across counties, and there is little evidence of substitution from investing locally to nonlocally within treated prefectures.