Comment

Speculations on Legal Informality: On Winn's "Relational Practices and the Marginalization of Law"

Frank K. Upham

At the end of the 1980s in an effort to increase the effectiveness of its development loans, the World Bank's legal staff began to address what it calls governance issues in borrowing countries. Concerned that the way power is exercised in Third World countries may contribute to the inefficient use of World Bank funds but constrained by its Articles of Agreement from considering "political" criteria in its lending, the General Counsel of the Bank, Ibrahim F. I. Shihata, drafted a memorandum that distinguished "governance" from "politics" and identified the former as a legitimate consideration in the award of Bank loans.[1] At his most general, Shihata equates governance to "good order"; in more specific terms, he calls it "the rule of law," which he defines at one point as a "system based on abstract *rules* which are actually applied and on functioning *institutions* which ensure the appropriate application of such rules" (emphasis in original).

Were the World Bank's importance measured solely by the amount of its outstanding loans or were it alone in its appeal to the rule of law as an important step in the road to economic and social development, perhaps one could cite Yogi Berra—"*déjà vu* all over again"—and move on to more interesting topics. But the World Bank is more than a major lender to less developed countries: it helps set the ideological tone for development economics and politics. Its infatuation with the rule of law, or at least with the *role* of law, is shared by, *inter alia*, the United Nations Development Project (UNDP), the Inter-American Development Bank,

NOTE: The author confesses to having sinned: he has lectured twice on land law and property rights in Laos under the joint auspices of the United Nations Development Project and the World Bank. He would like to thank John Davis, Tony Freyer, Mark Ramseyer, Celia Taylor, David Trubek, and Jane Winn for reading a draft of these comments. Address correspondence to Frank K. Upham, New York University School of Law, 40 Washington Square South, New York, NY 10012.

[1] While the idea that the rule of law is nonpolitical is an intriguing topic, I pursue here only the economic development side of Mr. Shihata's memorandum. Readers interested in a cautious claim that at least certain aspects of Western legal ideology are becoming a global norm should see Franck 1992. Franck only mentions the "rule of law" once, at p. 49.

Law & Society Review, Volume 28, Number 2 (1994)

the Asia Foundation, the Ford Foundation, and the United States Agency for International Development (USAID), which is picking up where it left off in the 1970s at the end of the last law and development movement and sending American law professors far and wide to instruct countries emerging from communism and dictatorship in the construction of effective legal systems. David Trubek, who has participated in both law and development movements, estimates that these organizations have spent about $1 billion on legal reform projects since the 1980s.[2]

Before I relate these phenomena to Winn's article, let's look more closely at why the World Bank through its General Counsel Shihata sees a "government of laws and not of men" as a necessary legal foundation for economic growth:

> Concern for rules and institutions is particularly relevant to a financial institution which at present does not only finance projects but is also deeply involved in the process of economic reform carried out by many of its borrowing members. Reform policies cannot be effective in the absence of a system which translates them into workable rules and makes sure they are complied with. Such a system assumes that: a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the proper application of the rules and to allow for departure from them as needed according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are known procedures for amending the rules when they no longer serve their purpose. (Shihata 1991:85)

Shihata goes on to state that in the absence of such a system, the fates of both individuals and enterprises will be left "to the whims of the ruling individual or clique" and that only such a system can provide the "general social discipline" that makes economic reform possible.

To a student of Japanese law, Shihata's rhetoric is surprising. One would have thought that his faith in the rule of law's role in development would not have survived the interment of the *first* law and development movement. That it did and has indeed regained a prominent place in development bureaucracies can probably be explained largely by Eurocentrism and the interests of Western nations in ideological dominance, but the econo-

[2] Trubek further notes that most of this amount has been in the form of grants, rather than loans, because recipient countries are not eager to borrow for legal reform. It is my impression that legal reform is usually undertaken by Third World countries not primarily because they consider it necessary to their internal economic development but because legal reform is an explicit precondition to World Bank assistance or because they are told that there will be no foreign investment without Western-style laws. The result may be a two-tier legal system with one level directed at multinational corporations and other external sources of investment or loans and one level directed at domestic activity. These two levels are interrelated, however, and there are instances where foreign legal advice is sought for primarily domestic purposes such as land registration.

mists' penchant for sharply defined property and contract rights and the lawyers' and private foundations' identification of democracy and human rights with certain legal forms undoubtedly play supporting roles. What interests me, however, and what relates to Winn's article, is a preoccupation with explaining the failure of societies in Africa and Latin America to develop and the relative disinterest in examining law's lack of role in the successes of first Japan, then Taiwan, South Korea, Singapore, and Hong Kong, and now the People's Republic of China, Thailand, Malaysia, and Indonesia.

When observers from the World Bank, USAID, UNDP, IMF, or other international development organizations focus on law in the failed economies of Eastern Europe or sub-Saharan Africa, they see legal chaos; they see the opposite of Shihata's good order and rule of law that apparently flourish in Europe and North America, and with which most of them are most intellectually comfortable and familiar. It is natural, then, to conclude that there is a causal connection between the existence of some kind of formal legal system on the one hand and economic growth and social order on the other. This leap of faith is given intellectual cover by the social theory of Max Weber and his concept of rational law. Unfortunately, the East Asian experience indicates that this easy and intuitive conclusion is most likely fundamentally wrong. As noted by others more than 20 years ago, studies like Winn's bring into question not only the universality of Weberian theories of law and development but also their accuracy with regard to the emergence of European capitalism (Trubek 1972).

What is striking about the Taiwan described in Winn's article is the legal informality of the economic and social order. The biaohui seem quite effective without legal guarantees of the "rule of law" type, and their role in the financing of small businesses seems to have been unaffected by the conversion of the hehui gongsi into commercial banks and the concomitant loss of any formal legal protection for the biaohui. Taiwan's formal legal system does play a role in the widespread use of postdated checks but until recently only in the threat of criminal prosecution. This role is similar to the Romanies' false or selective criminal accusation of individual members of the group in order to maintain internal discipline. The formal legal system is instrumental to group cohesion but in a manner that is more or less unrelated to the legal norm and quite far from Shihata's vision of the role of law in economic activities.

What Winn describes is not limited to Taiwan. What she calls "relational practices" is called *guanxi* in descriptions of economic relationships in the People's Republic of China (PRC) and seems to play a similarly central role there, again in conjunction with the marginalization of formal law (Jones 1993). The extremely

rapid economic growth in China over the past 15 years has led to an increase in economic legislation aimed at foreign economic relationships, and there is a real question whether legal formality addressed to external transactions and parties can coexist with domestic legal informality over the long term. It is not clear, however, that the formalization of legal relationships with outsiders led to similar changes in domestic law in late 19th century Japan or that there has been a dramatic increase in the use of formal law for domestic concerns in the PRC.

Japan's legal system also contains large elements of informalism, especially in the area of economic law that was the focus of Winn's article. American badgering exemplified by the Structural Impediments Initiative (SII) negotiations has forced Japan to clarify the processes governing some markets and the interaction of public and private spheres over the last decade, but there is little or no reason to believe that what is emerging in Japan, even in regard to foreigners, resembles even in aspiration the World Bank's rule of law or Weber's rational law. Indeed, the U.S. government itself has essentially admitted as much in its recent shift from demanding structural reforms in Japanese markets and its legal system to demanding a system of market share goals instead. It seems to this observer that American trade warriors finally realized that they could no longer wait for the emergence of an American-style legal system in Japan, no matter how theoretically inevitable it may have seemed in an advanced capitalist democracy like Japan.

The evidence that legal informality, as opposed to legal formality, may produce economic growth comes not only from Asia. David Trubek in his epitaph to the first law and development movement noted the operation of aspects of the Brazilian economy without "an autonomous legal order guaranteeing private rights through general rules" (Trubek 1972:48).[3] But perhaps the most ironical description of the power of legally informal institutions in economic growth is Hernando de Soto's *The Other Path*, which describes the success of informal elements in Peru's economy in achieving economic growth and social mobility despite their almost total isolation from formal legal protection. What is most interesting about de Soto's work is the lesson drawn from it by de Soto himself and by American conservatives who have adopted it. Instead of weakening their faith in the need for formal law and for its most celebrated constituent part, the judicial enforcement of property and contract rights, the conservatives call for the official recognition of the informal economy and

[3] He also called for greater comparative studies of Brazil and other Third World societies but made virtually no mention of Asia, where, by 1970, in Japan, Taiwan, and arguably South Korea had already provided several examples of economic and social development without a "law and development" style legal system. Not surprisingly, Trubek is including East Asia in his activities as part the *second* law and development movement.

its inclusion within the legal system. Of course, they want recognition by and inclusion within a deregulated market economy that would be very different from that outside of which Peru's informal economy has emerged. It remains true, however, that de Soto and others, in seeming defiance of their own evidence, assume that productive capitalism needs formal adjudication, judicially enforced contracts, and inviolable property rights.

If the experience of Asian economies demonstrates that the strict judicial enforcement of property and contract rights is not necessary to economic growth, can we go the next step to claim that the economies' extraordinary growth means that formal law may actually prevent growth? Certainly the enforcement of formal property rights in Peru would have prevented the progress of de Soto's informal sector, and there are now economists, especially within Japan, who argue that the informal relationships of Japan's interlocking corporate networks and ubiquitous if not always successful cartels are more efficient than the vigorous antitrust policies that the Americans have tried to persuade the Japanese to pursue. It is also true that the destruction of property rights was instrumental to the growth of railroads and industries such as coal mining in the United States during the 19th century (Freyer 1981; Scheiber 1973; see, e.g., *Penn. Coal Co. v. Sanderson* 1886). To conclude from these examples, however, that strictly enforced property rights always inhibit rapid economic growth would be to replicate Shihata's mistake.

What is needed is a recognition of the variety of roads to economic growth in capitalist systems and the variety of roles, including perhaps no role at all, that formal law can play in the process. My point is that leading institutions and foreign corporations do not need security in their loans and investments; it is simply that force feeding the rule of law to developing countries may not be the best way to achieve it. Indeed, money and talent spent on chasing the rule of law chimera in nations like Laos or Vietnam may detract from the creation of the stable investment environment that must be the World Bank's and Shihata's ultimate goal.

Recognition of a diversity of processes of economic growth, however, means swimming against the streams of globalization and international convergence that now threaten to swamp academic and public discourse on international political economy. The collapse of Soviet communism and the market transformation of Asian communism have combined with increasing levels of international trade to convince many observers that convergence of all systems is either normatively attractive, descriptively inevitable, or both.

Informality of the type described by Winn has two profound implications for such a view of the world. First, it demonstrates that convergence is not here yet and that, at least for now, provision must be made for differences in capitalist systems. Second

and more interesting, informality may mean that convergence may never arrive because informality prevents the development of plausible rule of law discourse, which has become the legal language of system convergence in the same way that market economics has long been the language of international economics. Convergence of national economies requires mutual intelligibility, which means, first, that the processes of the market and of economic regulation in each country be predictable and knowable and, second, that persons from another legal culture will be able to recognize these characteristics to the extent that they can understand legal developments, even if they are not competent to participate directly in them. In other words, there must be an international legal culture that penetrates each national legal culture to the extent that practitioners, within which I include bureaucrats, trade officials, businesspersons, and anyone else who has to deal with legal phenomena, can describe and evaluate economic and legal structures, such as the biaohui, in language that each can understand.

Shihata and the World Bank may assume that the rhetoric of the rule of law can serve this role, but I have grave doubts. Perhaps an example from French and Japanese economic regulation can complement Winn's article and illustrate why I am pessimistic. Both France and Japan protect their small merchants by limiting the opening of large-scale retail stores in established commercial areas. Both systems give local merchants a voice in whether and on what terms a large store can open, and both systems anticipate that the final decisionmaking body, which in the Japanese case is the Ministry of International Trade and Industry (MITI), will follow statutory and administrative criteria and be held legally accountable initially by the central administration and eventually by the judiciary if it does not (Upham 1993, 1994).

Despite their statutory similarities, the two systems have historically operated in very different ways. Although plagued by its own problems, including the bribery of members of the decisionmaking committees, the French system has operated in a way more or less connected to the statutory scheme, and when it did not, the Conseil d'État was available to correct gross deviations. MITI, on the other hand, virtually ignored statutory procedures during the 1980s and chose instead to delegate its power under the Large Scale Retail Stores Law (LSRSL) to local merchants themselves. It simply announced that it would not accept any applications from large retailers unless they appended statements from local merchant groups that the latter consented to the terms in the application. This delegation of public power to private parties created a system of bargaining in which the large merchant had to purchase the right to open from local merchants. Once the local merchants' consent was obtained, the

application was filed, and MITI approved it. Since Japanese administrative law doctrine effectively insulated the process from legal attack, the result was a radically decentralized system, which varied from neighborhood to neighborhood and which was virtually unknowable without a deep understanding of the local circumstances.

An American, Thai, or Nigerian lawyer or businessperson coming to these two systems with the appropriate legal and language skills will be able to understand the French system to a much greater extent than the Japanese one. In the former, a reading of the statutes, the accompanying regulations, decisions of the Conseil d'État, and consultations with French legal professionals would provide the foreigner an approximate picture of the process. Even where the system had been corrupted, legal knowledge should give the outsider an indication of the person to whom a bribe might be offered. A similar approach to the Japanese system would have been a waste of time. The formal process described in the statute was an afterthought to the actual process, the thick book of administrative criteria was ignored, and the only court decision of which I am aware merely explained why the issues were not legally cognizable and why the plaintiffs lacked standing. And since any necessary payoffs went to power brokers within the local retail community, rather than to the formal decisionmakers, a legal analysis could not even help in corrupting the system (Upham 1993).

It is interesting to note that although France and Japan share restrictive regulation of retailing with virtually every other country of continental Europe, only Japan's restrictions became a trade issue for American trade negotiators. Although the Americans asked for the general deregulation of Japanese retailing, they never claimed that Japan restricted retailing more stringently than Germany, France, or Italy, and it would have been difficult for them to have done so. Rather than the results of the system, it was its total impenetrability that distinguished the Japanese system, and one of the goals of the Bush administration, which made the law one of the foci of the SII in 1989, was to convince the Japanese to make their regulation of the retail market transparent to foreigners. To a large extent, the Japanese have satisfied U.S. demands, primarily by a general loosening of regulation and a jump in the number of stores opening, but also by implementing the law in a way that is closer to the statutory procedure and by establishing special procedures to inform foreign stores of the progress of their applications.

Although this result might be cited as an example of convergence—the regulatory process was nudged a bit closer to Shihata's rule of law—caution is advised. The Americans have addressed a great many other issues in Japanese regulation, including ones of transparency, with a great deal less success. Even

with retailing, the fundamental process remains insulated from legal accountability and there is no *legal* guarantee that radical informality will not reappear.[4] More important, the informality that typified the pre-SII retail sector still dominates Japanese economic regulation. There has been no general move within the Japanese bureaucracy to eliminate their informal mode of operation. Although I speak with a great deal less authority, I know of no move within the private sphere to formalize their way of doing business, of relating to the government, or of managing the *keiretsu* and trade association networks that characterize much of the Japanese economy. Without such movements, the political economy of Japan will remain informal, perhaps not as impenetrable to outsiders as Taiwan's biaohui or China's *guanxi* but still very different from the universal rules uniformly applied that are necessary for mutual intelligibility.

It is important to note at this point what I do not mean by this discussion of the rule of law. I do not argue that the rule of law describes reality in the United States, France, or anywhere else, or that it is even theoretically possible. Nor do I argue normatively that it would be attractive if it were. The first of these propositions is clearly false and the second at least debatable. What I am arguing is that rule of law rhetoric is a language of convergence in the same way that the language of market economics is. Despite the fact that the existence of perfect markets is both theoretically and practically impossible and widely recognized as such, market rhetoric dominates the discourse of international trade and enables persons from various capitalist nations to believe that they can understand each other's economies. Similarly, rule of law rhetoric dominates the discourse of international trade disputes and specifically of the dispute mechanism of the General Agreement on Tariffs and Trade and the negotiations of the Uruguay Round. As long as the legal systems and economic regulation within countries like Taiwan and Japan remain legally informal and inaccessible through their own formal legal systems, it is hard to imagine the possibility of "globalization" or "convergence" except in the trivial sense of, for example, the same number of large stores opening in Fukuoka, Provence, and Arkansas.

Given the extraordinary success, social as well as economic, of the East Asian countries that share legal informality—what Winn calls the marginalization of law—one is hard pressed to see why we should hope that they will converge on, say, British, Italian, or American practice, even if it were possible. It might make international trade disputes easier to understand and resolve, but it

[4] There are political reasons why it will not reappear, the main one being that the domestic consensus has shifted away from protection of small merchants and toward greater concern for consumers. The Americans are also monitoring the progress of this reform and would protest any backsliding that affected American interests.

would mean the disappearance of a legal regime that has not only produced much of the increase in world wealth of the past two decades but that also represents a different path for social, political, and legal justice for the world.

References

Berger, Suzanne (1993) "Domestic Institutions, Free Trade, and the Pressures for National Convergence: US, Europe, and Japan." Analytic Summary of Presentations and Discussion at 22–26 Feb. 1993 Bellagio Conference, MIT IPC Working Paper 93-002WP, June 1993, on file with the author.

de Soto, Hernando (1989) *The Other Path*, trans. J. Abbott. New York: Harper & Row.

Franck, Thomas M. (1992) "The Emerging Right to Democratic Governance," 86 *American J. of International Law* 46.

Freyer, Tony (1981) "Reassessing the Impact of Eminent Domain in Early American Economic Development," 1981 *Wisconsin Law Rev.* 1263.

Jones, Carol A. G. (1993) "The Globalization of Rule of Law? Some Questions from Asia." Manuscript on file with the author.

Scheiber, Harry (1973) "Property Law, Expropriation, and Resource Allocation by Government: The United States, 1789–1910," 31 *J. of Economic History* 232.

Shihata, Ibrahim F. I. (1991) "The World Bank and 'Governance' Issues in Its Borrowing Members," in F. Tschofen & A. R. Parra, eds., *The World Bank in a Changing World.* Dordrecht: Martinus Nijhoff.

Trubek, David M. (1972) "Toward a Social Theory of Law: An Essay on the Study of Law and Development," 82 *Yale Law J.* 1.

Upham, Frank (1993) "Privatizing Regulation: The Implementation of the Large Scale Retail Stores Law," in G. D. Allinson & Y. Sone, eds., *Political Dynamics in Contemporary Japan.* Ithaca, NY: Cornell Univ. Press.

——— (1994) "Retail Convergence: The Structural Impediments Initiative and the Regulation of the Japanese Retail Industry." Presented to Bellagio Conference on Domestic Institutions, Free Trade, and the Pressures for National Convergence: US, Europe, and Japan, Bellagio, Italy, 22 Feb. 1993, revised 1994 and on file with the author.

Winn, Jane Kaufman (1992) "How to Make Poor Countries Rich and How to Enrich Our Poor," 77 *Iowa Law Rev.* 1 (reviewing de Soto 1989).

——— (1994) "Relational Practices and the Marginalization of Law: A Study of the Informal Financial Practices of Small Businesses in Taiwan," 28 *Law & Society Rev.* 193.

Case Cited

Penn. Coal Co. v. Sanderson, 113 Pa. St. 125, 6 A. 453 (1886).