Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan

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This article looks at one component of Taiwan's development experience, the informal financing techniques used by small businesses, to clarify the interaction between the formal Republic of China (ROC) legal system and the network structure of Taiwanese society. The ROC legal system has supported the economic development process directly by regulating economic activity, and indirectly by facilitating the networks of relationships that also regulate economic activity. The relational structure of traditional, rural Chinese society has survived in a modified form in modern Taiwan, and this modern form selectively blends elements of the modern legal system, networks of relationships, and the enforcement services of organized crime. Ideas such as "legal centralism" and "legal pluralism" fail to capture the dynamic of the relationship between the ROC legal system and Taiwanese society, so the idea of "marginalization of law" is offered as a better description.

Scholars studying law in developing countries often have noted differences between the social foundations for law in those countries and the social foundations for law in economically developed Western societies. At times these scholars have suggested that economic development leads to "modern" legal relations and a correspondingly "modern" role for law. At other times, scholars have argued that customary and traditional forms of social order will persist and limit the effectiveness of regulatory systems modeled on Western law. This article examines the role of law in one important component of Taiwan's development experience—the informal financing techniques used by small busi-

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nesses—in order to determine the nature of the interaction between law and the network structure of traditional Chinese society.

In contrast to the predictions of scholars who have drawn a sharp distinction between modern law and customary social orders in developing (and Western) societies, the evidence presented here supports the notion that the relational structure of traditional, rural Chinese society has survived in a modified form in modern Taiwan and that this modern form blends elements of the modern legal system into networks of relationships. The legal system of the Republic of China ("ROC") has supported the economic development process not only by directly regulating economic activity but also by indirectly facilitating networks of relationships outside the law that also regulate economic activity. Further, when small businesses have been unable to rely on the formal legal system for such indirect support for relational practices, alternatives, including organized crime, have been called on to serve a similar function.

Rather than focusing on better known and successful legal initiatives taken by the ROC government such as legislation dating back to the early 1960s to stimulate foreign investment in Taiwan (Gold 1986:77), this study examines routine and widespread economic activities in which the impact of modern legal institutions is limited or indirect at best: those in the "informal sector" or "underground economy." "Informal sector" refers to economic activity deliberately transacted outside the purview of formal regulation, yet not generally considered criminal. Although the informal sector has made a significant contribution to Taiwan's rapid economic development over the past 40 years, it is as yet poorly understood. To understand informal economic practices in Taiwan, I first address the interactions among the formal ROC legal system, the networks of personal connections which characterize Taiwanese society, and informal substitutes for legal regulation (e.g., debt collection with the assistance of organized crime). This analysis is next applied to the informal financing techniques used by small private firms as just one example of the many types of economic activities routinely undertaken in Taiwan's informal sector (for the methodology for my research, see appendix 1).

Studying the practices of small and medium-sized businesses is a crucial step in understanding the origins of Taiwan's "economic miracle," because such firms have played a greater role in Taiwan's economic development than they have in other East Asian newly industrialized countries (Orrù et al. 1991:368). Until the mid- to late 1980s, small and medium-sized enterprises in Taiwan relied heavily on financial resources from outside the formal financial system because of a shortage of credit from regulated sources (Wade 1990:161). While limited access to bank financing

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clearly contributed to the growth of Taiwan's informal financial system, certain features of Taiwanese society also contributed to that growth, among them the maintenance of networks of personal connections, the availability of informal surrogates for legal enforcement, and the marginalization of formal legal institutions.

The findings of this study point to an apparent paradox. The development of a modern formal legal system may belie the social realities in Taiwan, obscuring the propensity of legal institutions to foster relational practices rather than displace them. The very commitment of many legal practitioners and government officials to the maintenance of a modern legal system based on foreign models seems to contribute to the marginalization of modern formal ROC legal institutions in a manner reminiscent of the marginalization of formal legal institutions in the traditional Chinese polity (Ch'ü 1961). In addition, the formalism of Taiwan's transplanted version of the Western legal tradition seems to limit the law's flexibility in adapting to contemporary Taiwanese social practices, thereby increasing the dependence of businesses on relational practices outside the law.

The conclusions drawn from this study raise important questions that link the subject matter of this article with larger themes in the study of law and development.[1] First, with regard to government-sponsored development initiatives, one possible inference from this preliminary study is that relational practices play a more significant role in development than has previously been acknowledged. If that is the case, then social and economic resources could be mobilized more effectively by officially acknowledging and even promoting relational practices in the economic development process in Taiwan and other Asian nations. Second, the idea of a perpetually marginalized legal system subordinated to relational practices profoundly conflicts with Western ideas of legitimacy based on the rule of law. This suggests that to understand societies experiencing rapid economic development and within which law plays a role very different from the role com-

[1] Although there is evidence that relational practices are endemic in Taiwan (Greenhalgh 1988:224), this article cannot catalog or analyze every significant form of relational practice in modern Taiwanese society, or even every informal or underground financial practice. Thus, while the findings of this preliminary study might support conjectures concerning the significance of relational practices within government, large-scale enterprises, or regulated financial institutions, they cannot serve to quantify the degree to which informal arrangements supplant formal regulation within those institutions. Furthermore, since my focus is on the routine financing of small businesses, I do not address any of the perhaps better-known recent examples of financial scandals involving large-scale credit or investment institutions. These include the Cathay scandal in 1985 (Fields 1990:194), the more recent problems involving Hung Yuan and other underground investment firms (Chen 1992), and the Hualon stock scandal in 1992 (Baum 1992). While these well-publicized cases of underground or illicit financial practices raise important questions about the effectiveness of the ROC legal system in regulating financial institutions and the connection between law, organized crime, and relational practices in Taiwan, they are beyond the scope of this article.

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monly ascribed to it in Western industrialized nations, we must reassess such concepts as legitimacy and modernity.

I. Marginalization of Law in Taiwan

A. The Paradox of Modern Legality in Taiwan

While the legal institutions of Taiwan have many modern attributes, that fact alone does not establish that Taiwan has a "modern" legal system. In order to decide whether or not Taiwan has a "modern" legal system, two separate issues must be resolved: What constitutes a "modern" legal system? And what are the actual characteristics of the contemporary ROC legal system? The first issue, determining what constitutes a "modern" legal system, is at least as problematic as the second, because of the tendency of scholars from societies with "modern" legal systems to conflate theoretical or ideological tenets regarding the rule of law with the actual social practices that constitute legal institutions in their own societies. Certain legal scholars have put forth the concepts of "legal centralism" and "legal pluralism" (Galanter 1981; Griffiths 1986) in an effort both to articulate some unstated assumptions that inform most studies of legal systems and to bring the analysis of legal systems closer to the actual social practices that constitute those systems.

While "legal centralism" and "legal pluralism" may be useful in cutting through some of the obfuscation surrounding the study of many legal systems, neither of these concepts captures the interaction in Taiwanese society between formal legal institutions, informal order, and networks of relationships. A satisfactory account of the role played by the legal system in modern Taiwanese society must simultaneously take account of native Taiwanese ideas about law and society,[2] which have been influenced by both the modern history of Taiwan and traditional Chinese values; the values implicit in Western ideas of modern legality; and the subtle cultural matrix that determines which ideas and values predominate under particular circumstances. While the ROC legal system does not play the dominant, central role assumed by theories of social organization grounded in the Western liberal democratic, free-market tradition, neither is Taiwanese society characterized by a plurality of well-defined, rule-governed social organizations that the concept of "legal pluralism" postulates as the basic form of social organization. The interaction of law and society in Taiwan might more accurately be characterized as the "marginalization of law," a process in which the ROC legal system plays a significant role in Taiwanese society but

[2] Paradoxically, many Taiwanese legal professionals subscribe, or at least claim to subscribe, to a vision of law based on "legal centralist" ideas.

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is often displaced by a more fundamental source of social organization—fluid, highly contextual networks of human relationships.

1. Modern Law and the Presumption of Legal Centralism

The modern legal system of the ROC was organized in a series of steps beginning in the late 1920s.[3] Most codes and statutes enacted during the Republican period (1911–49) on mainland China took German codes and statutes of the late 19th and early 20th centuries as their models, following the example already set by Meiji Japan in modernizing and Westernizing its legal system. Effective implementation of the modern ROC legal system was severely hindered throughout the Republican period. This was due to the limited effectiveness of Republican government on the Mainland during the 1930s, followed by the Sino-Japanese War from 1937 to 1945 and finally by the Chinese Civil War ending with the defeat of the KMT ("Kuomintang" [see appendix 2] or Nationalist Party) and withdrawal of the ROC government to Taiwan in 1949. Since 1949, however, the ROC legal system has played an increasingly important role in the economic and social life of Taiwan as the number of legal professionals has increased and the quality of their training improved and as the quantity and sophistication of legal doctrines have grown to meet the needs of a rapidly industrializing society.

Among the most well-known and successful legal initiatives taken by the ROC government are the Statute for Encouragement of Investment and related changes in tax, land use, and labor and company laws facilitating direct foreign investment in Taiwan and export-oriented growth through the establishment of export-processing zones (Hsu 1985:283). These laws were introduced or amended as part of a broad program of economic reforms in the early 1960s. These reforms laid part of the foundation for Taiwan's subsequent "economic miracle" and its transformation from an underdeveloped agricultural country to a highly industrialized country. Today, Taiwan's per capita GNP is equivalent to that of some European countries.[4]

While the success of these governmental initiatives is well known, they are not representative of the general role played by the modern ROC legal system in Taiwanese society. Indeed, focusing on government led programs that helped nurture Taiwan's successful export-oriented industrialization obscures the role more commonly played by the ROC legal system in regulating economic activity. Much of Taiwan's industrialization has

[3] The Civil Code was enacted in 1929 and the Criminal Code, the Civil Procedure Code, and the Criminal Procedure Code were enacted in 1935. A draft Constitution was adopted in 1936 and finally ratified in 1946.

[4] According to the *1993 World Almanac*, the 1992 per capita GNP of Taiwan was $7,380, which compares favorably with that of Portugal ($5,580) and Greece ($7,650).

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taken place outside the relatively highly regulated environments of the export-processing zones and through domestic rather than foreign investment (Haggard & Chen 1987:93). Thus, the visibility of such initiatives can easily lead to overestimating the importance of state-sponsored regulation and underestimating the importance of alternative ordering mechanisms.[5]

This tendency of some theories of the role of law to emphasize the importance of state-sponsored regulation has been labeled "legal centralism" by scholars trying to devise less-biased models of the operation of law and legal institutions in society. Legal centralism designates not so much a theory as an unarticulated premise that underlies most contemporary discussions of the role of law in society. Legal centralism has variously been described as "a picture in which state agencies (and their learning) occupy the center of legal life and stand in a relation of 'hierarchic control' to other, lesser normative orderings such as the family, the corporation, the business network" (Galanter 1981:17); the idea that "law is and should be the law of the state, uniform for all persons, exclusive of all other law, and administered by a single set of state institutions" (Griffiths 1986:3); or "the dogma that there exists . . . a dominant normative order, defined by a general set of rules and principles (the law), emanating from the state, governing all members of society equally and impersonally, and enforced and applied through the ordinary courts" (Gordon 1985:423).

The idea of legal centralism has often been criticized as an inaccurate characterization of the role of law even in Western societies (see, e.g., Ellickson 1991:4; Scott 1992:668; Williamson 1985:20), and its weakness as a concept has long been recognized from a theoretical, jurisprudential perspective (Dworkin 1979: 62). Nevertheless, the tacit assumption of the normative primacy of state-sponsored rule systems has proven remarkably resilient in discussions of the role of law in modern societies (Griffiths 1986). Galanter (1981:20) points out that while empirical studies of law in modern societies have repeatedly "discovered" the pluralistic, non–state-centered nature of the social order, this has little noticeable impact on official accounts of the role of law in those societies.

2. Legal Pluralism, Legal Marginalism, and Chinese Society

Scholars attempting to avoid the unwarranted assumptions of the legal centralist perspective have developed the idea of "legal pluralism." Legal pluralism has been defined as "a state of affairs

[5] In a similar vein in his study of labor conditions in small businesses, Shieh (1990:14) criticizes the dominance of a "statist" approach in existing studies of Taiwan's development, which overemphasizes the role played by governmental initiatives, often disregarding the role played by ordinary working people and popular culture.

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in which behavior pursuant to more than one legal order occurs" (Griffiths 1986:2). According to Griffiths, a narrow interpretation of legal pluralism would recognize multiple sources of law-like regulation within a single society while still assuming the primacy of state-centered law. A radical interpretation of legal pluralism, however, would deny any hierarchical superiority to state-centered law. From this perspective, institutions such as schools, hospitals, universities, churches, and businesses may promulgate law-like norms that merit consideration together with state-sponsored legal norms in understanding the order of a modern society. When such alternatives to legal regulation are taken into account, legal pluralism seems to offer a better description of many contemporary Western societies than does legal centralism (Galanter & Luban 1993:1401).

However, legal pluralism may not provide an adequate alternative to legal centralism for non-Western societies. This is true for Taiwan, where the social order is anchored in networks of interpersonal relationships rather than founded on either a central, universal, dominant legal order or a plurality of legalistic orders. Fei Xiaotong (1992:61–63), a Chinese sociologist, devised two evocative metaphors to contrast the basic social structures of Chinese and Western societies. Fei described the organization of Western society as comparable to that of a haystack composed of bundles of straw, because individuals, like the pieces of hay, form discrete organizations with clear boundaries, like the bundles that in aggregate compose society. The organization of Chinese society, in contrast, is like the concentric ripples that spread out when a pebble is thrown into a pond. Each person is at the center of a unique network of countless relationships, and while every person is embedded in such a network, no two persons share the same network.

While the ideas underlying either legal centralism or legal pluralism are consistent with the image of a society composed of individuals bundled into defined groups, neither corresponds to the fluidity and highly contextual sense of self and social organization implied in the image of the ripples in a pond. While the role played by legal institutions in constituting the social order is clear in the image of society as bundles of hay, it is not clear what role formally constituted institutions, such as legal institutions, play in a society made up of networks of relationships.

While neither legal centralism nor legal pluralism captures the nature of legal regulation within the Chinese tradition, the absence of a native Chinese tradition of legal analysis (Jones 1974:331) means that there are few indigenous jurisprudential theories that can be drawn upon in developing an alternative model of law and development in modern Taiwanese society.[6]

[6] The assertion is not that there is no recognition of the importance of law in indigenous Chinese philosophy or social theory, but that there is no native tradition of the sort

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One attempt to capture the salient elements of the role of law in traditional Chinese society is expressed by the idea of the "Confucianization of law" (Ch'ü 1961:267). This refers to the development and maintenance of a formal legal system not as the core of a universal, state-centered normative order but rather as a device to reinforce and stabilize networks of human relationships. According to Confucian precepts, these relationships constitute the basis of a virtuous and harmonious society. In the traditional Chinese polity, the administration of law (*fa*) was understood to be punitive, coercive, and morally debased in comparison with the uplifting spiritual influence of ritual practices and human relationships (*li*) (Bodde & Morris 1971:13).

Although Confucian teachings may have limited vitality in modern Taiwanese society, participation in relationships remains the primary factor both in determining the sense of self and in constituting the social order in the contemporary Taiwanese world view and social psychology (Bond & Hwang 1986:221). Social organizations and institutions with well-defined structures, such as the formal legal system, are relegated to a subordinate position in human affairs. The idea of subordinating law to networks of relationships diverges radically from models of society based on either legal centralism or legal pluralism. An expression such as the "marginalization of law" or "legal marginalism" may better express the role played by legal institutions in a predominantly relational society while also avoiding any suggestion that law furnishes a universal, uniform, or dominant social ordering mechanism.

Legal institutions in Taiwan are marginalized not only by the propensity of members of society to seek their objectives through networks of relationships but also by a distinctive sense of what legal institutions can and should accomplish. One of the fundamental premises of the "legal centralist" idea of modern law is that law, together with individual expressions of free will within the framework of a social order demarcated by law, should constitute the normative structure of liberal society. The traditional Chinese sense of the relationship between law (*fa*) and the social order is very different. In terms of Confucian ideology, *li* (often translated as "ritual" or "propriety") is regarded as the morally superior wellspring of social order, while positive law is merely a tool of the state, to be invoked as necessary to censure antisocial behavior.

It would be simplistic and inaccurate to assume that these Confucian ideas operate in modern Taiwanese society in the

of doctrinal exegesis associated with jurisprudence in the Western European tradition (Jones 1974:332-34). The Chinese "Legalist" School of political philosophy emphasized the role of coercive techniques of social control in strengthening the authority of a central administration rather than the interpretation of legal rules (Bodde & Morris 1971: 18).

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same form they once had in traditional Chinese society. However, some semblance of these ideas is still visible under the veneer of modern legality in Taiwan, like a pentimento reappearing through the image that has been painted over it. Many Taiwanese people interviewed for this study, including legal professionals steeped in modern Western traditions of legality, routinely presumed that the invocation of law involved suppression and punishment and often dismissed the idea that law could empower participants in realizing their objectives. The unstated assumption that law is best suited to reprimand misconduct and that nonlegal forms of social intercourse were better suited to enabling or facilitating voluntary interactions often underlay the distinctive manner in which local participants interpreted laws and decided whether to avail themselves of legal institutions in Taiwan.

B. Marginalization of State-centered Regulation

In Taiwan, the manner in which the formal modern legal system is administered often facilitates, directly or indirectly, relational practices. Factors contributing to the marginalization of ROC legal institutions include the legacy of martial law and one-party rule; ambivalence among personnel charged with enforcing the law about the values of modern legality; a tendency toward rigid formalism in drafting legislation that both divorces law from social realities and obscures the exercise of official discretion; the relatively limited number of trained legal professionals; and the allegedly common practice by some government officials of ignoring violations of the law when they choose to do so.

Some of the most dramatic and obvious restraints on the ROC legal system resulted from the imposition of martial law (1937–87) and the Emergency Measures of 1948, suspending or modifying parts of the 1946 Constitution. The Emergency Measures enhanced the power of the executive branch of government during the period of the "communist insurgency on the Mainland," while martial law provided that many offenses against the government or public order would be tried in courts-martial, not in civilian courts. The policies of the Nationalist Party (also known as the Kuomintang or KMT) also undermined the integrity of the ROC legal system through an authoritarian, "quasi-Leninist" system of political control (Cheng 1989). Before the repeal of martial law and liberalization of the KMT regime, the autonomy of the ROC legal system was in many respects effectively subordinated to the interests of KMT party apparatus and the executive branch of the ROC government.

One reason the KMT kept such a tight grip on the political system of Taiwan was the latent ethnic tension between Main-

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landers and Taiwanese.[7] Until the late 1980s, one of the most notable features of the political landscape in Taiwan was the continued dominance of a ruling elite drawn primarily from refugees who came to Taiwan from mainland China in the late 1940s and the corresponding suppression of many of the civil liberties of the Taiwanese people. The tension between the Taiwanese and the Mainlanders became acute in 1947 when an uprising by local people against corrupt KMT rule in Taiwan was violently suppressed. Although this ethnic tension was not officially acknowledged until recent years, it has remained a significant factor in Taiwanese politics and society ever since (Tien 1989:36).

Policies, official or unofficial, of a central government cannot be the exclusive determinant of an institution as large and complex as a national legal system, so elements of local legal culture and the attitudes of individual practitioners must also be taken into account. Many government staff members charged with enforcing the law in Taiwan seem to have ambivalent feelings about the values of modern legality. During interviews, legal professionals tended to emphasize the observance of formal, modern legal values in Taiwan and to obscure the role played by the legal system in maintaining relational practices and the informal sector. The invocation of modern legal values in Taiwan, however, often seems to mask a much more traditionally Chinese sense that the power of law should be invoked not to constitute the social order but to reinforce a social order primarily constituted by relationships. The speakers seemed to be invoking the ideals of a modern legal system while downplaying the social realities of modern Taiwanese society in order to avoid acknowledging the conflict between Chinese values and Western legal values.

One way in which this kind of ambivalence among legal professionals toward the values of modern legality is indirectly expressed is in the predilection for highly formalistic laws that are often significantly divorced from social realities. A high degree of formalism in drafting legislation maintains the distance between legal institutions and other social activities, encouraging recourse to alternative ordering mechanisms such as networks of relationships or simply relegating the law to irrelevance. In addition, rigid formalism subordinates legal institutions to political imperatives by disguising the exercise of official discretion. By enacting formal laws that are not always consistent with social realities, ROC legislators tacitly sanction the exercise of considerable discretion in their application.

Even the most ardent proponents of modernization of the ROC legal system acknowledge that the existing corpus of ROC

[7] Today, roughly 70% of Taiwan's 20 million people are "Taiwanese" (descendants of immigrants from Fukien province in the 18th and 19th centuries), 12-15% Hakka, and 1-2% aboriginal; the remaining 12-15% are "Mainlanders" (post-1949 refugees from Mainland China or their Taiwan-born descendants) (Tien 1989:36).

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law is labyrinthine, replete with "ironies and inconsistencies," although they would prescribe larger doses of modernization and liberalization as a cure for the problem (Liu 1990:214). Unofficially, ROC authorities often tolerate gross and notorious violations of the law for extended periods of time, as was the case with underground investment companies. From 1982 until the collapse of most of these firms in 1989, Taiwanese people invested the equivalent of U.S.$8.5 billion in underground investment companies, most of which were little more than Ponzi schemes (Chen 1992:127). In addition, ROC authorities have been known to selectively enforce highly restrictive regulations in order to achieve unofficial, unstated objectives such as the harassment of political dissidents (Arrigo 1994).

The extent of official discretion in Taiwan is not overt, and it differs from both Japanese and American models. The use of formalism to mask official discretion in Taiwan contrasts with the Japanese practices of "legal informality" or "bureaucratic informality" in which modern legal institutions have been adapted to permit the overt exercise of discretion by government officials. In Japan, open-textured drafting of legislation is used to make express grants of discretion to decisionmakers. In addition, institutional mediation is widely used to harmonize Japanese legal standards and social conditions (Upham 1987:17). Nor have ROC legislators adopted the common U.S. practice of granting a degree of discretion to decisionmakers through the use of flexible standards and balancing tests in drafting legislation (Llewellyn 1953:782).

Another significant factor limiting the autonomy of the legal system from political and relational influences is the relatively small number of legal professionals in Taiwan and the large numbers of "back doors" to the legal profession. This is important because the number of practicing lawyers in Taiwan has historically been very restricted. In 1991, the ROC Ministry of Justice estimated that there were only 2,254 members of the private bar.[8] Until very recently, the tiny number of successful candidates passing the regular bar exam[9] was never adequate to meet even the limited demand for lawyers recognized by the ROC authorities. Before the recent relaxation in standards applied to

[8] The data on numbers of legal professionals and admissions to the bar were provided by the Ministry of Justice in correspondence in August 1992. Given Taiwan's 1990 population of 20,454,000, this represents a ratio of about 1 lawyer per 9,000 persons, which is equivalent to the Japanese ratio of 1/9,400 persons but much lower than the ratios of other civil code countries such as France, with 1/2,000 or the former West Germany with 1/500. Galanter 1992:82; Ocasal 1992:14.

[9] For 1950-91, of 37,308 persons sitting the bar exam, 1,723 (4.62%) candidates passed the exam. In any one year, the total number of successful candidates might be as low 16 of 2,142 (0.75%), the result in 1988. Starting in 1989, however, the bar exam pass rate dramatically increased, producing a rapid expansion in the number of licensed lawyers in Taiwan. In 1991, an unprecedented 363 of 3,977 (11.14%) passed, the highest number ever to qualify.

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candidates sitting the bar exam, the number of lawyers in Taiwan was supplemented by admissions to the bar under other criteria. These "back doors" to admission are often open to lawyers who pass no formal qualifying examination, or pass a less rigorous qualifying exam, but who have been screened according to informal, often political, criteria.[10] Informants estimated that until recent years, two-thirds of all lawyers in Taiwan had come through various back doors, relying at least in part on patronage connections not only for admission to the bar but trading on those personal and political connections after admission to the bar for their effectiveness in representing clients. Thus for many years, even among the small number of lawyers admitted to private practice, only a minority achieved their position or ply their trade by relying exclusively on their formal legal training.

The common allegations of corruption among legal personnel and lax enforcement of existing regulations are evidence that legal institutions are at least perceived as subordinated to interpersonal networks in Taiwanese society. Allegations of corruption among judges and prosecutors in Taiwan are widespread but difficult to verify. One magistrate (himself relatively young and having qualified by formal exam) acknowledged that judges' reputation for taking bribes was not without some foundation. He felt that judges who had gotten their positions through various back doors were more likely to permit their judgments to be influenced by entreaties from colleagues, while younger magistrates who qualified through formal exams were more likely to resist such appeals to personal connections.

With regard to the potential abuse of prosecutorial discretion, informants offered anecdotal evidence to support similar conclusions. Discussions with government officials charged with enforcing business registration and licensing laws indicated that while the official posture was one of rigorous and uniform enforcement of the law, in fact, given the magnitude of noncompliance, the official practice in most instances was one of tolerance. Official investigations and prosecutions were only commenced in response to complaints, and in the absence of any complaints, any enforcement action was unlikely against even quite obvious violations.

[10] From 1981 to 1991, a total of 857 candidates were admitted to the bar without any qualifying exam because of their status as magistrate, prosecutor, law professor, doctor of laws, senior judicial administrator, military judge, or military prosecutor. While access to positions such as magistrate or military judge may in turn be based on competitive examinations, the pass rates for those exams have historically been higher than the pass rates for the regular bar exam. For example, for 1981–91, pass rates for the magistrate/prosecutor exam ranged from 5% to 10%; pass rates for the military judges exam had pass rates from 40% to 78%. (The total number of candidates for the magistrates/prosecutors exam is equivalent to the number of candidates for the regular bar exam, but only a small handful of candidates sit for the biannual military judges exam.) The scope for political screening of candidates for admission to the bar is highest with lawyers coming from military service, legal academia, and government service.

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The administration of law in Taiwan is thus a highly complex and nuanced process, reflecting the limitations imposed on legal institutions by the structure of legislation, political constraints, cultural predispositions, and other variables. While the ROC legal system may function with a high degree of efficacy in some contexts, that degree of effectiveness is clearly not uniform. The restrictions on the effectiveness of the ROC legal system are so substantial, however, that the ROC legal system cannot be said to stand in the relation of hierarchic control over other normative systems in Taiwanese society that conformity with the ideal of legal centralism would require. Given the diminished scope of state-centered law in Taiwanese society, a theory of the role of law and development in Taiwan must identify alternative sources of normative ordering outside the state and then determine what factors account for the displacement of formal law in some situations and not others. The primary alternatives in Taiwanese society seem to be networks of relationships and informal surrogates for the legal system.

C. Relational Practices and Other Alternatives to Legal Regulation

While traditional Chinese society was characterized by dense networks of relationships with relatively little role for formal legal institutions (Fei 1992), modern Taiwanese society cannot simply be equated with traditional Chinese society. The last four decades of rapid industrialization have had a profound impact on Taiwan's social fabric (Tien 1989:31). Thus it would hardly be surprising to find that while the relational structure of Chinese society has survived in some form in modern Taiwan, that structure was modified by the social conditions of a rapidly industrializing, increasingly urban society heavily involved in international trade and commerce.

The evidence gathered for this study of the role of law in Taiwan's development suggests that many elements of the modern ROC legal system have been drawn into relational structures to compensate for the loss of more traditional techniques of maintaining relationships. Where formal legal mechanisms were inadequate, informal alternatives to legal regulation, such as those provided by organized crime, are sometimes relied on as substitute mechanisms to police cooperation and punish violations of relational or other norms.

1. Personal Relationships and Network Building

In both Western and Chinese economies, many exchanges of goods and services take place within relationships rather than as discrete transactions between strangers in an anonymous competitive market. American legal theorists devised the concept of "relational contract" (Macaulay 1963; Macneil 1978) to adapt

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modern contract law to actual business practices. Relational contracts, which consist of flexible, long-term relationships, can be contrasted with either discrete contracts, in which no relation exists between the parties apart from the simple exchange of goods, or corporations, which consist of complex hierarchical structures that facilitate cooperation (Coase 1937; Williamson 1985).

While the networks of relationships characteristic of a Chinese society have many points in common with the relational contracts identified in American society by Macaulay, Macneil, and Williamson, there remain significant differences. These differences seem to be ultimately grounded in a different sense of how the self is constituted in relation to other members of society and in relation to social norms external to any personal relationship. The Western concept of "contract" in its most general form is based on the presumption of an individualistic, "boundaried" sense of self manifested through exercise of free will with reference to transcendent norms.[11] The contrasting Chinese idea of relationship presupposes a more contextualized sense of self, where the self is actually constituted by relationships and family relationships are the most important (Bond & Hwang 1986:220). In order to convey a sense of these differences, the label "relational practices" is used in this article to distinguish Taiwanese relational business practices from the American relational contracts.

The family is the basic social unit in Chinese society, and the interdependence and cooperation of family members is based on a pragmatic assessment of the benefits that accrue through collective action with family members. Unlike the Western concept of family, the Chinese idea of family has no clear boundaries but is highly flexible and can expand to include more than those bound by blood or marriage (Fei 1992:61). Building connections, or *guanxi*, with individuals not bound by family relationships proceeds on the basis of analogies to family relationships and can counteract, although not entirely overcome, the anxiety associated with dealing with nonfamily members (Hwang 1987: 952). In the absence of self-consciously forged relationships, the Chinese presumption is that there are no preexisting duties owed between strangers, and dealing with strangers is therefore highly problematic and fraught with potential dangers (Redding 1990:66).

A calculated process of either building connections with promising outsiders or refusing to make connections with less desirable favor seekers, together with the maintenance of family connections, forms much of the institutional framework within which business transactions in Taiwan take place (Orrù et al.

[11] This sketch of the Western sense of self is of course little more than a caricature that has been often criticized as inaccurate even when applied to the United States (e.g., West 1988).

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1991). The process of building or dismantling relationships in Taiwan consists in doing (or not doing) "favors" (*renqing*) for others and allowing everyone to maintain a sense of "face" (*mianzi*). Within Chinese social relations, it is essential to have "face"—to impress others as being a successful, responsible person so that one may have access to the resources that others control and allocate through favors (Hwang 1987).

In trying to obtain access to scarce resources, a person will first seek assistance from someone with whom he or she has either a family connection or a particularistic tie, such as a school classmate, a neighbor, a work colleague, or a former teacher or student. That relative or friend will feel some pressure not to cause the favor seeker to lose face by denying the favor, as well as not to lose face himself or herself by appearing to be someone without sufficient connections to resolve the problem. The person making the decision either to help or to evade the request for help will take into account the petitioner's quality of connections and personal integrity in order to estimate the likelihood that the petitioner could return the favor at some undetermined future date.

When Chinese society was still predominantly rural, procedures for establishing and maintaining relationships through kinship networks were fairly stable and readily comprehensible to all members of society. Thus, many commercial transactions could take place within relationships as a mutual gift exchange rather than as a free-market transaction (Fei 1992:101, 126). In contemporary Taiwan, however, many entrepreneurs have been forced to go outside their local communities to conduct their business. In addition to greater exposure to other Taiwanese businesses from outside their immediate community, many entrepreneurs have entered into sustained contact with foreign institutions, often on the basis of formal legal arrangements. In contemporary Taiwanese society, relational practices alone may not provide the security necessary for economic transactions to take place between people without kinship ties.

The problem of "bad faith business failure" (*exin daobi*) illustrates the type of risks faced by business owners when doing business outside a well-established relationship. According to many informants, business failures are common in Taiwan because businesses are small and undercapitalized and rely heavily on short-term contracts from overseas buyers. The customary informal solution to the problem of business insolvency is for colleagues to accept 30% of the full amount owed, producing an informal composition (i.e., voluntary dicharge granted by creditors) after a business fails. According to a magistrate, the 30% figure became customary among business people because under sentencing guidelines applied when dishonoring a check was a criminal offense, the sentence imposed included a fine equal to

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30% of the amount of the check together with a jail sentence. Since the principal of the business would have to pay at least 30% of any debt evidenced by a check if the creditors turned the matter over for prosecution, it became customary to simply offer the 30% to the creditors in exchange for not instituting a criminal prosecution.

Not all business failures are a function of bad luck or errors in judgment, however, and some business people seemed to be exploiting creditors' willingness to accept 30% in settlement of the debts of a failed business. This gave rise to the proverbial "10–7–3–4" scheme used in connection with *exin daobi:* a product purchased for $10 could readily be sold for $7 and, after the principal offered creditors the customary $3 to settle the debts of the business, the purchaser would pocket a profit of $4. Several informants who were actually in business acknowledged being familiar with the "10–7–3–4" concept, indicating that even if the practice is not widespread, concern over the possibility of such fraudulent schemes may be.

Given the insecurity caused by the potential for fraud in dealings with relative strangers, parties to business transactions that are conducted outside the immediate family circle may take the precaution of reinforcing the security of the relationship by appropriating elements of legal or other regulatory mechanisms. This procedure of using legal institutions to reinforce what are ultimately nonlegal relationships is well known even in studies of law and society focused on American society. Relational contract theory presumes that the parties incorporate elements of the formal legal system into the structure of their relationship because relational contracts are just one element of the subject matter of contract law generally (Macneil 1978). For example, taking a security interest in personal property may be thought of as laying the foundation for flexible cooperation within a long-term relationship rather than simply providing a contractual mechanism for improving a creditor's chances of recovery after default (Scott 1986:903). Courts can be thought of as conferring "bargaining endowments" on the parties to a conflict rather than merely adjudicating disputes through the application of rules (Galanter 1981:6). Discounting postdated checks, discussed in detail below, is a prime example of using selected elements of the ROC legal system to reinforce relationship structures that became increasingly less personalistic as Taiwan developed economically.

2. Organized Crime as a Surrogate for Law

If the ROC legal system is unable fully to provide the necessary backstop for a relationship in modern Taiwan, the parties have the option of turning to substitutes. Organized crime plays

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a significant role in policing transactions in the informal sector in Taiwan. While the term *liumang* is used in ordinary conversation to denote either a hooligan/delinquent or a member of an organized gang, the discussion that follows focuses on the activities of the latter, more formally known as *bangliufenzi*.

Gang members may own and operate businesses themselves, they may demand protection money from other businesses, or they may provide various services to other businesses. Operating barbershops (i.e., massage parlors/brothels) or nightclubs, gambling, moneylending, and smuggling are among the illicit activities organized gangs undertake in Taiwan, although in recent years they have become more active in otherwise legitimate businesses such as real estate development and stock brokerages (Sheu 1990).

Gangs also derive substantial revenues by demanding protection money from legitimate businesses such as restaurants and other retail establishments. Informants described the following process: a man (presumed to be associated with the organized gang with jurisdiction over the location of the store) offers for sale a container of cheap tea for 10 or 20 times its fair value. The merchant or restauranteur then pays the sum demanded rather than risk a disruption of business.

According to informants who claimed to have first-hand experience dealing with gang members in commercial contexts, gangsters also offer such services as providing bodyguards, offering to represent interested parties in negotiations, collecting debts, or other dispute resolution services. Members of organized gangs perceive themselves as providing valuable services and operating a business with a view to its long-term growth and continued operations, and thus avoid unnecessary violence in the discharge of their duties (Sheu 1990). They sometimes even have business cards printed showing themselves as officers of enterprises offering, for example, dispute resolution and debt collection services.

While recourse to gang members was mentioned repeatedly by informants as one element of doing business in the underground economy in Taiwan, very few informants would admit to having personally dealt with gang members, making it difficult to know if the practice is really as widespread as informants seemed to think it is. For example, in response to "How can you tell you are dealing with a gangster rather than an ordinary business person?" one businessman who claimed to have dealt with gangsters stated that they can be identified from among a group of businessmen because although they have no apparent qualifications or ability, they act in an arrogant and overbearing manner. Another businessman stated that gang members can be identified because they stand to the side of negotiations with their hands in their pockets, suggesting they are carrying guns. Short of overt

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acts of violence, the criteria informants used for distinguishing gang members from legitimate businessmen is apparently fairly vague and situation-specific.

Informants variously reported that gangsters work for flat fees payable in advance and on a contingency fee basis, suggesting that gangsters may negotiate different forms of compensation for different matters. There was a striking consistency, however, in the descriptions of how a party learns that the other side of a commercial dispute has hired gang members to assist in resolving the dispute. The gang members might be hired, for example, to settle a dispute about whether allegedly nonconforming goods should be paid for in full, or whether work under a lucrative contract should be subcontracted to a particular party. The party being threatened arrives at work to find several strange men sitting around, perhaps in the reception area. The men say nothing, sitting patiently all day or playing cards to pass the time. The threatened party can infer from this that the other party to the dispute has hired gang members and that if the dispute is not brought to a speedy resolution, the level of intimidation will soon increase. Increased sanctions include threats to kidnap family members or of bodily harm to the threatened person.

Gangsters can also be more effective than courts in collecting debts acknowledged to be due. Courts are often perceived as unhelpful to litigants because, in the words of several informants, the standard of proof is "too high," although this may just be another way of saying the court expects formal documentation of transactions that most parties cannot provide. Assuming a party can obtain a favorable judgment, he or she may still not be able to locate any assets to attach. Debtors' assets in Taiwan are difficult to locate because of a lack of public access to records of ownership of company assets, unreliable accounting practices, and the ease and regularity with which assets can be transferred or held in the name of family members. Thus the relational system of relying on family and friends and not on formal, public recordkeeping can frustrate legitimate attempts at debt collection. By hiring gang members to collect debts, however, the relational system that obscures the location of assets from formal collection attempts is mobilized in reverse to generate assets. If a debtor or a debtor's family members are threatened with physical harm, then the debtor will mobilize assets by calling on relational ties to pay the obligation, thus permitting a creditor to recover in excess of the debtor's personal assets.[12]

[12] One local attorney, who recognized that gang members were effectively in competition with lawyers in some arenas, recounted a tale of woe that had befallen a client forced to deal with gang members. The client had sold on a commission basis investments in limited partnerships in U.S. real estate that later became worthless. A few investors demanded that the client repay their investments in full and refused to accept that the client, acting as agent for a now-defunct principal, could not return their money. The frustrated investors apparently hired gangsters to put pressure on the salesman. The

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II. Informal Financial Practices of Small Businesses in Taiwan

Before I describe certain common informal financial practices, I must clarify the concept of the informal sector and how it applies to Taiwan's economy. The term "informal sector" was coined 20 years ago by a researcher studying levels of employment in developing countries in order to discuss what all those purportedly unemployed people were actually doing (Hart 1973). Castells and Portes (1989:12) defined the informal sector as "unregulated activity in a legal and social environment where similar activities are regulated," and distinguished informal (or underground) economic activity from both criminal activity and regulated economic activity. Thus, by definition, underground or informal economic activity directly implicates the role of the legal system in society.[13] According to a study reported in 1990, the informal sector accounted for about 57% of all economic activity in Taiwan (Chai 1990).[14] For developed countries such as the United States, estimates of informal economic activity range from 3.4% to 21.7% of all economic activity (Tanzi 1982:88).

While many activities in Taiwan take place outside the scope of formal legal regulation, however, it may not be particularly useful to lump them all together under the rubric "informal" or "underground." In this article, "informal" will denote activities that should be registered or licensed by the authorities but are not, or that give rise to a tax liability but no taxes are paid. Business enterprises in Taiwan are required to register with the appropriate administrative agency in order to receive permission to engage in economic activities (ROC Business Registration Law, art. 3). Small-scale businesses apply to local or municipal authorities, while larger businesses apply to the Ministry of Economic Affairs. The dividing line is whether a business has paid-in capital of over New Taiwan ("N.T.") $40 million and assets of over N.T. $120 million.[15] According to official statistics compiled in 1989,

gangsters appeared at his workplace, telephoned his home and threatened his family members and finally kidnapped him, releasing him only after he wrote checks for the full amount the investors had lost. The salesman was only able to cover the checks by borrowing money from friends and relatives.

[13] Several problems arise from the attempt to define the informal sector exclusively by its relationship to formal regulation. One is that it is not clear how "informal" can be so neatly demarcated from what is "criminal" in any society, because many activities of the informal sector are actually criminal according to statute or administrative regulations. The definition of the "informal sector" as economic activity taking place outside the reach of formal regulation presupposes formal regulation as the norm and is thus another example of the pervasiveness of the idea of legal centralism in theories of the relationship between law and development.

[14] Chai estimated the informal sector in Taiwan made up 16% of economic activity in 1962, 32% in 1982, and 40% in 1986.

[15] This standard applies to manufacturing businesses; similar standards exist for extractive, trading and service businesses. Rules Governing Small & Medium Enterprise

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98% of all registered businesses in Taiwan are small and only 2% are large, whereas 60% of GNP is contributed by small businesses and 40% by large (ROC SMMB 1989). A business may engage only in those activities for which it has applied and been granted permission by the relevant authority—blanket authorizations to engage in "any lawful business" are not granted. Informal activities in Taiwan are conducted not only by companies that fail to register but also by companies that exceed the scope of activities authorized by their business registration.

Business enterprises are also required to register with tax authorities. Local tax authorities collect the business tax—a value-added tax ("VAT") introduced in 1986—and the land value increment tax,[16] while central authorities collect the income tax levied on profit-seeking enterprises. Informal activities are carried on by businesses that fail to pay any tax, as well as those that pay some tax but take deliberate steps to understate the level of taxable activities they have undertaken.

Until recent years, ROC authorities concentrated on generating tax revenues through duties levied on foreign trade and adopted a fairly relaxed attitude toward collecting domestically oriented taxes such as the income tax. This was one component of a general policy of noninterference with small-scale economic development that led not only to widespread tax evasion among small businesses but also to pollution problems, chaotic land use, and unregulated labor conditions (Wade 1990:175, 268–70). In recent years, however, ROC tax authorities have made major efforts to increase the incidence of tax payments by businesses by reducing corruption and opportunities for evasion. If successful, these efforts will diminish the magnitude of tax evasion and subject many business practices to sustained government scrutiny, undermining the ability of participants to use networks of connections to evade regulation. The most prominent initiative was the replacement of the old business receipts tax with a VAT in 1986.[17]

Assistance, arts. 4 & 5 (last revised 14 July 1982). In 1990 when this information was obtained, the exchange rate for the U.S. dollar and N.T. dollar was about 1:26.

16 The land value increment tax was introduced by Dr. Sun Yat-sen, founder of the ROC, and was based on the 19th-century "single tax" movement in the United States. See George 1879.

17 The old tax could easily be evaded by using forged receipts instead of the numbered receipts provided by the government. The new tax is levied only on the incremental value added by an enterprise, and taxpayers are required to produce receipts for both purchases and sales to establish what that increment is. Failure to produce sales receipts will tend to reduce tax liability, but failure to produce purchase receipts will tend to overstate tax liability, thus creating an incentive for buyers to demand receipts from sellers and creating a paper trail government officials can retrace. To induce retail customers to demand receipts, the government holds a lottery in which the winning number is one of those printed on uniform VAT receipts. Large taxpayers provide VAT information in computer-readable formats, and the local tax authorities have created substantial databases on firm revenues and expenses that permit them to cross-check taxpayer reported information for reliability.

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While the new VAT system is unquestionably more effective than the system it replaced, allegations of widespread tax evasion persist among people in business. Techniques for evading VAT include systematic underreporting of both expenses and sales so that some income is reported and some tax paid but the payment is only a fraction of what is due. This strategy of partial payment and partial disclosure is reported to be practiced with regard to many types of tax. These strategies of systematic underreporting require multiple participants to be successful, and without a high degree of trust between participants they would be too risky to undertake. The need for discretion in accounting services in particular has apparently given rise to a profession of "underground" accountants who prepare both "outside" or official books for public consumption, and "inside" or accurate books for the owner's use alone (Wuo 1987).[18]

Small businesses in Taiwan typically have relied more heavily on debt finance than on equity capital and have been forced to look to the informal financial sector to provide that debt finance (Wade 1990:160–61). Until the significant liberalization of banking in Taiwan beginning in the late 1980s (Winn 1991), commercial banks and other regulated financial institutions in Taiwan catered primarily to the needs of large and medium-sized businesses, leaving small businesses to secure financing through whatever channels they could. This bifurcation in credit allocation was due to a variety of factors: until the mid-1980s, there was a chronic shortage of credit generally in Taiwan; small businesses did not usually maintain the kind of accounting records that commercial lenders required; and commercial banks allocated

[18] Tax collection agencies are aware of the problem of multiple account books. Account books that have been shown to the tax authorities are marked with red seals to force the taxpayer to consistently show the authorities the same set of books with each audit. Taxpayers who can establish to the tax collection authorities' satisfaction that their tax returns are based on a legitimate accounting system are permitted certain tax concessions. Income Tax Law, art. 77, provides for "blue" returns, prepared by a public accountant, making the taxpayer eligible for entertainment expense deductions and a three-year loss carryforward. Income Tax Law, arts. 37.1 & 39. Taxpayers with businesses over a certain size are required to have their accounts certified by a public accountant, and in recent years the standards for certification have been tightened up. Businesses with no reliable accounting records have their tax liability estimated by the tax authorities based on information on gross sales revenue. The estimates are made based on a complex matrix of average profitability rates for hundreds of different industries. Income Tax Law, art. 80. Penalties can be assessed if too many records are missing. Income Tax Law, art. 105.

The tax authorities are also well aware of the pressure on government employees to be drawn into personal relationships at the expense of their official responsibilities. Tax auditors are now required to meet with taxpayers only in open-plan government offices where co-workers are able to witness and overhear any exchanges between the auditor and the taxpayer, and on-site audits are now the exception. While this may have reduced the pressure on auditors to bend the rules, it also removes any opportunity the auditor may have had to compare the reported size of the taxpayer's business operation with the actual physical plant and equipment used in the business. Furthermore, one banker reported that the practice among businesses is now to learn the auditor's name in advance and invite that person for a meal prior to the audit.

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credit to large and medium-sized businesses in accordance with policies established by the government, which not only regulated the banks but also owned them.

Some of the financing of small businesses is provided by family and friends in the form of capital contributions not rigorously styled as either equity or debt. Other financing is acquired through the use of rotating credit lotteries, known as *biaohui;* discounting postdated checks; borrowing from underground moneylenders who usually operate with at least the protection of organized gangs; and real estate loans arranged by scriveners, known as *daishu.* The following discussion focuses on the nonfamilial, nonregulated financing mechanisms.

Biaohui, Mutual Savings & Loan Societies, and Small & Medium Business Banks

1. The Structure of Biaohui

Rotating credit associations, known as *biaohui* in Chinese, have been found in cultures and regions as diverse as sub-Saharan Africa, Southeast Asia, Korea, and the West Indies (Geertz 1962). The basic structure (subject to countless variations) is that a group of people agree to meet at regular intervals, each making contributions of an agreed amount, creating a pool of savings that is then given in turn to the highest bidder. The right to bid is reserved to members who have not yet received the collected pool until finally each member of the group has received the pool once. This form of savings lottery is common in societies that possess a monetized economy yet do not have well-established modern financial institutions. Rotating credit lotteries reinforce community bonds while mobilizing savings. In so doing, they facilitate investment and the accumulation of capital.

Biaohui have existed in China for hundreds of years and are still very popular in Taiwan today. According to a recent Ministry of Justice study (1985:302–4), 68% of adults in Taiwan had participated in biaohui, while 95% thought they were a very popular and widespread activity. In 1985, many informants declared that biaohui were not as popular as they once were because they rely on the strength of such traditional Chinese values as face and the importance of relationships, and those values were being eroded in contemporary Taiwanese society by the process of rapid economic development. In 1990, however, informants acknowledged that biaohui seemed as popular as ever but still predicted their imminent demise because of the general decline in moral standards. It is therefore difficult to determine whether biaohui are actually losing popularity. It is possible that the frequent assertion that biaohui are losing popularity should be interpreted

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as an expression of disquiet at the rapid pace of social transformation in Taiwanese society rather than as a factual observation.

According to various informants, biaohui may be organized by friends, such as co-workers or neighbors, on a noncompetitive basis so that the collected pool of funds is received by each member in turn without bidding. They may also be organized on a very large scale by entrepreneurs raising the equivalent of venture capital by drawing together a large group whose only common interest is some connection to the organizer of the biaohui. Individuals may participate in biaohui to generate personal savings, to participate in a social activity with friends, to raise money to meet unexpected expenses such as uninsured medical expenses, to ease sudden cash-flow problems in a business, to make a major purchase such as an automobile, or to make a down payment on property (ROC Ministry of Justice 1985:95).

Among the reasons given in response to the Ministry of Justice survey for the popularity of biaohui were interest rates for investors that were higher than regulated financial institutions could offer; instant availability of funds; no parallel to the requirement usually imposed by regulated lenders that borrowers furnish either collateral or a surety; no troublesome procedures involved in launching a biaohui; and the lack of alternative sources of funds (ibid., p. 55). Another factor enhancing of the appeal of biaohui is that participants do not generally pay taxes on their earnings.[19]

Most informants felt that while biaohui had been very popular in the past, they would become less popular in the future for a variety of reasons. While many of the factors contributing to the continued popularity of biaohui are still significant, 83% of respondents to the Ministry of Justice survey were worried about the risk of failure of biaohui, 96% thought that failures of biaohui had a serious impact on society, and 81% thought that it was not uncommon for biaohui to fail before all participants had been awarded their turn to collect the pool (ibid., pp. 129–31). Respondents cited as reasons for the failure of biaohui economic slumps, lack of ethical standards among people in business, greed among members, and deterioration of the bonds of human relationships (ibid., p. 58).

The rights and responsibilities of biaohui organizers and members are quite distinct and well defined. The organizer of a biaohui traditionally enjoys a major benefit from playing that role: the right to receive the first pool. In return, the biaohui organizer is expected to guarantee the performance of all other

[19] In an interview in 1990, a senior official in the Ministry of Finance's Department of Tax readily acknowledged the ROC authorities' inability to collect taxes on biaohui earnings, but he countered by pointing out that even in the United States, the Internal Revenue Service had trouble collecting taxes on wages paid babysitters (a prescient observation in light of the recent Zõe Baird scandal).

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biaohui members, taking over their share of the payments if they are unable to do so. The primary risk of loss to biaohui members arises from the fact that the biaohui organizer may not fulfil that obligation as guarantor if participation in the biaohui breaks down before all members have had their turn to receive the collected pool. For example, a participant whose primary interest is in earning a high return on her investment might permit all the participants in more urgent need of the credit and more willing to bid high interest rates[20] to receive the collected pool first with a view to waiting to the end of the biaohui process. Such a participant would enjoy the highest rate of return of all the participants by the time she finally collects the pool, unless the biaohui is not continued to completion, in which case that participant would suffer the greatest loss of principal. If the biaohui organizer and biaohui participants are members of the same networks of personal connections, the risk of default by the biaohui organizer is minimized. If the participants do not know each other and have only a limited connection to the organizer, the risk of the biaohui organizer absconding is obviously greater.

While the rights and liabilities of members of biaohui are not defined in ROC statutes or codes, two ROC Supreme Court judgments clarify the legal status of biaohui. In these precedents, the Court held that unless otherwise agreed by the members, biaohui consists of contracts between the organizer and each member, with no legal relationship existing among the members (1960 Tai-Shang-Zi 1635; 1974 Tai-Shang-Zi 1159). Only in the event that the organizer fails to exercise his or her rights against defaulting members can a member subrogate to the rights of the organizer and pursue recovery from other members (ROC Civil Code art. 242). The lack of a cause of action from a member who has made regular contributions but not yet received a turn at the collected pool and members who have had their turn is a major flaw in the regulation of biaohui, forcing frustrated members to either accept their losses or find nonlegal recourse against the other participants in the hui.

2. *Regulating and Deregulating Biaohui*

In the 1950s, the ROC authorities established a group of regulated financial institutions known as "Mutual Savings and Loan Societies" or *hehui gongsi*. The hehui gongsi were in fact little more than aggregates of biaohui, in which the hehui gongsi played the part of biaohui organizer. According to bankers formerly associated with hehui gongsi, company representatives, employed on a commission basis, went out to organize biaohui

[20] Interest rates may be expressed as either a discount off the regular contribution amount that other hui participants do not have to pay or as a premium over the regular contribution that the bidder will pay for the remainder of the hui.

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among their family, friends, and acquaintances. Savers received the benefit of a corporation as guarantor that the biaohui would continue through completion while still enjoying interest rates above those offered on deposits by banks, and borrowers had a source of unsecured credit. The hehui gongsi were profitable and popular. Notwithstanding the success of the hehui gongsi as a decentralized, community-based financing vehicle, the managers of the hehui gongsi began over time to shift their focus, bringing their practices more in line with those of commercial banks.

According to former hehui gongsi managers, the first modification of hehui gongsi practices came when representatives stopped calling on biaohui members in the community and biaohui members were encouraged to come to an office of the hehui gongsi to make their periodic payments. Next, the pretense of organizing biaohui was gradually dropped, and instead schedules of payments and lump-sum returns were drawn up approximating the experience of an individual member of a biaohui. Savers could choose among the various schedules based on their preferred duration of the savings plan and the periodic contribution they wished to make, and could switch from a savings plan to a loan repayment format at any time. Savers were thus interacting directly with the hehui gongsi, but their experience was virtually identical to that of participating in a large, impersonal biaohui.

Hehui gongsi management favored eliminating their direct involvement with biaohui and becoming more like banks because they wanted to compete with banks for business lending opportunities that had lower transaction costs to the institution than supervising actual biaohui. In attempting to lower their transaction costs on lending operations, the hehui gongsi management adopted many of the standards used by commercial banks for screening loan applications, most notably in requiring that the borrower offer collateral, preferably in the form of real estate, or offer personal guarantors known to have substantial assets.

While Taiwan had many commercial banks at that time, retail banking services tended to be limited to deposit taking and did not include much lending to individuals or small businesses. The hehui gongsi were thus providing services to a segment of the market that other banking institutions did not serve. By phasing out biaohui as a form of commercial credit and converting hehui gongsi into conventional banks, hehui gongsi managers and bank regulators eliminated one of the only significant sources of unsecured credit from a regulated financial institution available in Taiwan.

This gradual progression from biaohui to conventional deposit taking and lending practices was accelerated with the 1975

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reform of the banking law. One objective behind the 1975 revision was to "modernize" ROC banking. However, this led drafters of the legislation to simply remove references to biaohui financing, as well as to *qianzhuang* (native Chinese banks; see McElderry 1976), since these were perceived as anachronisms in a modern banking system.

The hehui gongsi were reorganized as small and medium business banks, whose only significant difference from other commercial banks was that they were restricted in the geographical scope of their operations. According to managers of small and medium business banks who had started out as employees or managers of the hehui gongsi prior to their reorganization as banks, the new small and medium business banks were not prohibited from engaging in biaohui activities, but they were prohibited from expanding that type of business above 1975 levels and were denied licenses to conduct foreign exchange operations until they had phased out all biaohui activities.

While the hehui gongsi appeared traditional and anachronistic to ROC bank regulators in 1975, there are certain structural similarities between their biaohui activities and the highly successful lending programs of the widely acclaimed Grameen Bank in Bangladesh (Huq & Sultan 1991:169), which was established about the same time the hehui gongsi were reorganized into banks in Taiwan. Grameen Bank programs are primarily designed to provide credit to indigent laborers to free them from the exploitation of moneylenders. The structure of those programs emphasizes mutual support and accountability among members of small groups that qualify collectively for credit and foster savings as part of the loan repayment plans. The challenge faced by the Grameen Bank founders was to find a way to channel credit to borrowers without any form of collateral and yet retain incentives to guarantee repayment. Their solution was to require borrowers to form groups in which the members each personally guarantee the credit of the others. The Grameen Bank programs have a substantial educational component and require members of borrowing groups to scrutinize one another's investment choices critically.

The structural similarity between Grameen Bank programs and organized biaohui lies in the reliance on personal networks based on common economic interests as an alternative to collateral and in spreading the risks of business failure through those networks. The Grameen Bank programs are more interventionist than the hehui gongsi programs in Taiwan, however, and encourage members of borrowers' groups not merely to rely on reputation in the community as a proxy for business acumen but to establish for themselves that the credit is being used prudently. In Taiwan, by contrast, government intervention in relational business practices was limited to reinforcing the traditional

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role of the biaohui organizer. By substituting a regulated financial institution for an individual as the organizer of the biaohui, members of the hui faced less risk of loss in the event the hui was not carried through to completion because a regulated financial institution was by law the guarantor of all the members.

Viewed only in terms of the reorganization of the hehui gongsi into banks, it would appear that the modernizing impulses of the ROC authorities and the rationalizing impulses of hehui gongsi management produced the desired result: The clients of hehui gongsi were transformed from traditional biaohui participants into borrowers and depositors of modern banks. However, this completely overlooks the fact that if the elimination of biaohui as a regulated form of credit was supposed to provide a disincentive to continued participation in biaohui (by increasing the risk of loss associated with participation), it was a complete failure. Rather, a successful and mutually beneficial link between localized and personalistic business practices and the ROC authorities was severed rather than nurtured. The biaohui is apparently as popular as ever but now takes place without any connection to any official agency, thus expanding the size of Taiwan's informal financial sector.

The inability of ROC authorities to recognize that biaohui might be a cultural resource to be nurtured rather than an anachronism to be jettisoned as modernization progressed seems to be related not only to a narrow conception of modernization but also to the reluctance of legal professionals in Taiwan to invoke law to facilitate traditional economic practices. This reluctance is diametrically opposed to the idea of economic regulation embodied in the Uniform Commercial Code, which envisages law as technique to facilitate and reflect the reasonable customary practices of merchants.[21]

B. Postdated Checks

A large component of Taiwan's informal financial sector is comprised of postdated check ("PDC") transactions (Winn 1986). The popularity of the PDC as a financing vehicle stems from the fact that from 1960 to 1987 the ROC Negotiable Instruments Law ("NIL") provided criminal penalties for bouncing checks. The holder of a dishonored check could therefore initiate criminal proceedings against the drawer of the check, in effect sentencing him or her to debtors' prison, with the costs of prosecution paid by the state rather than creditor.

The intent of legislators in adding criminal penalties to checks but not to other negotiable instruments was to safeguard

[21] 1990 Official Version Uniform Commercial Code § 1-102(2)(b), provides: "Underlying purposes and policies of this Act are . . . to permit the continued expansion of commercial practices through custom, usage and agreement of the parties."

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the security of Taiwan's then-nascent modern payment system. The unintended consequence of adding criminal penalties was that the ROC legal system provided a cheap and effective tool creditors could use to reinforce otherwise precarious business relationships. Parties interacting through networks of relationships assumed they could verify the other party's good faith by simply asking for a PDC to document any extension of credit. The fear of criminal prosecution was used to supplement the more traditional fear of loss of face that would follow any default on the debt. Using PDCs to document commercial transactions thus helped maintain the viability of attenuated relationships without forcing the parties to assume the expense and inconvenience of completely converting the transaction from a relational to a legal basis by drawing up a contract that fully expressed the parties' agreement.

According to several informants interviewed in 1990, PDCs are still commonly issued by businesses needing short-term credit to purchase goods and services, even after the repeal of criminal penalties for bouncing checks. PDCs are either held by businesses that can afford to wait until they become due or, if the party receiving a PDC in payment cannot afford to wait several weeks or months for payment, they are sold at a discount to banks or moneylenders. Regulated financial institutions such as banks regularly purchase PDCs at a discount, so these transactions are also significant in the formal financial system, but the ease of documentation associated with PDC transactions and ready transferability of PDCs makes them a popular form of finance in the informal sector as well.

Banks restricted access to checking accounts due to the specter of criminal penalties looming as a consequence of miscalculating the balance in one's checking account, thus preventing checks from gaining widespread use as a cash equivalent. According to bankers, checking accounts were only made available to people in business and persons with substantial assets, while the average consumer in Taiwan paid cash for all purchases. Even after a customer agreed to open a checking account, banks rationed the number of checks a customer could have at one time, waiting until one set of checks cleared before giving the customer a few more.

Notwithstanding the restrictive posture adopted by banks in opening checking accounts, PDCs became very popular as a financing vehicle. As the economy of Taiwan grew rapidly during the 1970s and 1980s, and it became more difficult to do business exclusively with family and close friends, PDCs were used to bolster increasingly tenuous networks of connections. The assumption that few people would willingly risk incarceration as a cost of doing business gave people in business the confidence to do busi-

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ness with people outside or only tangentially connected to their networks of personal relations.

PDCs, however, were an imperfect substitute for the personal connections they supplemented or even replaced because deceitful borrowers devised various ruses to avoid suffering criminal penalties. Informants reported that people willing to engage in deliberately fraudulent practices such as *exin daobi* (bad faith business failures) would usually abscond long before criminal prosecution could begin, leaving those guilty of nothing more than bad business judgment to go to jail.[22] In 1983, in the midst of a recession in the local economy, ROC officials estimated that up to 40% of the inmates in Taiwan's overcrowded prisons were serving sentences for writing bad checks (U.S. Department of State 1985:752).

In spite of these shortcomings, PDCs became popular with informal lenders and borrowers as well as with regulated financial institutions. Bankers even acknowledged requiring borrowers or lessees signing loan agreements or leases to provide the bank with a PDC for every payment due under the agreement at the time it was signed. A banker explained that they did this because prosecuting a bounced check was easier than suing in the event of default.

If PDCs were an imperfect substitute for close personal connections with business partners, they were also an imperfect substitute for modern financing techniques that focus on certain financial variables as indicators of profitability. For example, with cash-flow financing, the basis for extending credit is the estimated profitability of the business enterprise, not the assumption that the consequences following a default are so draconian that the business owners will take any steps to avoid default. The ready availability of criminal prosecution for loan defaults undercut incentives to establish comprehensive credit reporting services, more reliable financial reporting by borrowers, or other elements of a modern financial system. Punitive sanctions for bouncing checks were neither supporting the modernization of Taiwan's financial system—the original legislative intent—nor fostering the sound development of relational business practices, which might have been a more pragmatic objective.

Although the addition of criminal penalties to checks contributed to the popularity of PDCs as a financing mechanism in Taiwan, the repeal of criminal penalties in 1987 did not have the catastrophic effect on business credit that some observers feared. This was because the repeal fortunately coincided with the end of the credit shortage Taiwan had suffered for over 30 years.

According to informants in 1990, lenders continue to rely on PDCs as a financing vehicle, however, in part because Taiwan's

[22] See pt. II.C for further discussion of *exin daobi*.

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check clearinghouse provides one of the few readily accessible, cheap sources of credit information available in Taiwan. The clearinghouse maintains comprehensive records of all bounced checks, including cross-references to major shareholders for company accounts, and will make the information available for a nominal charge to anyone with both a checking account number and the identification number assigned all individuals in Taiwan. In addition, bank members of the clearinghouse are required to close any accounts that have more than three bounced checks in a year, creating a strong incentive for account holders needing access to PDC financing not to bounce many checks. In transactions between friends, the holder of the check will permit the drawer of a check to exchange it for a new PDC if the drawer is unable to cover it when it becomes due rather than damage the friend's credit record by presenting it and letting it bounce.

PDCs became important in part because they were used as a simple technique to reinforce the network structure of business as rapid industrialization and urbanization made interpersonal relationships increasingly attenuated. A legal device, criminal prosecution, was used to reduce the temptation to engage in fraud or other opportunistic behavior by parties no longer closely bound by ties of family or community. Because the legal system was invoked merely to reinforce relationships and to punish parties unable to resolve problems within relational networks, the legal system remained a "marginalized" even though an essential element of the PDC informal financing system. That the legal regulation of PDCs was not central to the system is demonstrated by the continuing vitality of PDCs as an informal financing technique after the repeal of criminal penalties. The simple, inexpensive credit reporting service provided by the check clearinghouse now seems to substitute for criminal penalties in maintaining the popularity of PDCs as an informal financing vehicle in Taiwan.

C. Moneylenders and Daishu

A significant segment of the informal financial system in Taiwan is comprised of *dixia qianzhuang* or underground moneylenders. These moneylenders often have connections to organized crime (Sheu 1990) and provide very short-term credit at high interest rates. This credit is not provided within the context of relationships but is based on strictly calculated, self-interested short-term transactions between the parties involved. Thus, while not legal, the structure of these transactions is highly legalistic, and sanctions are imposed by legal surrogates such as the gangsters who provide these moneylending services or provide protection to moneylenders.

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This form of lending is considered part of the informal sector because such moneylenders may neither pay taxes on their income nor be licensed to engage in moneylending operations. They may also exceed the maximum interest rate permitted under the Civil Code of 20% (ROC Civil Code, Bk. II: Obligations, art. 205) or in periods of tight credit even commit criminal usury, for which no rate is specified but which consists of taking advantage of another's need and charging an obviously excessive interest rate (ROC Criminal Code, art. 344).

These moneylenders generally discount PDCs or take stock certificates or automobiles for collateral and lend only for a period of days or weeks. When asked if the repeal of the criminal penalties for checks had any impact on how he conducted his business, one moneylender responded that he had never relied on the criminal penalties but that he had "other ways" to make sure that people repaid their loans. Customers of these moneylenders may be struggling to cover outstanding PDCs or trying to cover gambling debts.

One common way to locate an underground moneylender is through classified advertisements in newspapers. Telephone calls to ads in the *Zili Wanbao* (Independent Evening News) in June 1990 revealed that for borrowers with a checking account, the interest rate to borrow the equivalent of several hundred U.S. dollars would be between 2% and 2.5% a month at a time when the prime rate quoted by commercial banks was around 10% per annum. If a car was offered as collateral, the amount lent would be more if the moneylender has possession of the car, or less if the borrower retains possession. While moneylenders who take collateral such as cars may do business out of a fixed location, moneylenders who only discount PDCs may arrange to deliver the loan proceeds to the borrower and refuse to disclose the location of the moneylending operation. When a government official was asked why underground moneylenders are able to conduct such open and notorious operations without fear of prosecution, the official indicated that this practice of not disclosing the location of their operations made them hard to prosecute.

The financing services provided by *dixia qianzhuang* operate almost entirely outside the scope of the ROC legal system, contributing to the marginalization of the formal legal system, but rely on a draconian system of punishment that is at least quasi-legal in its severity. Underground moneylenders are not doing business on relational terms because their transactions are relatively short term and if the borrower fails to meet his or her obligations, the breach is resolved through harsh consequences, not an unstated agreement to accept some unspecified equivalent favor in the future. Thus the networks of relationships that are so common in Taiwanese society are not the exclusive technique for

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organizing business transactions, but the alternative to relational networks is not always the modern formal legal system.

Another significant form of informal finance associated primarily with real estate is provided by *daishu*, a profession that might be translated as "scrivener." As with moneylenders, these transactions are predominantly legalistic rather than relational in structure, but unlike transactions with underground moneylenders, the legalistic structure gives rise to rights upon default that can relatively quickly and easily be pursued within the ROC legal system.

There are no licensing requirements to qualify as a daishu, and daishu are not permitted to draw up contracts or litigation papers. The only responsibility of daishu in Taiwan is to convey ownership of real estate, for which they may charge regulated fees. These fees are quite low by U.S. standards. In 1990, the fee to convey one unit of real property in Taipei was the equivalent of U.S.$200 and outside Taipei, U.S.$150. While it is not unknown for daishu to advance their own capital to help close a transaction, providing in effect a short-term bridge loan, it is more common for daishu to introduce prospective borrowers to lenders. Daishu can collect an unregulated commission of 1–3% for lining up informal credit for a prospective purchaser.

Informal mortgage lenders, unlike underground moneylenders, are often just private persons with savings to invest rather than professional lenders. Borrowers may ask a daishu for an introduction to such a lender because informal lenders are usually willing to lend up to 80% or 90% of the purchase price of the property, while regulated lenders will not lend more 40% to 60%. Banks are also unwilling to lend money for undeveloped land. Informal mortgage lenders usually only lend for 1 or 2 years; a commercial bank might lend for 5 to 7 years. There is no equivalent of the 15- or 30-year residential mortgage in Taiwan.

While commercial bank interest rates for real estate mortgages in 1990 were around 12% per annum, an informal mortgage lender might charge 2% or 3% a month. If a borrower defaults, the informal mortgage lender must institute a foreclosure proceeding to recover the land. If the agreed interest rate is above the maximum legal rate, the lender will usually take the precaution of having the excess interest documented in a separate promissory note that is presented in the foreclosure proceedings as a separate, unsecured obligation owed by the borrower to the lender to be paid after the mortgage has been satisfied in full. When asked why a court would not refuse to enforce such a contract as void, one magistrate pointed out that it would be very difficult for the borrower to prove it was for excess interest.

The practice of informal mortgage lenders, unlike biaohui, depends on real property collateral rather than on networks of

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connections except for the introduction provided by the daishu. While the informal mortgage transaction is legalistic in its structure, in aggregate, informal mortgage transactions serve to frustrate ROC authorities' attempts to regulate financial markets in Taiwan. Restrictions placed on mortgage lending by banks or other regulated lenders may not have the desired effect of dampening real estate speculation if a substantial volume of mortgage funds continues to flow through the offices of daishu.

Mortgages arranged by daishu rely on elements of the ROC legal system in order to function, yet remain part of the informal economy because the terms of the mortgage may violate some laws. Thus the mere presence of elements of a legally enforceable obligation does not guarantee that parties are aware that the transaction is regulated by law in its entirety. On the other hand, the popularity of such informal mortgages demonstrate that many Taiwanese may prefer investments protected by marginalized legal institutions to investments guaranteed by nothing more than relational sanctions.

III. Mobilizing Relational Resources through Law

Although the ROC legal system is currently marginalized in many realms of social and economic interaction by networks of relationships or legal surrogates, it is not clear that it will remain so in the future. Many observers of the ROC legal system might accept the label "marginalized" for the current operation of the system while insisting that the modernization process is well underway and that with further progress, the legal system will eventually come to play the central, universal ordering role generally associated with modern legal systems. That outcome is far from inevitable, however, and a more realistic agenda for future development of the formal legal system in a society principally constituted by networks of relationships might be to selectively reinforce or undermine those network structures in accordance with more general public policies, rather than to displace them altogether.

A. Relational Capital and Relational Entrepreneurs

Given that Taiwanese society, while showing signs of increasing individualism and other indicators of modernization, still relies heavily on relational practices in ordering commercial transactions, an official policy of promoting those relationships might facilitate economic development better than a policy of repressing them. The network structure of Chinese society might seem to be an impediment to increasing the effectiveness of the formal legal system; yet the considerable human investment in the creation and maintenance of those networks is a social re-

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source within Taiwanese society that has arguably contributed to Taiwan's rapid economic development to date.

The social investment in networks of relationships might be thought of as a form of "relational capital," drawing an analogy to concepts like human capital (Becker 1964) or symbolic capital (Bourdieu 1977). The economist Gary Becker coined the term "human capital" to account for the relationship between education, on-the-job training, and variations in earnings over time and with age. The social theorist Pierre Bourdieu developed the concept of symbolic capital to designate productive capacity accumulated in the form of authority, knowledge, reputation, or relationships but that may be converted to capital assets recognized by economists. In Taiwan, the large investment of social resources in teaching individuals the importance of human relations creates a framework within which relational practices take place. Relational capital serves an economic purpose because, once established, it should lower the transaction costs of parties doing business through interpersonal networks. The types of transaction costs that might be reduced include evaluating the integrity of a potential colleague, comparison shopping for better quality or price terms, fully specifying of all terms of an agreement in advance, or designing and implementing monitoring systems.

Although the decision of the parties to do business through relationships constitutes a departure from conditions of market competition, it need not result in the kind of inefficient allocation of resources associated with monopoly or oligopoly. If the terms of the ongoing relationship are fair to all the parties, the resulting distribution of resources through relationships may approximate the competitive free-market result (Kenney & Klein 1983).

Since the functions of formal political, economic, and legal institutions are merged in the activities of various participants in the informal sector, a concept such as "relational entrepreneur" could be developed to describe the activity of individuals who, like impresarios, orchestrate the networks of relationships that constitute the informal sector. The rationality of relational entrepreneurs could be compared to the rationality of managers, workers, politicians, voters, judges, and others as analyzed in conventional Western social sciences.

B. Relational Practices and Democratic Theory

The idea that relational practices might displace or marginalize formal legal institutions in commercial transactions may not pose a problem from the viewpoint of economic efficiency, but given the centrality of concepts like the rule of law to Western ideas of democracy, it raises profoundly troubling issues of polit-

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ical legitimacy. Liberal democratic theory assumes law is needed to check abuses of power in modern society, and the appeal of constraints grounded in a very legalistic concept of legitimacy such as fundamental human rights cannot be lightly dismissed. Even if relational practices can be proven to be as effective in ordering commercial transactions as more legalistic alternatives, they may not prevent abuses of power in a society where modern legal institutions are marginalized and social norms are highly contextualized.

Whether a theory of modern political legitimacy in a predominantly relational society will evolve for Taiwan may depend on whether the type of relational practices described in this article are just a transitory phenomenon in the modernization process or are indicative of deep structural differences between Western and non-Western societies. From the information gathered for this preliminary study, it is impossible to predict what the future holds for Taiwan. Taiwanese society may become more stereotypically modern, and the propensity to organize social interaction through relationships will be displaced by individualistic, rule-governed behavior (Yang 1988). Or Taiwanese society may continue to fuse remnants of traditional Chinese society with elements of modern society in a distinctly non-Western way.

Perhaps the most intriguing possibility is that Taiwanese society and modern Western societies will tend to converge at some point that is now still foreign to both, with Taiwanese society becoming less relational and more individualistic, and Western societies continuing to move away from the constructs of 19th-century liberalism toward a more self-consciously contextualized, fluid social structure. Not only relational contract theorists (Macaulay 1963) but feminists (West 1988) and advocates of "multiculturalism" (Takaki 1993) have argued that American society is neither as individualistic nor as legalistic as it is often portrayed. More economists and sociologists are attempting to recognize the "embeddedness" of individuals in their social environment in their studies of economic and social activities (Granovetter 1985). If convergence between Taiwanese and Western societies takes place in some form not now recognized in either society, then the need for a political theory that can distinguish legitimate and illegitimate relational practices will be a concern not just for Taiwan but for societies that now invoke the ideal of the rule of law for their legitimacy.

IV. Conclusion

There is a significant relationship between Taiwan's rapid economic development and indigenous Taiwanese social practices and ideas about law. This relationship has generally been misconstrued or overlooked by much of the academic literature

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discussing Taiwan's economic "miracle." Networks of interpersonal relationships have played a significant role in promoting economic development, while the ROC legal system has often been reduced to a role of enabling those relationships rather than establishing the kind of universal normative order often associated with the idea of a modern legal system. A substantial component of Taiwan's economic development has taken place in the informal sector, outside the purview of the ROC legal system. This study is the first attempt to develop a systematic account of the marginalization of Taiwan's modern legal system and the concomitant heightened significance of alternatives, such as networks of personal connections or informal surrogates for legal regulation, in contributing to Taiwan's rapid economic development.

The role played by the ROC legal system in indirectly supporting relational practices is not one that can readily be expressed in terms of legal theories constructed to account for the relationship between law and development in Western nations. The conflict between contemporary Taiwanese social reality and liberal-democratic theory, when recognized, is usually followed by exhortations for the Taiwanese system to further modernize, thus resolving any conflict in favor of the Western model (e.g., Chai 1990; Liu 1990:214; Hsu 1985:328). If, however, Taiwan's system is not so much moving toward convergence with Western models as developing along alternative lines, then analyzing how formal legal institutions in Taiwan are marginalized may better explain processes of economic development and democratization in many nations outside the Western legal and political tradition.

Appendix 1. Methodology

The interviews upon which this study is based were primarily conducted during four trips to Taiwan. In 1986, I conducted 31 interviews with managers and lending officers at foreign and local banks, government officials involved in financial regulation and local attorneys. The primary focus of these interviews was the failure of the court-ordered company reorganization process in Taiwan in the early 1980s (Winn 1988). The high degree of informal economic activity among local businesses was often cited by respondents as a major factor in the failure of the reorganization process. During a brief visit in 1987, I interviewed other government officials concerning the problems of regulating financial institutions in Taiwan in light of the size of the informal financial sector.

In 1990, I conducted 65 interviews with lawyers, judges, business people, bank officers, government officials involved in tax collection and licensing business enterprises, academics studying related issues, and one gang member. In 1991, I conducted 19 additional interviews. Some were follow-up interviews with parties already interviewed on an

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earlier occasion. Others were with managers at small and medium enterprise banks or government officials charged with regulating those banks. In those interviews, I pursued information on the actual conduct of informal financial practices and the responses of regulators to those practices. In addition, I sought to develop a definition of the informal sector in Taiwan, to gather evidence on how participants in the informal sector conducted their business and to determine to what degree informal practices diverged from practices of regulated businesses.

While obstacles to collecting unbiased information on informal or extralegal activity are present in any society, they are compounded in the case of Taiwan by a high degree of reluctance to be open with strangers. This is due not only to cultural norms that stress the exchange of information within existing relationships (Hwang 1987), but also to the legacies of martial law and to a very repressive internal security apparatus (Meany 1992:101). Martial law was established by the ROC government on mainland China in 1937, brought to Taiwan with retrocession from Japan in 1945 and was effectively repealed in 1987. However, the National Security Law enacted in 1987 preserves some important features of the former martial law regime, so the people of Taiwan still do not enjoy complete freedom in the exercise of civil liberties.

Given these obstacles concerning mistrust of strangers and difficulties acquiring a random sample of informants, a practical alternative was to mobilize relationships with trusting local informants. I believe that those I interviewed represent a diverse, well-informed sample of people in Taiwan with first-hand knowledge of the workings of the informal sector and of official attempts to regulate informal economic activity. However, because all interviews took place in Taipei, the capital of Taiwan province, the sample may not accurately reflect conditions in smaller municipalities or rural areas in Taiwan.

Appendix 2. Rendering Chinese Ideographs in Romanized Form

The problem of rendering Chinese ideographs into a romanized form raises several issues worth noting. In this article, the Pinyin romanization system developed in the People's Republic of China will be used unless a Chinese word has been conventionally rendered in another romanization system or it is the name of a person who has adopted a particular romanization for his or her name. The choice of the Pinyin romanization system is problematic with regard to discussions of Taiwan because it is not among the several romanization systems actually in use in Taiwan, such as the Wade-Giles, Yale and *Kuoyu Chuyinfuhao* systems. It was chosen for use in this article, however, because it is the most widely used romanization system outside Taiwan, and therefore most likely to be familiar to readers of this article, and because there is no single authoritative system among the several in use in Taiwan. Thus, familiar names such as Taipei or Hung Yuan are not rendered in Pinyin (viz., *Taibei* or *Hong Yuan*) but less well known Chinese words are rendered in Pinyin (e.g. *biaohui* rather than *piaohui* in Wade-Giles, *biaohwei* in Yale, or *biauhuei* in *Kuoyu Chuyinfuhao*).

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