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**Of Guanxi and Taipans:  
Market Power and the East Asian Model  
as a Competition Policy Package**

by

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**Abstract**

The most pronounced reality of the East Asian business environment is the *taipan* and his business strategy, *guanxi* (relational contracting). We characterize *guanxi* as an endogenous contractual response to weak formal rule-of-law environments and the need to provide a *second party* enforcement mechanism against ex-post opportunism. This takes the form of narrowing the choice of potential partners or agents to a smaller group where non-formal sanctions are binding. The *taipan* extends beyond *guanxi* into the capture of state apparatuses as a response to the absence of adequate property rights protection against predatory expropriation. This capture may, however, itself become a springboard for predatory behavior. Both these responses lead to market power and cartels. The East Asian model's principal market enabling features (export promotion, EPZs and DFIs) also served as a competition and regulation policy package in this type of environment. This differed from the usual confrontational inhospitality or anti-trust tradition which, in this environment, may not have worked.

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## I. INTRODUCTION

Solutions to idiosyncratic and non-standard obstacles to production and exchange are par for the course of a special set of players known as *entrepreneurs*. These hurdles may be technological, organizational, and financial or risk defusing. In frontier or under-developed areas, the common missing ingredient is the absence or the severe inadequacy of *formal* or *state-provided* contract enforcement and property rights protection (North, 1990; Barzel, 2002). Ex-post opportunism makes for prohibitive transactions cost that result in highly fragmented or even missing markets. Not only is the state remiss in contract enforcement, it may itself serve as a vehicle for expropriatory tendencies among the political elite. For an entrepreneur to thrive, it must solve these twin weak governance problems.

The *guanxi* system, also known as *relational contracting*, solves the contract enforcement and ex-post opportunism problem by limiting exchanges among players who are also members of a group or community that is subject to an existing, informal, but effective, system of sanctions. Guanxi-based contracts face lower opportunism risk and transactions cost than and, thus, can drive out those contracts dependent only on absent or weak state-provided or *third party enforcement*. In North's (1990) phraseology, guanxi is a *second party enforcement mechanism* drawing its power from community sanction. Williamson (1983) called this effort *private ordering* in the absence of adequate *public ordering*.

Because political power may be lodged outside this group or community, the guanxi entrepreneur, if successful, also faces considerable expropriation risk. The wielders of political power can either selectively enforce certain laws or pass new laws to

effect partial or total expropriation. The entrepreneur solves this by coupling with or capturing the state's rule-making apparatus. Property rights protection is effectively internalized.

The entrepreneur that successfully deals with these twin problems of weak governance is a *taipan*. The very process of his emergence in the weak governance setting should explain the many stylized facts about taipans and their operations. We first pause to review some known facts about taipans in East Asia.

### **A. Modern Taipans**

The economic landscape in most of East Asia is dominated by very large conglomerates headed by powerful tycoons or *taipans*, largely overseas Chinese (huaquio). Between 60-80% of market capitalization in Indonesia (60%), Thailand (80%), Malaysia (70%) and the Philippines (50-60%) are in their hands ("Asian Business Survey" ("ABS 2001" from here on), *The Economist*, 7 April 2001). The stylized facts about the taipans and their operations are the following (ABS 2001);

1. They operate largely on the basis of *Guanxi* – contracting on the basis of relations and connections rather than written rules, the *relational contracting* mode.
2. They preside over sprawling business empires without the blessing of clear synergistic logic (Robert Kuok of Malaysia is into food, manufactures, banking, property, media, etc.; Lucio Tan of the Philippines is into airlines, banking, tobacco, breweries, property. The Salim's are into retail trade, banking, property, etc.).
3. Each company in the empire is run by a family member and outside auditors and professional managers are a rarity;
4. The use of complex pyramids of share-and-cross holdings of companies anchors their legendary penchant for secrecy. Books of account, when available, are opaque and uninformative. (Lucio Tan of the Philippines (ABS, 2001) thrives on such pyramids).
5. The delegation of authority is meager and information is a closely guarded monopoly of the patriarch;
6. Wherever the taipan operates, he enjoys a monopoly or near-monopoly position;
7. The cultivation of political powers via rumored shady but mutually beneficial relations is par for the course (Harry Stonehill was run out of the Philippines in the 1960s to keep his *payola black book* from being opened and implicating many figures. Lucio Tan was a close associate of then President Joseph Estrada of the Philippines; Danding Co-Juangco of the Philippines said to be a close Marcos crony and was also a favorite of Estrada; the Salims of Indonesia were linked to the President Suharto).

8. The aura of untouchability is fueled by stories, contrived or otherwise, of ruthlessness when provoked. (After paying the kidnap ransom for a daughter, John Gokongwei of the Philippines is rumored to have had all perpetrators killed by putting a substantial bounty on each of their heads. This ruthlessness extends to business partners who violate trust.)

These powerful tycoons are also known in the region as “taipans” reminiscent of their 19<sup>th</sup> century counterparts. The feature that the paper focuses on is the acquisition by the taipan of contract enforcement and property rights protection capacity.

Observes *The Economist* on the clash of Asian business cultures: “Developed economies have rule-based governance systems that incur enormous fixed cost but negligible incremental costs...By contrast, the poor countries of Asia have not been able to afford the investment in high fixed costs of such a system, and have, therefore, settled for the large incremental costs of a *guanxi*-based system.” The *guanxi* system, like the *Maghribi* system (Grief, 1993, 2001) and even the *merchant law* (Grief et. al, 1994) are second party enforcement systems developed in the absence of adequate third party enforcement (North, 1990; Barzel, 2002). Needless to add, they, time and again, require mechanisms other than simple cessation of repeat business. While only a faint penumbra of their 19<sup>th</sup> century counterparts, the stylized facts about the current crop of taipans, nonetheless, echo most pronounced aspects of 19<sup>th</sup> century taipans – vertical integration into second party enforcement in the absence of weak governance (see, e.g., Criswell, 1981). It is also evident, however, that as some East Asian countries progressed in the wake of opening up, the grip of *guanxi* and second party enforcement has slowly

loosened in favor of more rules-based contracting (e.g., ABS, 2001, focuses on ACER and its chairman Stan Shih as exemplar).

### **B. Vertical Integration Into SPE**

The motivation for vertical integration is myriad. Coase (1937), addressing the boundaries of the firm, proposed the umbrella concept of high *transactions cost* of arm's length market exchange. Subsequent proposals would elaborate on Coase. Williamson (1975), following Coase but with sharper lenses, threw in ex-post opportunism, lock-ins and asset specificity as the driving forces. Klein et. al. (1979) added the threat of *quasi-rent appropriation* and its avoidance as a motivator. Barzel (1982) placed the difficulty of measurement and the disputes it triggers at the roots of integration. Grossman and Hart (1986) identified *residual rights of control* as one motivator.

The absence of an adequate supplier of a particular input or service essential for the production or distribution of a final product signals the high transactions cost of arms-length exchange and motivates vertical integration. This market for the input or service may be missing or the state tasked to provide it is weak. Third party enforcement (North, 1990) of property rights and enforcement of contracts is one such all-important supposedly state-provided service. The boundary of the firm in the frontiers, thus, extends into the provision of Williamson's *private ordering* (1983).

In the Middle Ages, such TPE was inadequate in Europe and had to be supplemented by second party mechanisms, such as *Community Responsibility System* (Greif, 2001) and *Maghribi trading* or merchant law based on network (Greif et. al., 1994). In the Wild West of America, the railroad tycoons maintained their own private

enforcement: occasional posses and bounty hunters to deal with bandits and troublemakers. In the Far East through the Victorian period, the *taipans* of the Princely Hongs maintained virtual private army and navies to protect their trade and mete occasional punishments on bandits and pirates (Criswell, 1981). Entrepreneurship required vertical integration into second party enforcement. Second party enforcement, however, conduces toward less competition even as it resolves the “missing market” problem.

This vertical integration is something very special because enforcement becomes *private* and *excludable*. Other players cannot avail of it and, thus, cannot operate. These effectively form barriers to competition. Since enforcement has considerable scale economic potential, this has serious implication for the structure of the market.

In this paper, we propose a nexus-of-contract explanation for the emergence of a taipan, characterized loosely by the above. The background is a weak *third party enforcement* environment where entrepreneurs to operate and survive must acquire enforcement capacity. The take-off model used here is in Fabella (2004), where contracts involve a cash advance in period one from a principal P to an agent A who delivers effort or repayment in period two. This is called cash-in-advance contracts.

The idea is that a taipan is an entrepreneur in a weak TPE environment who vertically integrates into a *second party enforcement (SPE)* to survive. While TPE is public, SPE is *private and excludable*. Thus, the taipan is one part Schumpeterian in that he brings otherwise infeasible markets into existence through his command over an SPE, and one part *robber baron* in that this command may erode an already weak TPE, result in the capture of state apparatus and deter competitors. In particular, his capture of state

apparatus may retard institutional change. Whether the taipan stays Schumpeterian (growth enhancing) or becomes a *robber baron* (growth-retarding) is an important question. The effect of openness on the evolution of taipans is discussed.

In Section II, we model the contract environment characterized by weak TPE and results in a “missing market”. The guanxi approach is then developed as a contract theoretic response. In III, we cover the birth of a taipan as entrepreneur who captures state enforcement and rule-making apparatus in order to internalize property rights protection.

## II. THE CASH-IN-ADVANCE CONTRACT

### A. The Cash-in-Advance Contract

Consider a production contract where the principal P advances the agent A a portion  $w_1 = bw$ ,  $0 \leq b_1 \leq 1$  of the agreed-on fee  $w$  in period one, A supplies observable and contracted effort  $e$  in period 2 and, when the output  $X$  is observed in period 2, receives the rest of the fee,  $(1-b)w = w_2$ . We assume that spot contracts are not feasible.

A, after receiving  $w_1$  and enjoying  $u(w_1)$  may, however, decide to renege, i.e., refuse to supply  $e$  and, instead, supply  $e$  to his next best alternative, which gives him his outsider reservation utility period 2  $U^0$ . Let the TPE be given by  $(Q, L)$ . Let the probability of being punished be  $Q$  and the punished be  $L > 0$ . The expected second period utility with reneging is  $Q(u^0 - L) + (1-Q)U^0 = QL$ . If he reneges, his total two-period utility is  $U^0 + u(w_1) - QL$ . If  $u(w_1) > QL$ , A gets more by reneging than by abiding which gives only  $U^0$ . When  $u(w_1) > QL$ , we have what North (2002) calls weak *third party enforcement (TPE)*.  $Q$  is the index of efficiency of state-supplied TPE. Thus, under weak TPE, A abides by the contract only if

$$u(w_1) + u(w_2) - v(e) \geq U^0 + u(w_2) - QL$$

or

(1)

$$u(w_2) - v(e) \geq U^0 - QL$$

which is the *augmented participation constraint (APC)* for the model. If (1) is true, then the ordinary participation constraint (PC):  $u(w_1) + u(w_2) - v(e) \geq U^0$  is automatically satisfied. If (1) is satisfied, A will never renege since it does not pay to do so. This has also been called the *enforcement proofness constraint* (see e.g., Laffont and Mortimart, 2002) in an adverse selection context.

The principal offers a contract  $C(w^*, e^*)$  to A where  $(w^*, e^*)$  solves the following:

$$\begin{aligned} & \max_{w,e} pF(e) - w \\ & \text{s.t. } u(w_2) - v(e) \geq U^0 - QL. \end{aligned} \tag{2}$$

In Fabella (2004), it is shown that (i)  $e^*$  rises and  $w^*$  falls as  $Q$  rises; (ii)  $e^*$  falls and  $w^*$  rises as  $b$  rises if the Arrow-Pratt relative risk aversion exceeds one. Thus, clearly  $\pi^* = pF(e^*) - w^*$  falls as either  $Q$  falls or  $b$  rises and the principal may, altogether, *stop* this type of economic activity if the governance environment weakens enough. Our starting point is a weak TPE  $Q^0$  that results in the principal realizing no profit.

### B. Initial State: Missing Market

Let there be  $n$  identical potential principals and let  $p(n)$  be the oligopolistic price with  $n$  firms and  $p'(n) < 0$ . Entry into the market is free. Let  $Q = Q^0$  be low enough so that for each principal:

$$\Pi^*(Q^0, b, L, n) = p(n)F(e^*(Q^0, b, L)) - w^*(Q^0, b, L) < 0, \quad n \geq 1. \quad (3)$$

Thus, no principal can make money and the market of  $X$  does not exist even under a monopoly. Anarchy or lawlessness has this effect. This means that the market price  $p$  is potentially very high. This is missing market failure.

### III. THE GUANXI PARADIGM

Suppose a potential entrepreneur observes that the *missing market* condition (3) holds for the best agent chosen by “technical aptitude” from the whole population of agents available in the vicinity. This agent also displays a certain average tendency to violate a contract in this weak TPE environment. The entrepreneur also observes that he can limit his choice of agent to a subset of this population for whom renegeing on this contract has an expected cost higher than the QL foisted by TPE. That is, for this subset of agents, contract violation entails an added personal or social cost  $G$  unrelated to QL. The tradeoff is that the “technical aptitude” of the best agent in this subset is inferior to best agent from the whole population and this impacts on the prospective revenue of the enterprise. Indeed, one can continue trading off “technical aptitude” for higher  $G$  by a progressive narrowing of the subset.

Let  $f$ ,  $0 \leq f \leq 1$ , be the index of the restrictiveness of the set of agents from whose ranks  $A$  is drawn. If the set is the whole population,  $f = 0$ . Let  $g(f)$  be the technical aptitude associated with  $f$ , and  $g'(f) \geq 0$ ,  $g(1) = \max g$ ,  $g(0) = 0$ . Thus, “technical aptitude” is at its highest when  $f = 0$ . But as the set of agents progressively shrinks ( $f$  rises) the personal cost  $G$  also rises, i.e.,  $G(f)$  and  $G' > 0$ ,  $G(0) = \max G$ , i.e., the renegeing likelihood also falls.

The contract design problem for this entrepreneur effectively becomes:

$$\begin{aligned} & \max_{w, e} pF(e)(1 - g(f)) - w \\ \text{s.t.} \quad & u(w_2) - v(e) \geq U^0 - QL - G(f). \end{aligned} \quad (4)$$

Optimal  $e^*$  and  $w^*$  are solved from the two equations:

$$\begin{aligned} pF'(1 - g(f)) &= v'/u'(1 - b) \\ u(w_2) - v(e) &= U^0 - QL - G(f). \end{aligned} \quad (5)$$

Thus, both  $w^*$  and  $e^*$  are functions of  $p$ ,  $b$ ,  $U^0$ ,  $QL$ ,  $g(f)$  and  $G(f)$ . The maximized profit  $\Pi^* = pF(e^*)(1 - f) - w^*$ , is also a function of the same set. Written as a function of  $f$  alone, we have:

$$\Pi^*(f) = pF(e^*(f))(1 - g(f)) - w^*(f).$$

The missing market condition may now be true only for small values of  $f$  at or near zero.

At  $f = 0$ , we have:

$$\Pi^*(0) = pf(e^*(0)) - w^*(0) < 0. \quad (6)$$

If the partial of  $\Pi^*$  with respect to  $f$ ,  $\Pi^{*'}(f) < 0$ , then the market remains nonexistent. But there are some  $(g, G)$  profiles that can reverse this. Suppose for some  $(g, G)$  that  $\Pi^{*'}(f) > 0$ . Then raising  $f$  reverses the sign of the missing market condition (3). One can, for example, maximize  $\Pi^*(f)$  with respect to  $f$ , i.e., set  $\Pi^{*'}(f) = 0$  to get  $f^*$ . If

$$\Pi(f^*) = pF(e^*(f^*))(1 - g(f^*)) - w^*(f^*) > 0. \quad (7)$$

Then the market for  $X$  becomes viable. The role of entrepreneurs here is to find the proper  $(g, G)$  profile that allows (the reversal of (3)). The entrepreneur who does is a *guanxi entrepreneur*.

Guanxi, thus, allows markets that may otherwise not exist due to inadequate contract enforcement and ex-post opportunism, become viable.

The *guanxi approach* consists of judicious limiting of the choice of agents to a subset of the population whose personal reneging cost  $G$  is prohibitive enough and independent of the TPE penalty  $QL$ . The set may be limited to close blood relations or to the same close-knit ethnic group among whom “face” or other informal sanctions are important. But this approach is implicitly costly as it sacrifices technical aptitude. Contracting is limited to a subset of the population.

As the economy modernizes and QL rises, the cost of guanxi becomes revealed. Clearly, where QL is large enough to deter renegeing, only “technical aptitude” matters. Competing with products of other producers operating under adequate TPE, i.e., where QL is sufficiently high, the opportunity cost of guanxi becomes telling and burdensome. If he buys inputs only from his small guanxi circle while a competitor buys inputs from a larger circle that includes the guanxi circle, the competitor gets his inputs at, at worst, no higher but presumably at lower (if the larger circle is the world, e.g., in an open economy) price.

Incidentally, this second party enforcement mechanism appears also to describe the Maghribi system in the Middle East. But having solved the contract enforcement problem he must then address the property rights protection problem. The taipan is one who goes beyond guanxi.

#### **IV. PROPERTY RIGHTS PROTECTION SPE**

A guanxi entrepreneur must also solve the weak property rights protection and the risk of expropriation problem. Suppose he faces an expropriation tax  $t$ , legal or illegal, the level of which is a decreasing function of the intensity of pressure,  $r$ , applied in taipan T’s behalf by the political power holder K. That is  $t = t(r)$ ,  $t' < 0$  and  $t(0)$  is large. That is, if  $r = 0$ , the taipan is not viable. To be viable, T must buy  $r$  from K. Let K’s utility function be  $U_k = u_k(m) - v_k(r) \geq U_k^0$ , where  $u_k(m)$  is K’s utility defined over payoff  $m$  from T,  $v_k(r)$  is the disutility of pressure  $r$  and  $U_k^0$  is K’s reservation utility. Thus, the full contract design problem facing T is

$$\max_{w, e, m, r} pF(e)(1 - g(f)) - w - t(r) - m$$

$$\begin{aligned} \text{s.t.} \quad u(w) - v(e) &\geq U^0 - QL - G(f) & (8) \\ u_k(m) - v_k(r) &\geq U_k^0. \end{aligned}$$

This generates two optimal contracts:  $C(w^*(f), e^*(f))$  and  $C(m^*, r^*)$ . The maximized profit is

$$\Pi^*(f) = pF(e^*(f))(1 - g(f)) - w^*(f) - t(r^*) - m^*. \quad (9)$$

It is possible that for  $r = 0$ ,  $t$  is so large that  $\Pi^*(f) < 0$ , for any  $f$ . If at some  $f$ , and some  $(r^*, m^*)$ ,  $\Pi^*(f), \Pi^*(f^*) > 0$ , then the taipan is viable and the market for  $X$  will exist. The taipan is the entrepreneur who finds the profile  $(g, G)$  and the contract  $C(m^*, v^*)$  which makes (9) strictly positive.

The taipan vertically integrates into property rights protection by partly privatizing the political rule-making and enforcement apparatus. Since the payoffs here are normally illegal, they should never appear in the books of accounts. Thus, the secrecy and double accounting.

This vertical integration may, however, take a more sinister turn. The imposition  $t$  may be a *legitimate tax*,  $K$  may be the *tax collection and judicial apparatus*, and  $m$  may be the payola to  $K$ . Again the jealously guarded secrecy.

A third interpretation is that  $K$  is an astute tax lawyer who, for a handsome fee of  $m$ , provides the expertise  $r$  to build a *tax pyramid* that lowers  $T$ 's tax liability.

It is possible for all three to coexist at any given time. Lucio Tan is rumored to dine with Presidents, own or pick the BIR commissioner, buy legislators and hide behind complicated pyramid schemes. His predecessor in cigarettes, Harry Stonehill, being

American in an increasingly anti-American environment of the 1960s, may have been just fending off expropriation by putting politicians in the payroll. He failed. Lucio Tan has so far succeeded.

These defensive mechanisms, once established, can be turned into anti-competitive instruments. The capture of rule makers can pass laws favoring the taipan and legitimizing entry barriers. How must the regulatory response be in the frontiers?

#### **IV. EAST ASIAN MODEL as REGULATION and COMPETITION POLICY**

In a guanxi-dominated environment, contracts other than spot are effectively limited to a subset of the population where informal sanctions have a bite. The business profile tends to have an ethnic and/or religious hue. Inter-marriages within the group only strengthen the informal sanction mechanisms and reinforce guanxi. The tendency towards market power concentration and collusion is pronounced, especially when the two or three competitors are of the same ethnic and/or social group. Market power and wealth, in turn, become highly concentrated and attracts expropriatory overtures from political powers. These must then be softened or captured.

The common approach, known as the “inhospitability” or “anti-trust” tradition, is to pass laws directly to counter the usual manifestations of collusion such as price manipulation. In a weak governance milieu, this law can itself lack teeth and become a rent tollgate for political powers. Anti-trust laws designed to break up concentrations of market power also can be just wellsprings for payoffs. They do not attack the source of the problem. The “inhospitability rule” may not, as Williamson (1983) observed, be welfare-improving.

The real entry barrier is the weak TPE of contracts and property rights. If QL is strengthened, then entrants from outside the guanxi circle can raise competition and reduce concentration. The courts of law could be upgraded to protect property. Thus, investing in the rule-of-law could be the best competition policy initiative. This is, of course, easier said than done as well as costly. How did this happen in East Asia in the second half of the 20<sup>th</sup> century?

The East Asian model's emphasis on export and foreign investment promotion punctuated by export processing zones (EPZs) may have served the cause competition and regulation policy reform very well as the unintended consequence.

Export promotion meant a shift in the incentives structure in favor of the export sector. Those who dare test the waters (mostly guanxi types in the beginning) find themselves competing for export shares with rivals whose goods are, in contrast, not weighed down by guanxi-related costs. The guanxi circle is no longer a help in the distribution segment of world market while they may carry guanxi costs at home. They, in time, become effective advocates for stronger TPE. Other non-guanxi players may also find foreign export niches that were not open to them in guanxi-dominated local market. It is possible that the local distribution and marketing segment is where ex-post opportunism is rife. Export markets are immune. In this way, export promotion may have given impetus to better rule-of-law in East Asian tradeable sector.

The export promotion strategy also took another form – the export processing zones – which helped foreign and local non-guanxi players along. The EPZ was not only a set of export-friendly hard infrastructures. It was, even more, a commitment to better, faster and faceless procedures; a new set of rules and even a new set of enforcers with

which foreign investors were familiar. This was a crucial part of the attraction of EPZs. Indeed, the *Subic Bay EPZ* (Philippines) sells itself to investors less as an infrastructure-enabled hub than as a new set of institutions that are familiar to foreign locators.

Thus the so-called East Asian Model was not only a trade posture; it was a competition and regulation policy brought about not by direct confrontation with the taipans but by market enabling policies. It created a strong constituency for the rule-of-law (exports sector); it created a sub-environment where the rule-of-law is better served (EPZs) and, thus, where non-guanxi players do not have to deal with unfair advantages that taipans can steer their way.

The gradual import liberalization forced guanxi players to compete with foreign rivals unburdened by guanxi costs. This made the tradeable sector less congenial for guanxi-based business. Most retreated to the nontraded goods sector, viz., banking property and retail trade.

The relaxation of entry of foreign players in these service areas again forced the guanxi businessmen to further modernize, either by joint ventures or by Harvardizing the next generation, as did Li Kashing of Hongkong.

Thus, competition and regulation policy was served by enabling the market implicit in the East Asian model. The “inhospitability rule” could not have done better.

## **V. SUMMARY**

In weak third party enforcement environments, entrepreneurs have to confront additional idiosyncratic hurdles of ex-post opportunism by business partners and the

absence of adequate property rights protection from predatory political elites. *Guanxi* serves to address the first by shrinking the set of potential partners to those for whom nonformal sanctions and even second or first party enforcement bind. Thus, the business activity takes on an ethnic, religious or familial color, which is true of East Asia. To address predatory property expropriation, the entrepreneur enlists state officials and politicians in a web of payoffs and favors. Who succeeds in both, we characterize as the taipan. Bringing to life otherwise missing or highly fragmented markets is his Schumpeterian role.

We model the taipan as a nexus of contracts involving a vertical integration into second party enforcement and property rights protection. Many of the accepted stylized facts about East Asian taipans: tax pyramids, legendary secrecy, an aversion for outside auditions, monopoly or shared monopoly positions, business sprawl, shadowy cultivation of politicians and the capture of rule-making apparatus can all be traced to this two vertical integration into second party enforcement. The boundary of the firm is different in the frontiers.

Since second party enforcement is *private and excludable*, it tends to foster market power and entry barriers. Second party capability is, thus, a second best substitute to good third party enforcement: it can underpin the existence of markets but it can also truncate those markets once extant.

The usually prescribed regulatory remedies include confronting market power and cartels with new laws directly penalizing so-called unfair “restraint of trade” practices. This is the “inhospitality tradition” in regulation. Stricter tax laws are also par for the course. In weak governance environments, this is either ineffective or counter-productive

since enforcement is what is precisely lacking. They serve to deter only those without connections and enrich the unscrupulous bureaucrats.

New laws surrounding contracts enforcement such as *bankruptcy laws* are helpful only insofar as the enforcement apparatus (sheriffs and judges) are rule-of-law-minded enough.

In East Asia, throughout the second half of the 20<sup>th</sup> century, competition and regulation policy appeared to have taken a backseat to the so-called *East Asian model*. This is only half true. The market-enabling features of this model, viz., export promotion, export processing zones, direct foreign investment liberalization and gradual import liberalization served as the better regulation and competition policy package. Where the model was a great success, these features did serve to weaken *guanxi* and transform *taipanism* into its more modern reincarnation. Market enabling policies may have served to indirectly advance the first best policy – the provision of adequate third party enforcement. Direct confrontation would have been only harmful.

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